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SECURE 2.0 – What You Need to Know
Roth Contributions

The Setting Every Community Up for Retirement Enhancement (SECURE) Act, passed in 2019, included numerous changes to the rules governing retirement plans with the goal of increasing access and savings for American workers. Building upon the success of SECURE, SECURE 2.0 was introduced to further enhance retirement security. SECURE 2.0 included provisions that continue to emphasize Roth contributions in 401(k) and 403(b) plans. Below is a brief history of Roth and the changes we will see in the coming years.

The Introduction of Roth Contributions

The Taxpayer Relief Act of 1997 introduced the Roth Individual Retirement Account (IRA) as a variation of the traditional IRA. Roth IRAs permitted individuals to contribute after-tax income to their retirement accounts, with the promise of tax-free earnings and therefore tax-free qualified withdrawals in retirement. The only drawbacks were limitations on the amount that could be contributed to a Roth IRA and income restrictions that prevented higher earners from making Roth IRA contributions.

The appeal of tax-free qualified withdrawals in retirement created a growing interest in Roth-style contributions. The Roth 401(k) made its debut in 2006 as part of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA). This legislation enabled employers to offer employees the option to contribute to their 401(k) plans on a Roth after-tax basis. Roth 401(k) contributions are subjected to the same contribution limit as traditional pre-tax 401(k) contributions which is significantly higher than the amount allowed in an IRA. There are also no income restrictions for Roth 401(k) which enables higher earners to enjoy the tax-free qualified withdrawal benefit of these contributions.

Roth Provisions Under SECURE 2.0

We mentioned this in a previous article, but one of the major changes impacting Roth 401(k) contributions is the mandatory treatment of catch-up contributions as Roth instead of pre-tax salary deferrals. In general, the rule states that beginning in 2026, anyone who earned over $145,000 in the prior year will only be permitted to make catch-up contributions as Roth. The $145,000 compensation limit will be indexed to inflation so it will increase over time. The impact of this rule is that virtually all 401(k) plans will be required to either allow Roth contributions or disallow catch-up contributions. Due to the popularity of Roth and catch-up contributions, we expect all plans going forward will include Roth contribution provisions.

The second change introduced with SECURE 2.0 regarding Roth was the treatment of employer contributions. Employer contributions have always been a pre-tax contribution to an employee's account that is taxed upon withdrawal. Employers now have the option to permit employees to elect for some or all vested matching and non-elective (profit sharing) contributions to be treated as Roth contributions. This is an optional provision that has been available since SECURE 2.0 was signed into law on December 29, 2022.

We have cautioned our clients against allowing Roth employer contribution elections. The primary reason for our hesitancy is that we do not have guidance from Treasury about how these Roth employer contributions will be taxed. All Roth contributions are after-tax which means an employee who elects to have their employer contributions deposited as Roth must pay taxes on those contributions. We believe a 1099-R will be used to handle this reporting but who will prepare that 1099-R? Is this the responsibility of the employer, the employer's payroll provider, or the plan's recordkeeper? It is also possible that instead of 1099-R reporting the contributions will somehow be added to income on the employee's W-2. Until we have further guidance, we will continue to caution against adding this provision.

As an alternative we have recommended permitting Roth in-plan rollovers and transfers for clients who have inquired about Roth employer contributions. These types of in-plan Roth conversions have been around for several years so there is no ambiguity. Recordkeepers can make the pre-tax to Roth transfer and prepare the 1099-R. Allowing participants to make these types of transfers will in essence provide the same result as allowing employer Roth contributions.

Should you have any questions about these rules or the impact on your plan, please contact your Benchmark RPS representative at your convenience.