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IRS Releases Guidance on SECURE 2.0 Provisions

The Internal Revenue Service (IRS) has released Notice 2024-02, which provides guidance in a question and answer format regarding several provisions of the SECURE 2.0 Act of 2022 (SECURE 2.0). This article summarizes the guidance contained in Notice 2024-02.

Establishment of Auto Enrollment Plans

Most employers that establish 401(k) and 403(b) plans on or after December 29, 2022, must include an eligible automatic contribution arrangement beginning in the 2025 plan year. However, 401(k) or 403(b) plans established before December 29, 2022, are not subject to this requirement and are known as "pre-enactment plans".

401(k) Plans. When determining whether a plan is a pre-enactment plan, employers must determine when the plan was established. Notice 2024-02 clarifies that a plan is established when the plan provision for elective deferrals is initially adopted, even if the effective date is later. For example, if a plan that includes elective deferrals is adopted on October 2, 2022, and has a January 1, 2023, effective date, the plan is a pre-enactment plan because the elective deferral portion of the plan was established on October 2, 2022 (that is, before December 29, 2022).

403(b) Plans. 403(b) plans established before December 29, 2022, are considered pre-enactment plans without regard to the date that the plan's salary reduction agreement provision was adopted.

Mergers and Acquisitions. Employers will need to review the classification of each plan before merging the plans to determine if the ongoing plan is considered a pre-enactment plan. If two pre-enactment single-employer plans or a pre-enactment single-employer plan and a pre-enactment plan maintained by more than one employer are merged, the ongoing plan is treated as a pre-enactment plan.

If a merger involves one pre-enactment plan and another that is not, the surviving plan generally will not retain the pre-enactment classification. There are two exceptions to this guideline. First, in the merger of two single employer plans in an IRC Sec. 410(b)(6)(C) transaction, if the pre-enactment plan is designated as the ongoing plan, it will retain its pre-enactment plan status as long as the merger is completed by the end of the IRC Sec. 410(b)(6)(C) transition period. Second, when a pre-enactment plan maintained by more than one employer is merged with a single-employer plan that is not considered a pre-enactment plan, the ongoing plan is not treated as a pre-enactment plan with respect to that single employer, but the merger will not affect the pre-enactment status for the other employers participating in the ongoing plan.

Spinoffs. If a single employer plan is spun off from a single employer pre-enactment plan, the spinoff plan will retain pre-enactment status. If a plan is spun off of a plan maintained by more than one employer that was considered a pre-enactment plan, the spinoff plan will be treated as a pre-enactment plan only if the plan maintained by more than one employer was a pre-enactment plan with respect to the employer sponsoring the spun-off plan.

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Tax Credits for Small Employers

A small employer may receive a tax credit based on the start-up costs incurred to establish a new eligible qualified plan for a period of up to three years. SECURE 2.0 modified the start-up credit for certain smaller employers, created an additional contribution credit for certain employers who make contributions on behalf of their participants, and added a new military spouse eligibility credit.

Start-Up Credit Eligibility. Employers must have no more than 100 employees (or 50 employees, to qualify for the 100 percent start-up credit amount) who received at least $5,000 of compensation in the year preceding the first year that the start-up credit is available. Additionally, employers must remain an eligible employer each year thereafter to continue to claim the start-up credit. An employer cannot claim the start-up credit in later years if it fails to fall within the applicable employee threshold for the taxable year preceding the first taxable year of the employer's three-year start-up credit period. This is true even if the employer later drops below the 100- or 50-employee threshold for the 50 percent and 100 percent start-up credit amount, respectively.

Employer Contribution Credit Eligibility. The eligibility requirements for an employer to claim the employer contribution credit are similar to the criteria to claim the start-up credit. Employers must have had no more than 100 employees who received at least $5,000 of compensation from the employer for the year preceding the first year of the five-year employer contributions credit period and remain an eligible employer for any subsequent years with respect to which the employer contributions credit is claimed. Employers may claim the contribution credit for five years, starting with the tax year in which the plan became effective with respect to the eligible employer. Eligible employers that established plans before 2023 may be eligible for the maximum start-up credit and the employer contribution credit if there is a tax year during the employer's applicable three-year or five-year credit period that begins after December 31, 2022.

Notice 2024-02 indicates that the employer contribution credit is treated as a separate tax credit in addition to the start-up credit and that an employer may be eligible to receive both. The limits applicable to the start-up credit do not apply to the employer contribution credit.

Military Spouse Eligibility Credit. SECURE 2.0 gives small employers a tax credit for permitting military spouses to participate in an eligible defined contribution plan beginning in tax years after December 29, 2022. To claim the military spouse eligibility credit, the employer must meet the definition of an eligible employer for each tax year that it intends to claim this credit. The employer may claim this credit for any tax year that begins after December 29, 2022, even if the three-year credit period started in a prior tax year or if the military spouse participated in a defined contribution plan of the employer before the plan became an eligible defined contribution plan.

Employer Roth Contributions

Employers may offer a qualified Roth contribution program to plan participants and can choose to offer any or all of the options among the three different types of designated Roth contributions (Roth elective deferrals, Roth matching contributions, and Roth nonelective contributions). Notice 2024-02 states that the rules for Roth matching and Roth nonelective contributions are similar to the rules for designated Roth elective deferrals, notably: 1) participants must designate their irrevocable election to receive Roth employer contributions no later than when the contribution is allocated to their account, and 2) Roth employer contributions are includable in participant's income and are also subject to the separate accounting rules. The guidance also affirms the participant's ability to make or change her election to designate employer contributions as Roth at least once each plan year.

Participants must be fully vested at the time the designated Roth matching or Roth nonelective contribution is allocated to their account. If a participant is not fully vested, she cannot designate any part of a matching or nonelective contribution as Roth. Because Roth matching contributions and Roth nonelective contributions are treated as designated Roth account assets, they can be rolled over only to another designated Roth account or Roth IRA. Also, because these assets are part of a qualified Roth contribution program, the employer may allow in-plan Roth rollovers even if the employer does not permit participants to designate elective contributions as Roth contributions.

Taxation of Roth Contributions. Designated Roth matching and Roth nonelective contributions are taxable when actually allocated to the participant's account—even if it is a contribution for a prior year. Employer matching or nonelective Roth contributions are not subject to federal income tax withholding, Federal Insurance Contributions Act (FICA), or Federal Unemployment Tax Act (FUTA) taxes. For governmental 457(b) plans, designated Roth nonelective

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contributions (including amounts that would be matching if it were a qualified plan) are subject to FICA tax (as applicable) but are not subject to FUTA tax.

Roth Reporting. Reporting requirements for designated Roth matching and Roth nonelective contributions are the same as those for an in-plan Roth rollovers and are reported in Boxes 1 and 2a using code "G" in Box 7 on Form 1099-R, *Distributions from Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contracts, etc.*

Terminal Illness Distributions

SECURE 2.0 created a new exception to the 10 percent early distribution penalty tax for terminally ill individuals. A terminally ill distribution is any distribution made from an IRA or retirement plan (i.e., 401(a) plan, 403(a) plan, or 403(b) plan) to an IRA owner or an employee who is terminally ill and is made *on or after* the date on which the individual has been certified by a physician as having a terminal illness. The certification of terminal illness from a physician must include the following.

- A statement that the individual's illness or physical condition can be reasonably expected to result in death in 84 months or less after the date of certification.
- A narrative description of the evidence that was used to support the statement of illness or physical condition.
- The name and contact information of the physician making the statement.
- The date the physician examined the individual or reviewed the evidence provided by the individual, and the date that the certification is signed by the physician.
- The signature of the physician making the statement, and an attestation from the physician that, by signing the form, the physician confirms that the physician composed the narrative description based on the physician's examination of the individual or the physician's review of the evidence provided by the individual.

Retirement Plan Distributions. This provision does not create a new distributable event for elective deferrals, but will permit an employer to amend the plan document to allow for terminal illness distributions. If the retirement plan permits terminal illness distributions, the employee must provide a physician's certification to the employer verifying that the individual is terminally ill. The certification does not need to include the underlying documentation described above, but the terminally ill individual should retain both the documentation and a copy of the physician's certification for her records. The employer may not rely on the employee's self-certification that she meets the criteria to be considered a terminally ill individual. If an employer does not permit distributions for terminal illness, an employee may treat an otherwise permissible in-service distribution as a distribution due to terminal illness and still qualify for the exception to the 10 percent early distribution penalty tax. A retirement plan terminal illness distribution request must meet both the requirements of the permissible in-service distribution and a terminal illness distribution. The employee will report the terminally ill distribution on Form 5329, *Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts,* when she files her federal tax return. The individual should retain the physician's certification and supporting documentation for her personal tax records.

IRA Distributions. If a financial organization chooses not to report an IRA distribution as a distribution that's exempt from the 10 percent early distribution penalty tax, IRA owners may still qualify for the penalty tax exception by reporting the terminally ill distribution on Form 5329, *Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts,* when they file their federal tax return. IRA owners should retain the physician's certification and supporting documentation for their personal tax records.

Recontributions. The recontribution rules for terminal illness distributions are similar to those for qualified birth or adoption distributions. Individuals may recontribute any portion of the terminal illness distribution to their retirement plan (plan permitting) or IRA at any time during the three-year period beginning on the day after the date on which the distribution was received.

Safe Harbor Correction Method for Elective Deferral Failures

SECURE 2.0 provides a permanent safe harbor for elective deferral failures corrected after December 31, 2023, for plans that apply an automatic contribution or automatic escalation feature. Notice 2024-02 clarifies that corrective contributions may be made to both active and terminated participants. The permanent safe harbor is available for failures where the employer implements correct deferrals on the first compensation paid after the earlier of

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- the 9½-month period following the plan year during which an implementation error occurred, or
- the month following the month in which a participant notifies the employer of the error.

If an active or terminated participant affected by this type of failure would have been entitled to a matching contribution, a corrective matching contribution (adjusted for earnings) must be made within a "reasonable period" of time. A corrective matching contribution that is made by the last day of the sixth month following the month in which correct elective deferrals begin, or would have begun if the individual terminated employment, will be treated as having been made within a reasonable period.

Issues Specific to SIMPLEs and SEPs

SIMPLE Plan Contribution Limits. For 2024 and later tax years, SECURE 2.0 provisions increase the limit for individuals to contribute to SIMPLE 401(k) and SIMPLE IRA plans. Notice 2024-02 establishes a three-year rule that permits an employer to increase the contribution limits for a SIMPLE plan as long as the employer has not maintained a 401(a), 401(k), 403(a), or 403(b) plan during the three tax years immediately preceding the first year that the employer maintains a SIMPLE plan for substantially the same employees.

- **Automatic Increase.** The annual deferral and catch-up limits are increased automatically for employers with 25 or fewer employees who received at least $5,000 in compensation for the preceding year. For 2024, the automatic increase is limited to 110 percent of the deferral and catch-up amounts (i.e., $17,600 for deferrals and $3,850 for catch-up contributions). The annual limit will be indexed starting in 2025.
- **Employer Elective Increase.** Employers with 26-100 employees who receive at least $5,000 in compensation for the preceding year may elect to apply the increased limits but are also required to provide either a four percent matching contribution or a three percent nonelective contribution. Employers must also document the election, maintain the documentation, include the election in the terms of the plan, and notify employees of the election. The employer election must be made before the annual notice is provided to employees. Once the election is made, it is valid until the employer completes the formal process to revoke the election.

Notice 2024-02 provides a two-year grace period for employers that increase the number of employees to more than 25 who receive at least $5,000 in compensation. The employer may continue to apply the automatic increased limits for two years without having to provide additional employer contributions associated with an elective increase in contributions.

Transition to Safe Harbor 401(k) or 403(b) Plans. Employers may now terminate a SIMPLE IRA plan at any time during the year and replace it with a safe harbor 401(k) or 403(b) plan. Notice 2024-02 indicates that the establishment of a safe harbor 401(k) or 403(b) plan is considered an exception to the exclusive plan rule.

- **Termination of SIMPLE IRA Plan.** The employer must take formal written action to document the SIMPLE IRA plan's termination date and the safe harbor plan's effective date must be the day after the termination date. In addition, the employer must notify employees at least 30 days before the termination date that deferrals may not be contributed into the SIMPLE IRA plan after the termination date and any matching or nonelective contributions must be made up to the termination date.
- **Early Distribution Penalty Tax Not Applicable.** The early distribution penalty tax will not apply to SIMPLE IRA distributions during the first two years of participation if the amount distributed is rolled into a 401(k) or 403(b) plan as long as the rollover contribution is subject to the distribution rules described in IRC Sec. 401(k)(2)(B) or IRC Sec. 403(b)(12).
- **Contribution Limits in Transition Year.** The total contribution amount deposited into the SIMPLE IRA plan and safe harbor plan may not exceed the weighted average of the amounts contributed into both plans. The guidance indicates that if an individual exceeds the contribution limit, calculated using the weighted average formula, both the terminated SIMPLE IRA plan and newly-established safe harbor plan will be treated as violating the contribution limitation rules.
- **Safe Harbor Notice Requirement.** In the year of transition from a SIMPLE IRA plan to a safe harbor plan, employers must provide a safe harbor notice to employees. The notice must describe the limit on contributions to the safe harbor plan for the transition year.

SIMPLE and SEP Roth IRAs. Employers may allow participants the ability to deposit salary deferral contributions, when applicable, and employer matching or nonelective contributions to a Roth IRA.

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- **Employee Roth Elections.** If an employer offers a Roth option, employees must have the opportunity to make that election when they enter into a salary reduction agreement under the plan. Or, for SEP plans other than a salary reduction SEP (SAR-SEP) plan, the employee must have the “effective opportunity” to elect that a contribution be made to a Roth IRA. An employee must affirmatively elect to have SIMPLE and SEP contributions deposited to a Roth IRA.
- **Taxation of Roth Contributions.** Salary deferral Roth contributions are subject to income tax withholding as well as FICA and FUTA taxes. Roth matching or nonelective Roth contributions are excluded from wages.
- **Reporting.** Roth salary deferral contributions are included in the participant’s gross income in the tax year in which the participant would have otherwise received the contribution as compensation. The employer must report these contributions on Form W-2, *Wage and Tax Statement*. Employer Roth matching or nonelective contributions are includable in the participant’s gross income in the year that the contribution is actually made to the Roth IRA, regardless of whether the contribution is treated as made for the prior tax year. Employers must report these contributions on Form 1099-R, *Distributions from Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contracts, etc.*
- **Plan Documents.** Employers may use existing model Forms 5304-SIMPLE, 5305-SIMPLE, 5305-SEP, and 5305A-SEP, or an IRS-approved prototype plan without an amendment until the IRS issues new forms or provides additional guidance regarding the use of prototype plan documents.

De Minimis Financial Incentives

Notice 2024-02 clarifies that employers that sponsor 401(k) or 403(b) plans may now offer a de minimis financial incentive valued at no more than $250 to employees that don’t already have an election to defer in place. The financial incentive may be provided in the form of installments. A de minimis financial incentive is includable in an employee’s gross income and wages and is subject to withholding and reporting requirements for income tax purposes unless the incentive satisfies another exception under the Internal Revenue Code. This guidance also clarifies that de minimis financial incentives may not be provided in the form of employer matching contributions and are not subject to the rules that apply to a plan contribution, including the qualification and deductibility rules under IRC Sec. 401(a).

Cash Balance Plans

For cash balance plans that use variable interest crediting rates, effective for 2023 and later plan years, the interest crediting rate that is treated as in effect and as the projected interest crediting rate will be considered a reasonable projection of the variable interest crediting rate, not to exceed six percent. The effect of this SECURE 2.0 provision is to mitigate the risk that cash balance plans with variable interest crediting rates had in satisfying the accrual rules of IRC Sec. 411(b)(1) if principal credits increase with age or service, or if the interest crediting rate for a plan year was too low or negative. In the past, cash balance plans were often drafted to supplement the variable interest credit rate with a fixed annual minimum interest crediting rate to ensure compliance with anti-backloading rules. Notice 2024-02 eliminates the need for the supplemental annual minimum interest crediting rate when using a variable interest crediting rate, while also aligning with other interest crediting safe harbors in Treas. Reg. 1.411(b)(5)-1. This guidance also creates limited anti-cutback relief for cash balance plans that currently provide, or are amending to provide, for principal credits that increase with a participant’s age or service. The anti-cutback relief may be available in certain situations to a cash balance plan that amends its interest crediting rate on a prospective basis where interest credits are affected for interest credit periods that begin after the amendment date.

Plan Amendment Deadlines Extended

Notice 2024-02 extends the deadlines for plan documents to include the applicable provisions of the Setting Every Community Up for Retirement Enhancement Act of 2019, the Bipartisan American Miner’s Act of 2019, the Coronavirus Aid, Relief, and Economic Security Act of 2020, the Taxpayer Certainty and Disaster Tax Relief Act of 2020, and SECURE 2.0. With respect to pre-approved plans, the extended plan amendment deadlines apply to both interim (required) and discretionary amendments.

Qualified Plans. Generally, the amendment deadline for qualified plans is December 31, 2026; however, employers with union plans will have until December 31, 2028, and employers with governmental plans will have until December 31, 2029, to update their plan documents to include the applicable provisions.

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403(b) Plans. Generally, the amendment deadline for 403(b) plans is extended to December 31, 2026. Tax-exempt organizations described in IRC Sec. 501(c)(3) will have until December 31, 2028, to amend their union plans, and public schools will have until December 31, 2029, to make applicable changes to their plan documents.

Eligible Government Plans. Eligible government plans have until the later of December 31, 2029, or if applicable, the first day of the first plan year beginning more than 180 days after the date of notification by the IRS that the plan was administered in a manner that is inconsistent with the requirements of IRC Sec. 457(b).

The guidance does not specifically address tax exempt 457 plans.

IRAs. The deadline to amend the trust that governs an IRA is December 31, 2026, or such later date as the IRS prescribes. The deadline to amend the provisions of a deemed IRA as described in IRC Sec. 408(q) is the deadline applicable to the plan under which the deemed IRA is established.

Next Steps

The IRS is accepting written comments until February 20, 2024. In particular, the IRS has requested comments regarding de minimis financial incentives that are provided by a party other than an employer (Section 113 of SECURE 2.0), and defined benefit plans that use a statutory hybrid benefit formula not described in Q&A H-2 of the notice (Section 348 of SECURE 2.0).

Ascensus will continue to follow any new guidance as it is released. Visit ascensus.com for the latest developments.

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