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The Insider's Guide to Plan Design, Administration, Funding & Compliance

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IRS Issues Transition Relief for SECURE Act and Secure 2.0 Act Required Minimum Distribution Requirements

Robert S. Kaplan, Esq., QPA, QKA

The Internal Revenue Service (the IRS) has issued IRS Notice 2023-54, which provides transition relief on the implementation of required minimum distribution requirements enacted as part of both the Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act) and the SECURE 2.0 Act of 2022 (SECURE 2.0).

Background

Prior to the enactment of the SECURE Act, tax-qualified retirement plans, including 401(k) plans and individual retirement accounts (IRAs) were generally required to begin paying required minimum distributions to participants no later than the April 1 of the calendar year following the year in which the participant attained age 70½. An exception applies that allows 401(k) participants (but not IRA participants) who are still actively working for the plan sponsor and who own less than five percent of the plan sponsor to further delay required minimum distributions until the April 1 of the calendar year following their retirement. The SECURE Act raised the applicable age under which required minimum distributions begin from age 70½ to age 72, and SECURE 2.0 further raised this age to either age 73 or age 75, depending on the participant's date of birth.

Prior to the enactment of the SECURE Act, beneficiaries who inherited 401(k) and IRA accounts were generally permitted to, subject to the receipt of annual required minimum distributions, leave the account balance in the applicable plan or IRA for an indefinite period of time. This colloquially became known as a "Stretch IRA" because of the participant's ability to "stretch" payments from the account over a long period of time. The SECURE Act limited this ability and required beneficiaries who inherit accounts to receive a full distribution of the account within ten years of the death of the participant. This applied to most plans and IRAs for all deaths occurring beginning on or after January 1, 2020, but for governmental plans and certain collectively bargained plans this requirement began with deaths occurring on or after January 1, 2022.

In February 2022, the IRS issued proposed regulations implementing these SECURE Act requirements. These regulations included a requirement that beneficiaries still must continue to receive required minimum distributions prior to the full distribution of the account within the ten-year distribution. This provision was controversial within the industry, as there was some informal guidance from the IRS indicating that required minimum distributions would not be needed during this period. As

a result, the IRS issued IRS Notice 2022-53, which delayed the implementation of these regulations until at least January 1, 2023. Notice 2022-53 specifically indicated the beneficiaries of inherited accounts would not need to receive 2021 or 2022 required minimum distributions as long as the entire account were depleted within ten years of the death of the participant.

Since then, Congress enacted Secure 2.0, which - as noted above - further delayed the mandatory start of required minimum distributions. Under applicable law prior to Secure 2.0, individuals born in 1951 would turn age 72 in 2023 and would have needed to receive an initial required minimum distribution by April 1, 2024. Secure 2.0 changed the start of required minimum distributions to age 73 for 2023, resulting in a one-year delay in required minimum distributions for individuals born in 1951 or after. However because Secure 2.0 was passed in very late 2022, many recordkeeping systems began distributing required minimum distributions in 2023 as if the age 73 rule of Secure 2.0 had not been enacted.

New Guidance

The new IRS Notice 2023-54 first announces that the February 2022 regulations, when finalized, will not be effective until at least January 1, 2024. This will allow the IRS to revamp the proposed regulations to incorporate the Secure 2.0 requirements.

The guidance also provides some helpful transition relief to participants that inadvertently received a required minimum distribution in 2023 that they were not required to receive. Specifically, individuals born in 1951 that received a distribution between January 1, 2023, and July 31, 2023, can now complete a rollover of that money back into a tax-qualified retirement plan or IRA until September 30, 2023. In addition, any tax-qualified retirement plans, including 401(k) plans, will not be penalized for treating these inadvertent distributions as ineligible for rollover distributions.

Finally, the guidance extends the transition relief set forth in IRS Notice 2022-53 for an additional year. Under this relief, beneficiaries who inherit an account would not need to receive a required minimum distribution during 2023, as long as the entire account is depleted within ten years of the death of the participant. Going forward, we do not know if the finalized regulations, now expected to be in place beginning January 1, 2024, will follow the proposed regulations and require that beneficiaries with inherited accounts will be required to continue to receive minimum distributions prior to the depletion of the account within ten years of the death of the participant.

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401(k) Advisor

The Insider's Guide to Plan Design, Administration, Funding & Compliance

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The Corporate Transparency Act and Retirement Plans

Michael P. Coyne, Esq.

If you are not already familiar with The Corporate Transparency Act (CTA), you will likely become much more familiar over the next few months. The CTA is a federal law that was enacted in 2020 as part of the Anti-Money Laundering Act of 2020. The CTA requires certain entities, such as corporations, limited liability companies, and limited partnerships, to file a report with the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) identifying their beneficial owners. While the law exempts businesses with more than twenty employees and more than $5 million of revenue, many small business entities will have to report on their beneficial owners. Beneficial owners are those who exercise substantial control over the business entity or who own a 25% or greater interest in the business.

CTA will not directly affect qualified retirement plans, and its impact here will likely be limited. However, it could pose an issue for plans that have liberal participant-direction provisions. For example, a plan that allows a participant to invest in real estate could be required to make disclosures if the real estate company is required to report its beneficial ownership information. Similarly, companies that are owned by a retirement plan as a result of a ROBS transaction will likely have to report. Currently, the deadline to report existing entities is January 1, 2025, and for any entities created after December 31, 2023, the deadline is 30 days after its creation.

Note that in the above examples, the filing obligations do not fall on the retirement plan itself, but rather on the legal entity in which the plan assets are invested. Nevertheless, the legal entity may need information from the retirement plan and the trustee to complete the beneficial ownership reporting. If your clients have this situation, you should urge them to talk to their accountant or ERISA attorney concerning the reporting requirements.

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DOCUMENT UPDATE

A Deferral Opportunity with a Plan Merger

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An acquisition or merger of corporate entities or organizations may provide an opportunity to defer required minimum distributions otherwise required to be made under section 401(a)(9) of the Internal Revenue Code of 1986, as amended (the Code). For example, assume the seller has a 401(k) plan and certain participants in the plan have exceeded age 73 and would otherwise be required to begin receiving required minimum distributions except that the participants have not retired and are not 5% owners. Also, assume the buyer has an existing 401(k) plan. If the transaction is structured to merge and consolidate the seller with the buyer so that the buyer becomes the successor entity or organization of the seller and the 401(k) plan of the seller is merged and consolidated with the buyer's 401(k) plan so that the buyer's 401(k) plan becomes a successor 401(k) plan of the seller, and the participants in the seller's 401(k) plan continue to perform the same services at the same locations for the successor entity or organization, the buyer could take the position that the employees participating in the seller's 401(k) plan are at the "same desk" performing the same services for the successor employer and participate in the successor 401(k) plan and have not retired. Consequently, no required minimum distributions should be required under Section 401(a)(9) of the Code to the participants who have exceeded age 73.

Generally, the "same desk rule" is the IRS rule that provides that an employee who does the same work in the same location has not experienced a separation of service, even if there is a change in the employer due to a corporate transaction. An employee who continues to work "at the same desk" even if the employee is working for a new employer would not be eligible for a distribution of benefits under a 401(k) plan.

If, on the other hand, the transaction required the seller to continue operations after the transaction, only assets of the seller are acquired by the buyer, and the seller is required to terminate the 401(k) plan and permit amounts to be rolled over into the buyer's plan or to an Individual Retirement Account ("IRA"), the "same desk" rule generally should not

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apply because there is no successor employer or successor 401(k) plan.

If the transaction required the seller to terminate its 401(k) plan and permit rollovers to a tax-qualified plan or an IRA, such a rollover would not delay the application of the required minimum distributions rule, and those participants who have exceeded age 73 would be required to begin those distributions immediately.

The decision with respect to the retention or the termination of the seller's 401(k) plan needs to be made before the transaction occurs. So the buyer should decide whether to merge and consolidate the seller's 401(k) plan with the buyer's 401(k) plan before the transaction and the buyer's 401(k) plan document would need to reflect that merger and consolidation of the seller's 401(k) plan with the buyer's 401(k) plan. And in this case, the buyer must be careful to honor the "successor plan rule" of Coed section 401(k)(10).

After the transaction described above, if the seller's 401(k) plan is not terminated, it may not be terminated by the buyer if the buyer has a 401(k) plan that falls under the successor plan rule. The "successor plan rule" in section 401(k)(10)(A) of the Code and section 1.401(k)-1(d)(4)(i) of the Treasury Regulations would prevent the termination of the seller's 401(k) plan after the transaction. Section 1.401(k)-1(d)(4)(i) specifically provides that a distribution may not be made under section 1.401(k)-1(d)(1)(iii) - which permits a distribution under section 401(k)(10) in the event of the termination of a plan - if the employer establishes or maintains an "alternative defined contribution plan".

For purposes of this provision, an "employer" includes all affiliated employers under section 414 of the Code, and a plan is an "alternative defined contribution plan" if it is a defined contribution plan that exists at any time during the period beginning on the date of the plan termination and ending 12 months after the distribution of all of the assets from the terminated plan. However, there is an exception - if during the 24-month period beginning 12 months before the date of plan termination, fewer than 2% of the employees who were eligible under the defined contribution plan that includes the cash or deferred arrangement as of the date of plan termination are eligible under the other defined contribution plan, the other plan is not an alternative defined contribution plan.

The successor plan rule was created to prevent employers from circumventing the age 59½ early distribution restriction under section 72(t) of the Code that applies to deferred compensation by terminating a 401(k) plan to generate an otherwise distributable event.

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LEGAL UPDATE

IRS Issues Transitional Guidance for Required Minimum Distributions

Marcia S. Wagner, Esq.

In response to changes made by the SECURE 2.0 Act of 2022 (SECURE 2.0) to the required minimum distribution (RMD) rules of the Internal Revenue Code (the Code), the Internal Revenue Service (IRS) recently issued Notice 2023-54, which provides two forms of transitional relief for 2023 RMDs. The IRS will be issuing final regulations under Code Section 401(a)(9) and related provisions that will apply to RMDs no earlier than 2024.

Rollover relief. SECURE 2.0 changed the required beginning date for RMDs from tax-qualified plans and other eligible retirement plans from April 1 of the calendar year following the calendar year in which an individual attains age 72 to April 1 of the calendar year following the calendar year in which the individual attains age 73 or 75, depending on the individual's date of birth. As a result, a participant in a tax-qualified defined contribution plan (or an IRA) who was born in 1951 (thus, turning age 72 in 2023) will have a required beginning date of April 1, 2025, rather than April 1, 2024, and the first distribution made to that plan participant (or IRA owner) that will be treated as an RMD will be a distribution made for 2024, rather than for 2023.

While the law was clear on this issue, the IRS was told by plan administrators and payors that it would take some time to update their systems. As a result, plan participants (or IRA owners) who reached age 72 in 2023 could have automatically received distributions this year as would have been required under pre-SECURE 2.0 law. To address that circumstance, Notice 2023-54 provides three forms of transitional relief:

- For a distribution made between January 1, 2023, and July 31, 2023, to a participant born in 1951 (or to the participant's surviving spouse) that would have been an RMD under pre-SECURE 2.0 law, a payor or plan administrator will not be considered to have violated any of the Code provisions relating to eligible rollover

distributions by failing to treat the distribution as an eligible rollover distribution.

- For distributions described above, Treasury and IRS have extended the normal 60-day rollover period until September 30, 2023.
- For distributions made from an IRA between January 1, 2023, and July 31, 2023, to an IRA owner born in 1951 (or to the individual's surviving spouse) that would have been an RMD but for the change in the required beginning date made by SECURE 2.0, Treasury and IRS are extending the date for rolling over the portion of the distribution mischaracterized as an RMD until September 30, 2023. This rollover option is available even if the taxpayer had made another rollover within the preceding 12-month period, but the IRA owner will not be able to make another IRA rollover for a 12-month period.

Ten-year distribution relief. Under a change made by the original SECURE Act, if a participant or IRA owner died after reaching his or her required beginning date and was not an eligible designated beneficiary, the participant's or IRA owner's account balance had to be entirely distributed by the end of a 10-year period. It was generally believed that so long as all of the account balance was distributed by the end of the 10-year period, the Code requirements would be satisfied. But the IRS took the unanticipated position in its proposed regulations that annual required minimum distributions had to be made in each year during the 10-year period. The regulations took a similar position for distributions after the death of an eligible designated beneficiary or after a minor child reaches the age of majority. In light of the IRS's unexpected interpretation of the 10-year rule and in response to comments on the proposed regulations, the IRS issued Notice 2022-53, which provided that a defined contribution plan would not fail to be tax-qualified in 2021 or 2022 for failure to make a required distribution in accordance with the IRS interpretation of the 10-year rule in the proposed regulations, and a taxpayer who failed to receive such a distribution from a plan or IRA would not be subject to an excise tax under Code Section 4974 for failing to receive the distribution.

Notice 2023-54 has now provided relief for 2023 distributions that is similar to that in its 2022 Notice for 2021 and 2022 distributions. The relief applies to any distribution that under the proposed Code Section 401(a)(9) regulations would be required to be made in 2023 under a defined contribution plan or IRA subject to the 10-year rule for the year in which the employee (or designated beneficiary) died, if that payment is required to be made either (i) to a designated beneficiary of an employee (or an IRA owner) if the employee (or IRA owner) died on or after his required beginning date in 2020, 2021 or 2022, and the designated beneficiary is not using the lifetime or life expectancy exception to the 10-year distribution rule, or (ii) to the beneficiary of an eligible designated beneficiary, including a person who is treated as an eligible designated beneficiary with respect to a participant (or IRA owner) who died before December 31, 2019, if the eligible designated beneficiary died in 2020, 2021 or 2022, and was using the lifetime or life expectancy exception to the 10-year rule.

The IRS's Notice provides much-needed relief since the IRS has been slow to issue regulations regarding many SECURE Act provisions that were then further changed by SECURE 2.0. The IRS intends to finalize its proposed RMD regulations under the SECURE Act, with further revisions to reflect SECURE 2.0, that will apply to calendar years beginning no earlier than 2024.

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Q&A

SECURE 2.0: Guidance on the Changes to the Self-Correction Program under EPCRS

Adrienne Robertson, J.D., CPC, QPA

When the SECURE 2.0 Act of 2022 (SECURE 2.0) was enacted into law on December 29, 2022, one of the provisions it included significantly overhauled the self-correction program available under the Employee Plans Compliance Resolution System (EPCRS) to correct operational failures that occur in retirement plans. On May 25, 2023, the IRS issued Notice 2023-43, which provides guidance on these changes to the self-correction program. In this month's Q&A, we talk with Adrienne Robertson, J.D., CPC, QPA, Head of Regulatory and Fiduciary Services at Transamerica, about the changes made to EPCRS by SECURE 2.0 and the May IRS guidance.

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Q: Can you provide a quick summary of EPCRS and how the self-correction program worked before the enactment of SECURE 2.0?

A: EPCRS is the longstanding program run by the IRS, under which plan sponsors can correct most operational failures that occur in their retirement plans to keep those plans tax-qualified. Various correction programs were first established by the IRS in the early 1990s, which coalesced over the following decade into a singular correction framework, EPCRS, under which there are now three correction programs – self-correction, the Voluntary Correction Program (VCP), and correction for failures found by the IRS when a plan is under audit. Unless a particular type of operational failure was explicitly excluded from the self-correction program, self-correction has been generally available for any "insignificant" failures that occurred at any time in the past, and for "significant" failures that were corrected no later than the end of the third plan year following the plan year in which the failure occurred. Any failure that was excluded from or that did not fit into self-correction needed to be corrected under VCP, which involves a formal submission to the IRS and payment of a fee.

Q: How did SECURE 2.0 change the self-correction program?

A: The framework under which plan sponsors can use self-correction for insignificant failures, no matter how far back in time they occurred, and for significant failures if they occurred within the past three plan years has been the correction construct for more than two decades. However, whether a failure was significant or insignificant was what is called a "facts and circumstances" determination. While the ECPRS guidance does include a list of factors to be taken into consideration, the consequence of this approach has been that, for many failures, there has not been a bright line means of knowing with certainty whether they are significant or significant. Although this is less consequential if the failure occurred recently, for older failures, it put the burden on plan sponsors, and often their ERISA counsel, to make an assessment that – if correction of the failure were reviewed under audit – they believed the IRS would agree with. Section 305 of SECURE 2.0 did away with the concept of significant and insignificant in the context of using self-correction, instead making self-correction generally available for correction of all "eligible inadvertent" failures.

Q: What is an eligible inadvertent failure, and which eligible inadvertent failures may be self-corrected?

A: SECURE 2.0 defines an eligible inadvertent failure as any failure to comply with the plan qualification rules under the Code, including failures related to plan loans to participants, that occurs despite have adequate practices and procedures, with certain exceptions. Those exceptions include any failures that are egregious, that relate to the diversion or misuse of plan assets, or that are directly or indirectly related to abusive tax avoidance transactions. Any eligible inadvertent failure may be self-corrected under EPCRS, unless the failure was identified by the IRS before the plan sponsor took any actions demonstrating a specific commitment to self-correct the failure, self-correction was not completed within a reasonable period after the failure was identified, or subsequent applicable guidance otherwise restricts the availability of self-correction.

Q: Did these changes go into effect immediately?

A: The effective date of these changes under SECURE 2.0 was not fully clear. Rather than keeping with the structure of other SECURE 2.0 provisions, which contain "Effective Date" subsections, this provision instead included an "Issuance of Guidance" subsection. Subsection 305(g) instructs the Treasury to revise the current EPCRS guidance, Revenue Procedure 2021-30 ("Rev. Proc. 2020-31"), to reflect the changes to EPCRS contained in SECURE 2.0, no later than two years after the SECURE 2.0 enactment date. That raised the question as to whether the changes to EPCRS contained in Section 305 a) became immediately effective and the guidance merely needed to be updated within two years to reflect those changes, or b) would not become effective until the guidance itself was updated.

The guidance that was issued by the IRS in May, Notice 2023-43 (the "Notice"), addressed this question. It clarified that the changes to EPCRS made by Section 305 of SECURE 2.0 were, in general, immediately effective, provided that certain conditions are met; it also enumerated a variety of failures for which self-correction under the new SECURE 2.0 paradigm cannot be used until the guidance is updated.

Q: What conditions need to be met to use self-correction for eligible inadvertent failures?

A: The Notice reiterates the constraints established by SECURE 2.0. Specifically, for self-correction to be available, the failure cannot have identified by the IRS before any actions have been taken that demonstrate a specific commitment to implementing a self-correction; the self-correction must be completed within a reasonable period after the failure is identified; and the failure cannot be egregious, related to an abusive tax avoidance transaction, or related to the diversion or misuse of plan assets. The Notice then further clarifies that the correction must still satisfy the rules currently applicable

to self-correction under Rev. Proc. 2021-30, which include having established practices and procedures, using a correction method consistent with the general correction principles or a prescribed correction method under Appendix A or B of Rev. Proc. 2021-30, and not using a correction method that is prohibited under Rev. Proc. 2021-30.

Q: For what types of failures does the Notice preclude using self-correction until the EPCRS guidance is updated?

A: The Notice provides an enumerated list of eligible inadvertent failures that cannot be self-corrected until the current EPCRS guidance is updated. These exceptions include failures to initially adopt a written plan document, any failures in an orphaned plan, and significant failures (as that term is currently defined in the current guidance) in a terminated plan. They also include demographic failures that are not corrected in accordance with the applicable regulations under Code section 401(a)(4) or operational failures corrected by plan amendment, where the amendment conforms the document to plan operation in a manner that is less favorable for participants than the original plan document provision. Finally, certain failures related to SEPs or SIMPLE IRAs and certain failures under Code section 409 (relating to ESOPs) are excluded from self-correction until the guidance is updated.

Q: What else in the Notice will be helpful for plan sponsors looking to self-correct eligible inadvertent failures?

A: The Notice also enumerates what previous requirements no longer apply, effective immediately. Specifically: it is no longer necessary that the plan be the subject of a favorable determination letter; there is no longer a general prohibition against the self-correction of demographic failures, employer eligibility failures, or certain plan loan failures; the impact of a plan coming under IRS examination for a plan year containing a failure that is eligible for self-correction or in the process of being self-corrected are nullified; and the three-year window for correcting a significant failure is eliminated. The Notice further clarifies that an eligible inadvertent failure is considered "identified" by the IRS once the plan comes under examination unless the plan sponsor has demonstrated a specific commitment to implement self-correction with respect to that failure. It further notes that, in any case, if the eligible inadvertent failure is insignificant (as that term is defined under the current guidance), the plan sponsor may still self-correct that failure even if it is discovered on examination.

The Notice goes on to address the requirements under SECURE 2.0 that the plan sponsor be able to demonstrate a specific commitment to implementing the self-correction of an eligible inadvertent failure, and that the failure be self-corrected within a reasonable period after the failure was identified. Until the guidance is subsequently updated, determinations as to these requirements will be made on a facts and circumstances basis, although the Notice does provide some framework. The Notice states that a "mere" general statement of intent to correct eligible inadvertent failures is not an action demonstrating specific commitment. It also provides an outer window for what constitutes a reasonable period to self-correct. For failures that are not employer eligibility failures, self-correction by the end of the 18th month following the date the failure was identified will be considered to have been completed within a reasonable time; self-correction of employer eligibility failures will be considered to have been completed within a reasonable time if all contributions are ceased as soon as reasonably practicable, but no longer later than the end of the sixth month following the date the failure was identified.

The Notice also provides some useful clarifications. It confirms that a plan sponsor may use self-correction for eligible inadvertent failures that occurred prior to the enactment of SECURE 2.0, that a plan sponsor may still submit a VCP application to correct an eligible inadvertent failure if it so chooses, and that Section 305 does not create any new IRS recordkeeping requirements with respect to the self-correction of eligible inadvertent failures, although current requirements continue to apply. Self-correction of an eligible inadvertent failure does not, however, automatically result in a waiver of any excise or additional taxes that may be due as a result of the failure.

Q: What final takeaways do you have for us?

A: Overall, the Notice is quite helpful to plan sponsors. It confirms that eligible inadvertent failures may be self-corrected now, provides practical guidance around the use of self-correction for eligible inadvertent failures, and gives plan sponsors assurance that they may rely on the Notice until Rev. Proc. 2021-30 is updated, which should be prior to the end of 2024.

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BENEFITS CORNER

William F. Brown, Esq.

DOL Enforcement Lands a *Really* Big One

According to a DOL press release, fiduciaries of a retirement plan sponsored by DST Systems Inc., an information processing software and service provider based in Kansas City, have agreed to settle a lawsuit brought by the DOL and private plaintiffs. Although the press release doesn't mention it, presumably the private plaintiffs are among the 9,000 participants of the plan. In October 2019, the DOL filed the lawsuit in the U.S. District Court for the Southern District of New York, alleging that the defendants violated ERISA by failing to diversify the plan's assets to minimize the risk of large losses and failing to act prudently and loyally in managing these assets when the investment manager invested the plan's assets on a highly concentrated basis in a select number of securities. The defendants have agreed to pay a whopping $124.6 million, and possibly more, to resolve the litigation.

The facts behind the settlement deserve the word "shocking." One of the settling fiduciaries is the New York City-based investment management firm Ruane, Cunniff & Goldfarb Inc. According to the press release, Ruane Cunniff had total authority over the investments of the profit-sharing portion of the plan and that DST Systems and individual defendants failed to properly monitor its activities. As an example, Ruane Cunniff invested plan assets in the stock of a single pharmaceutical company, Valeant Pharmaceuticals International Inc. The concentration in Valeant stock grew to more than *45 percent* of the plan's assets. That level of investment hardly seems prudent for an individual's portfolio, much less that of a retirement plan. This mistake hit the fan soon after, when Valeant's stock fell dramatically in price, causing the plan's participants to experience significant losses to their retirement savings.

Press reports place this loss in excess of $100 million. Reportedly, after this debacle, Ruane Cunniff took steps to limit the investment concentrations of other ERISA-covered plans that it manages. One would hope so! If this was a tweet, or whatever that's called these days, SMH would follow.

SECURE 2.0 Tinkering Helps Small Businesses

The SECURE 2.0 Act of 2022 includes dozens of changes that impact 401(k) plans in many ways. Many of these major changes have been widely discussed. Others are less significant but can still help some plan sponsors, especially small business owners. Two of the latter are simplifying the "family attribution" rules, which impacts what businesses are considered to be under common ownership, and changes to the top-heavy rules.

Under current rules, a spouse's ownership of a business is generally attributed to the other spouse unless certain exceptions apply. Those exceptions are not available to residents of community property states. Spouses with minor children can also be impacted. These rules can result in treatment of completely separate businesses, each owned by one spouse, being lumped together in one controlled group, which can cause difficulties with the operation of a retirement benefit plan by one of the businesses.

Starting in 2024, SECURE 2.0 sweeps all these distinctions away with a uniform set of rules that apply in all contexts, including in community property states. In general, any ownership by one spouse is attributed to the other, unless the "spousal exception" applies. To use that exception, a spouse must meet all of the following conditions throughout the applicable year: the spouse does not directly own any stock in the company; the spouse is not a director or employee of the company and does not participate in the management of the company; no more than 50% of the company's gross income is derived from royalties, rents, dividends, interest, and annuities; and the stock is not subject to conditions which substantially restrict or limit the spouse's right to dispose of it and which run in favor of the other spouse or his/her children who have not attained the age of 21 years. In addition, attribution via minor children is disregarded when determining if the spousal exception is met. This clearer set of rules will be much easier to apply.

SECURE 2.0 has also altered the top-heavy rules. A 401(k) plan is considered "top heavy" when the combined account balances of key employees exceed 60% of total plan assets. A top-heavy 401(k) plan must generally provide non-key employees who are plan participants with a top-heavy minimum contribution equal to 3% of their annual compensation. That requirement can apply to any participant, so the employer has an incentive to use the longest waiting period possible for participation, which is one year of service. This can pose problems for employee recruitment, however.

SECURE 2.0 remedies this by eliminating the top-heavy minimum contribution for recent hires. Starting in 2024, an employer can avoid making the minimum contribution to employees who do not meet the maximum eligibility standards, which are one year of service and age 21. For example, if a top-heavy 401(k) plan allows employees to participate at age 18, those participants would not be eligible to receive the

top-heavy minimum contribution until they have worked for at least one year and attained age 21.

This is the same rule that is available for Safe Harbor contributions.

SECURE 2.0 Permits Automatic Portability for IRA Force-Outs

In a post on his own website, noted ERISA attorney Fred Reish explained the changes regarding force-outs to IRAs contained in the SECURE 2.0 legislation.

Under current law, if terminated participants do not elect to receive their benefits from a retirement benefit plan, the plan can force out a distribution if the account assets are less than $5,000. That amount increases to $7,000 in 2024. If the value of the forced-out account exceeds $1,000, the benefits must be rolled to an IRA, however.

Section 120 of SECURE 2.0 allows the provider of the IRA that received force-out amounts to continuously reach out to recordkeepers to see if the IRA owner has begun to participate in a retirement benefit plan serviced by one of those recordkeepers. If that is the case, the IRA provider can transfer the IRA balance to the IRA owner's account in that plan unless the IRA holder affirmatively elects to keep the funds in the IRA. To do this, the IRA provider must acknowledge that it is acting as a fiduciary for that purpose and must act in the best interest of the IRA owner. The IRA provider can collect a reasonable fee from the IRA for this service, and that fee will not be considered a prohibited transaction. The Senate Finance Committee's summary of this provision described it as an "automatic portability service."

Mr. Reish explained that the legislation permits the DOL to supplement the requirements regarding the prohibited transaction exemption related to this service and that in its Spring 2023 Regulatory Agenda, the DOL acknowledged that it needs to act on that aspect of the legislation. This prohibited transaction exemption goes into effect on December 29, 2023, so Mr. Reish thinks it is "reasonable" to expect DOL guidance before that date.

Target-Date Funds Dominate 401(k) Assets

An article by Michael Thrasher posted on the *Institutional Investors* website provides several insights into the use of target-date funds in 401(k) plans. These funds are "a nearly unanimous default option" in 401(k) plans and dominate the plans' assets. According to the Investment Company Institute, at the end of 2022, there were 60 million active 401(k) participants with $6.6 trillion in assets, and 59 percent of them were invested in target-date funds. In 2022, investors deposited a net $153 billion into target-date strategies, down slightly from $170 billion the previous year, according to Morningstar. Conversely, mutual funds and ETFs had $370 billion in net outflows. That was the first year in which mutual funds and ETFs recorded net outflows since Morningstar began tracking the data in 1993. Young workers appear to prefer the simplicity of target-date funds. In 2022, 50 percent of 401(k) savers in their twenties were invested in target-date funds, compared to 28 percent of savers in their sixties, according to the Investment Company Institute.

According to Thrasher-Vanguard, State Street Global Advisors, Fidelity Investments, BlackRock, and American Funds managed about 80 percent of the $2.82 trillion target-date fund market at the end of 2022. Within that group, the Vanguard Target Retirement series is a distinct leader. In 2022, that series took in more than $64 billion, nearly $44 billion more than the next highest series.

When the first target-date funds emerged in the 1990s, they were primarily built using actively-managed mutual funds. Over time, the rise of passive investing and ETFs changed target-date funds in the same way they did other investment portfolios. But the pendulum has now begun to swing back in the other direction. More volatile markets, inflation, and the prospect of better investment performance have prompted managers to diversify the components of their target-date funds to add some actively-managed components.

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REGULATORY AND JUDICIAL UPDATE

Item	Statement	Status
Deliberative fiduciary process did not preclude ERISA challenge to plan's adoption of recordkeeper's proprietary investment option	***Davis, et al. v. Magna International of America, et al.*, U.S. District Ct., E.D. MI, No. 20-11060, June 5, 2023.** Plan fiduciaries' utilization of a putatively prudent process for monitoring investment options was not sufficient to prevent plan participants from pursuing ERISA claims related to the selection of proprietary Target Date Fund investment options offered by the plan's recordkeeper, according to a federal trial court in Michigan. Magna International maintains a 401(k) plan that offers approximately 15 investment options, including a mix of actively managed and passively managed funds. During the class period, the investment menu included a series of Principal Trust Target Date Funds (TDFs). As a result, during the time Principal has been the plan's recordkeeper, 76 percent of the plan's current assets have been held in Principal Proprietary Investments such as the Principal Trust Target Date Funds. Plan participants brought a class action, alleging that the committee administering the plan and overseeing its investments (Committee) breached the fiduciary duties of prudence and loyalty by: (1) failing to objectively and adequately review the plan's investment portfolio with due care to ensure that each investment option was prudent in terms of cost and in the best interest of plan participants; and (2) maintaining certain high-cost funds in the plan despite the availability of identical or similar investment options with lower costs and/or better performance histories, as required by the plan's investment policy. In moving for summary judgment, the fiduciaries maintained that they followed a deliberative and prudent process for ensuring that (in compliance with *Smith v. CommonSpirit Health*, CA-6 (2022), 37 F.4th 1160) all fund options remain prudent. Specifically, the fiduciaries averred that they had a prudent process in place for monitoring investment options, including a written investment policy statement that was used to guide the review of plan investments. Initially, the court, citing the Second Circuit, explained that the presence of a deliberative process does not suffice in every case to demonstrate prudence (*Sacerdote v. New York University*, CA-2 (2021), 9 F.4th 95, 111). Accordingly, in assessing whether a fiduciary satisfied the duty of prudence, courts must assess whether a fiduciary employed the appropriate methods to investigate and determine the merits of a particular investment, and not merely whether any methods were used. The court agreed with the participants that the record contained evidence sufficient to create disputed questions of fact as to whether the Committee fiduciaries discussed or "even understood" the difference between certain types of fee arrangements and whether the fiduciaries acted prudently regarding the fees paid by the plan. The court especially noted testimony from a Committee member that he was "not familiar with revenue sharing as fee payment concept." In further undermining the Committee's putatively prudent process as less than "robust," the participants' expert noted the lack of any analysis or consideration of whether a custom or non-proprietary target date fund would be a better fit for the plan. Moreover, the participants charged, the fiduciaries did not consistently compare the performance of the plan's actively managed and hybrid funds to other actively managed funds with lower expense ratios.	**Deliberative process will not demonstrate prudence unless methods used were appropriate for determining the merits of a particular investment.**

Item	Statement	Status
	The court acknowledged the contrary arguments proffered by the fiduciaries. However, the court concluded that the participants raised genuine issues of material fact related to whether the Committee fiduciaries prudently monitored the plan's challenged investments. Accordingly, the court denied the fiduciaries' motion for summary judgment on the claim. The court similarly determined that the participants sufficiently stated claims related to the prudence of the Committee's monitoring of recordkeeping costs (based on a flawed Request for Proposal) and an alleged breach of the duty loyalty (based on the fact that Principal had interest in both recordkeeping and the TDF funds).	

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LAST WORD ON 401(K) PLANS

SECURE 2.0 "No-Brainers"

Douglas S. Neville, Esq.

SECURE 2.0 contains provisions that all 401(k) plans must implement and adopt (such as the new age for required minimum distributions) and other provisions that are optional. Now that several months have passed since SECURE 2.0's enactment, some trends are emerging as to which optional provisions are appealing to plan sponsors. Some optional provisions are so appealing, they might be described as "no-brainers." A few of those provisions are summarized below.

Increased Involuntary Cash-Out Limit

SECURE 2.0 allows plans to increase the threshold below which plans can involuntarily cash out participants who fail to elect a distribution. Effective for distributions after December 31, 2023, the new cash-out limit will be $7,000. Given that the limit is currently $5,000, this may not seem like a very significant change. But even the small increase is beneficial to plans because it will allow them to eliminate more accounts with small balances. Eliminating these accounts helps to reduce administrative burden and, in many cases, tends to reduce overall plan costs.

In addition, for plans that are close to the limit of becoming a "large plan" that is subject to plan audit requirements, cashing out more participants can help stay under the large plan threshold. Although having no more than 100 participants is generally required to be a small plan that is not subject to the audit requirement, the special "80-120 participant rule" allows plans with between 80 and 120 participants at the beginning of a plan year to file Form 5500 in the same category (large or small plan) as the prior year's filing category. For plans that are close to one of the applicable thresholds, adopting the higher cash-out limit can help attain (or retain) small plan status.

Self-Certification for Hardship Distributions

For plans with hardship distribution provisions, a welcome change is the availability of an option that will allow plan administrators of 401(k) plans to rely on a participant's written certification that: (i) the participant incurred a safe harbor hardship event that entitles the participant to a hardship distribution, (ii) the requested distribution amount does not exceed the amount required, and (iii) the participant has no alternative means to satisfy the financial need. This will eliminate a significant amount of the administrative burden associated with hardship provisions.

Increased Catch-Up Contribution Limits

For taxable years beginning after December 31, 2024, SECURE 2.0 allows an increase in the catch-up contribution limits for individuals ages 60-63 to the greater of: (i) $10,000 (indexed for inflation), or (ii) 50% more than the regular catch-up amount in effect for 2024. This change will be attractive for plan sponsors that want to allow their employees to defer as much as possible.

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