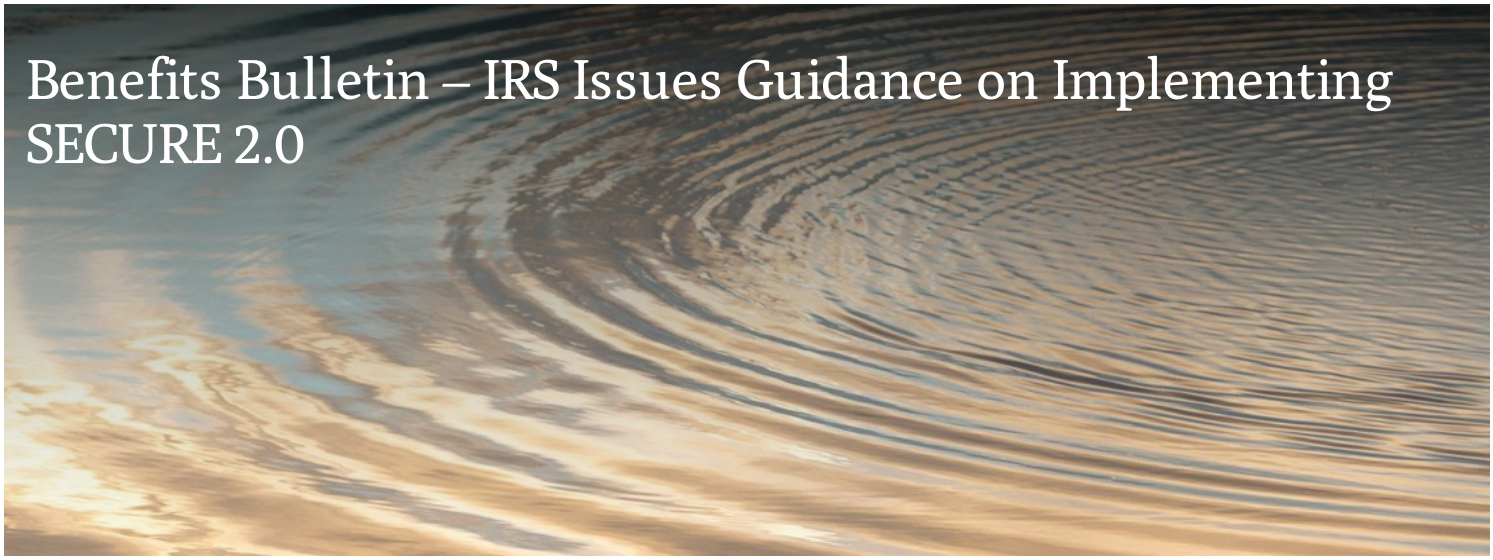
WINSTON & STRAWN LLP

BLOG

Benefits Bulletin – IRS Issues Guidance on Implementing SECURE 2.0



DECEMBER 28, 2023

The IRS recently published Notice 2024-2 (Notice) in the form of Q&As. The Notice was issued to provide guidance for implementing certain provisions of the SECURE 2.0 Act, signed into law on December 29, 2022 (Act). Of particular interest for our client base regarding qualified retirement plans are the following:

- **Automatic Enrollment**. The Act requires most new 401(k) and 403(b) plans established on or after December 29, 2022 to meet automatic enrollment requirements, beginning in the 2025 plan year. Plans that were in existence prior to December 29, 2022 (or annuity contracts purchased under a plan established before that date) do not need to be amended to include automatic enrollment features. The Notice clarifies that:
    - a plan is considered established on the date that the plan terms providing for the cash or deferred arrangement under 401(k) are initially adopted, even if there is a later effective date. For example, if a 401(k) plan was adopted in October 2022 with a January 1, 2023 effective date, it would not be considered a new plan, even though it was not effective until after December 29, 2022;
    - if a 401(k) plan established before December 29, 2022 merges into another 401(k) plan established before December 29, 2022, the merged plan would not be considered a new plan;
    - if a 401(k) plan established after December 29, 2022 merges into a 401(k) plan established prior to December 29, 2022, the merged plan would be considered a new plan; however, there is an exception if the 401(k) plan established prior to December 29, 2022 is the ongoing plan (and provided the merger occurs by the end of the applicable transition period under Section 410(b)(6)(c));
    - if a plan with a 401(k) feature is spun off from a plan that included a 401(k) feature established before December 29, 2022, the 401(k) feature included in the spun-off plan is also treated as if it were established before December 29, 2022; and
    - a Section 403(b) plan established before December 29, 2022 is not considered a new plan, regardless of the date of adoption of plan terms providing for salary deferrals.

    Please note: The information summarized above applies to mergers of single-employer plans. There are slightly different provisions for mergers of single-employer plans into plans maintained by more than one employer.

- **Exception to 10% Tax on Early Distributions to Terminally Ill Individuals**. The Act provides an exception to the 10% additional penalty tax on early distributions from qualified plans for terminally ill individuals, effective for distributions made after December 29, 2022. The Notice:
    - clarifies that amending a plan to provide for terminally ill individual distributions is discretionary;
    - defines “terminally ill individual distribution”;
    - clarifies the types of plans eligible to permit these distributions;
    - sets out the specific information that must be included in the certification of terminal illness and notes that self-certification is not sufficient; and
    - permits recontribution of terminally ill individual distributions to a qualified plan.
- **Cash-Balance Plans**. The Act permits cash-balance plans that credit variable rates of interest to assume that an interest rate is reasonable if the assumed rate does not exceed 6%. This change should help cash-balance plans more easily comply with the defined benefit accrual rules that prohibit backloading. The new provisions are effective after December 29, 2022. The Notice:
    - confirms that a cash-balance plan that provides for pay credits to participants that increase with age or service and provides for a variable interest crediting rate is no longer at risk of violating the accrual requirements of Code Section 411(b)(1) if the interest crediting rate falls below a certain point;
    - clarifies that a cash-balance plan can be amended to adopt the new provisions if: (1) the plan currently provides for principal credits that increase with a participant’s age or service and the amendment is changing the plan’s interest crediting rate or (2) the plan is implementing such a pattern of principal credits as part of the amendment;
    - provides that an amendment to a cash-balance plan to adopt the new provisions can only be adopted with respect to interest credits for interest crediting periods beginning after the later of the effective date of the amendment and the date the amendment is adopted; and
    - includes detailed information on the future interest crediting rates that can be used to comply with Code Section 411(d)(6) for cash balance plans that are amended to adopt the reasonable interest rate assumptions provided in the Act.
- **Safe Harbor for Correction of Employee Elective Deferral Failures**. The Act makes permanent the safe harbor for correcting employee elective deferral failures for plans with automatic enrollment or auto-escalation features, effective with respect to errors made after December 31, 2023. The Notice:
    - provides clarification that the effective date by which corrective deferrals resulting from an implementation error must be implemented is the earlier of (1) the first pay date that is 9.5 months after the end of the plan year in which the failure first occurred and (2) the first pay date in the month following the month the employee notifies the plan sponsor of the error;
    - confirms that implementation errors can be corrected using the safe harbor correction method in Rev. Proc. 2021-30;
    - clarifies that the safe harbor correction is also available for terminated employees and provides that the notice given to terminated employees is not required to include (1) a statement that appropriate amounts have begun to be deducted and contributed to the plan or (2) an explanation that the affected terminated employee may elect an increased deferral percentage to make up for the missed deferral opportunity;
    - provides that an individual affected by an implementation error who would have been entitled to additional matching contributions if not for the missed elective deferrals must receive a corrective allocation of matching contributions (adjusted for earnings) by the last day of the sixth month following the month in which correct elective deferrals begin (or for a terminated employee, would have begun but for termination of employment); and

- provides that, with respect to an automatic contribution error that began before December 31, 2023, a corrective allocation of matching contributions must be made by the end of the third year following the year in which the error occurred.

- **Optional Treatment of Employer Contributions or Nonelective Contributions as Roth Contributions**. The Act provides that employers may permit employees to treat employer matching and nonelective contributions (including qualified student loan repayments) as Roth contributions, effective for contributions made after December 29, 2022. The Notice provides that:

  - rules similar to those for designated Roth contributions will apply to designated Roth matching contributions and designated Roth nonelective contributions. For example, (1) the designation of the contribution as a Roth contribution must be no later than the time the contribution is allocated to the employee account and must be irrevocable, and (2) the contributions are subject to inclusion in income and separate accounting rules;
  - if the employer permits this designation, the employee must have an effective opportunity to make or change the designation at least once per plan year;
  - designated Roth matching contributions or designated Roth nonelective contributions are includable in gross income for the taxable year in which the contribution is allocated to the individual's account (even if the contribution is deemed to have been made on the last day of the prior taxable year);
  - a designated Roth matching contribution or designated Roth nonelective contribution can only be designated as a Roth contribution if the employee is 100% vested in these contributions at the time the contribution is allocated to the account. The contributions cannot be designated as Roth contributions if the employee is partially vested at the time the contributions are allocated to the account;
  - a plan will not fail the nondiscrimination requirements of Section 401(a)(4) of the Code because the employee can only designate a matching contribution or nonelective contribution as a Roth contribution if they are fully vested in that type of contribution at the time it is allocated to their account;
  - designated Roth matching and designated Roth nonelective contributions are excluded from wages for purposes of income tax withholding, so individuals may need to increase withholding or make estimated tax payments;
  - designated Roth matching and designated Roth nonelective contributions are not included in wages for purposes of FICA or FUTA;
  - designated Roth matching contributions and designated Roth nonelective contributions must be reported on Form 1099-R for the year in which the contributions are allocated to the individual's account and are reported in boxes 1 and 2a of Form 1099-R 9 (and code "G" is used in box 7);
  - if a plan uses a permitted safe harbor definition of compensation for purposes of Code Section 415, designated Roth matching and designated Roth nonelective contributions are not included in wages; and
  - designated Roth matching contributions and designated Roth nonelective contributions may be rolled over to another plan with a separate account that is established for designated Roth matching or designated Roth elective contributions.

Winston Takeaway – The IRS has indicated that the Notice does not provide comprehensive guidance but is meant to assist with implementation of the Act's provisions. We will continue to provide updates as additional guidance on these topics and others related to SECURE 2.0 are published. If you would like any additional information, please contact a member of the Winston team.

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