The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 35590

January 22, 2024

IRS Issues "Grab Bag" Guidance on Various Provisions of SECURE 2.0 Act

[35590]

January 22, 2024

TO: ICI Members
Pension Committee
Pension Operations Advisory Committee SUBJECTS: Pension
Tax RE: IRS Issues "Grab Bag" Guidance on Various Provisions of SECURE 2.0 Act

On December 20, 2023, the Internal Revenue Service (IRS) issued Notice 2024-02 (the "Notice"),[1] the long awaited "grab bag" guidance, in Q&A format, on various issues related to the SECURE 2.0 Act changes to the Internal Revenue Code (the "Code").[2] As a reminder, ICI submitted a letter to IRS and Treasury in March 2023, requesting guidance on several of these items.[3] The Notice is not intended to be comprehensive, but rather provides guidance on discrete issues to help the retirement community begin implementation. As noted below, comments on the Notice are due by February 20, 2024.

Specifically, the Notice addresses issues under the following sections of the SECURE 2.0 Act:

A. §101 (expanding automatic enrollment in retirement plans);
B. §102 (modification of credit for small employer pension plan startup costs);
C. §112 (military spouse retirement plan eligibility credit for small employers);
D. §113 (small immediate financial incentives for contributing to a plan);
E. §117 (contribution limit for SIMPLE plans);
F. §326 (exception to the additional tax on early distributions from qualified plans for individuals with a terminal illness);
G. §332 (employers allowed to replace SIMPLE retirement accounts with safe harbor 401(k) plans during a year);
H. §348 (cash balance plans);
I. §350 (safe harbor for correction of employee elective deferral failures);
J. §501 (provisions relating to plan amendments);
K. §601 (SIMPLE and SEP Roth IRAs); and
L. §604 (optional treatment of employer contributions or nonelective contributions as Roth contributions).

Section A: Expanding automatic enrollment in retirement plans (§101).

Effective for plan years beginning after December 31, 2024, the SECURE 2.0 Act will require newly established 401(k) and 403(b) plans to automatically enroll participants (subject to certain exceptions, including for certain new or small businesses). Plans in existence prior to December 29, 2022 ("Pre-Established Plans") are not subject to the new requirement. In the case of a multiple employer plan (MEP), the Act specifies that employers that join an existing MEP after enactment are not exempt from the requirement to automatically enroll participants. Also, the exceptions for new and small businesses apply separately with respect to each such employer participating in a MEP.[4] The Notice (pages 2 to 7) provides that:

- A 401(k) plan is considered "established" on the date the sponsor initially adopted the plan terms providing for plan, even if the plan becomes effective after the adoption date. In the case of a 403(b) plan, a plan is a Pre-Established Plan if it was established before December 29, 2022, without regard to the date of adoption of plan terms that provide for salary reduction agreements. [Q. A-1, A-5]
- If two Pre-Enactment Plans are merged together, the resulting plan will continue to be a Pre-Enactment Plan. The result is the same if a single employer Pre-Enactment Plan is merged with a MEP that is a Pre-Enactment Plan. [Q. A-2]
- If a Pre-Enactment Plan is merged with a plan that is not a Pre-Enactment Plan, generally the resulting plan will not be a Pre-Enactment Plan and will be subject to the new requirements (the Notice describes an exception for mergers in connection with a transaction described in Code section 410(b)(6)(C), where the Pre-Enactment Plan is designated as the ongoing plan). In addition, if a single employer plan that is not a Pre-Enactment Plan is merged into a MEP that is a Pre-Enactment Plan, then the plan merged into the ongoing MEP would not be treated as a Pre-Enactment Plan with respect to that employer. [Q. A-3]
- If a plan is spun off from a Pre-Enactment Plan, generally the spun off plan will continue to be a Pre-Enactment Plan. [Q. A-4]
- The requirements of §101 generally apply to a starter 401(k) deferral-only arrangement and to a safe harbor deferral-only 403(b) plan (which were created by section 121 of the SECURE 2.0 Act). [Q. A-6]

The Notice's application to an employer with a Pre-Enactment Plan joining a Pooled Employer Plan (PEP) or other MEP is not explicitly clear. One interpretation is that a single employer plan that is a Pre-Enactment Plan will lose its grandfathered status if it is merged into a PEP that was created after December 29, 2022. This result is not evident from the statute, since the statute provides that each employer is treated as if it is a separate plan.

Section B: Modification of credit for small employer pension plan startup costs (§102).

The small employer pension plan credit for startup costs is a credit available for a plan's first three years, for 50 percent of administrative costs, up to an annual cap of $5,000. Effective for taxable years beginning after December 31, 2022, the SECURE 2.0 Act modified the tax credit for small businesses that adopt a new qualified plan. For employers with no more than 50 employees, the credit equals 100 percent (increased from 50 percent) of startup costs. For defined contribution (DC) plans, a new additional credit for a plan's first five years is provided for employers with no more than 100 employees, based on the amount contributed by the employer on behalf of employees earning wages of $100,000 (as defined in Code section 3121(a)) or less (indexed). The amount of the credit is

a percentage of the amount contributed by the employer, up to $1,000 for with respect to each employee. The Notice (pages 7 to 15) provides that:

- The credit for employer contributions is treated as a separate credit that is in addition to the startup cost credit. [Q. B-1]
- For the new credit for employer contributions, a plan is considered established on the date the plan becomes effective with respect to the eligible employer. The determination of the first year the credit is available is similar to the determination for the credit for startup costs, except that the employer is permitted to elect for the first startup costs credit year to be the taxable year preceding the taxable year in which the plan becomes effective with respect to the eligible employer. [Q. B-2]
- For determining eligibility for the credits, an employer will only be eligible if it does not exceed the limit on the number of employees for the first taxable year of the credit period—the employer will not become eligible later if its number of employees dips to 100 or fewer (or 50 or fewer, for the increased startup costs credit) in a later year. [Q. B-3; B-4]
- An employer that was eligible for the startup costs credit for a taxable year prior to 2023 may be eligible for the increased startup costs credit (or the employer contribution credit) for years after 2022, only if there is a taxable year during the employer's applicable three- or five-year credit period that begins after 2022. [Q. B-5]
- For purposes of the $100,000 wage limit for the employer contribution credit, an employer does not have to consider an individual's earned income other than wages as defined in Code section 3121(a). Therefore, employer contributions for an individual who is self-employed (e.g., a partner) or a state or local government employee with no wages under section 3121(a), may be taken into account, even if the individual has earned income in excess of $100,000. [Q. B-6]
- Regarding the timing of contributions taken into account for the employer contribution credit, an employer should take into account contributions for the same taxable year that a deduction under Code section 404(a) would apply to the contribution. [Q. B-7]

Section C: Military spouse retirement plan eligibility credit for small employers (§112).

Effective for taxable years beginning after December 29, 2022, the SECURE 2.0 Act creates a new tax credit for small employers with DC plans that (1) make military spouses immediately eligible for plan participation within two months of hire, (2) upon plan eligibility, make the military spouse eligible for any matching or nonelective contribution that they would have been eligible for otherwise at two years of service, and (3) make the military spouse immediately fully vested in all employer contributions. The employer is eligible for a maximum credit of $500 for three years with respect to each military spouse who is a non-highly compensated employee. The employer is permitted to rely on the employee's certification that the employee's spouse is a member of the uniformed services serving on active duty. The Notice (pages 15 to 20) provides that:

- The employer can only claim the credit in years in which the employer is eligible (e.g., the employer cannot claim the credit for a year if, in the preceding year, the employer had more than 100 employees, even if the employer was previously eligible for the credit). [Q. C-1]
- If an employer amends a plan (or adopts another plan) to become an eligible DC plan under this provision, the employer may claim the credit with respect to a miliary spouse who participated in the plan (or another plan of the employer) previously. The credit period begins on the first date that the miliary spouse participates in any

eligible DC plan of the employer. [Q. C-2]

Section D: Small immediate financial incentives for contributing to a plan (§113).

Effective for plan years beginning after December 29, 2022, the SECURE 2.0 Act allows employers to offer de minimis small incentives (e.g., a gift card), not paid for with plan assets, to induce employees to enroll in a 401(k) or 403(b) plan. The Notice (pages 20 to 24) provides that:

- A de minimis financial incentive cannot exceed $250 in value. [Q. D-1]
- A de minimis financial incentive can only be provided to an employee who is not already participating in the plan (and for whom there is no election to defer already in effect). An employer could, however, offer an additional amount to be provided at a later date provided the employee is continuing to defer at that later date. [Q. D-2]
- A matching contribution is not a de minimis financial incentive. [Q. D-3]
- A de minimis financial incentive is not subject to the rules that apply to a plan contribution (e.g., qualification requirements and deductibility timing rules). [Q. D-4]
- A de minimis financial incentive will be includible in the employee's gross income and wages and is subject to applicable withholding and reporting requirements for employment tax purposes, unless it satisfies an exception under the Code (i.e., a $200 gift card is a cash equivalent and generally would be includible in income). [Q. D-5]

Section E: Contribution limit for SIMPLE plans (§117).

Effective for taxable years beginning after December 31, 2023, the SECURE 2.0 Act increases the annual deferral limit to SIMPLE plans, and the catch-up contribution limit that applies at age 50 for SIMPLE plans, to 110 percent of the otherwise applicable limits in 2024 (and indexed thereafter). The increased limits are available only to employers with no more than 25 employees, and, for employers with more than 25 employees and not more than 100 employees, the increased limits are available only to those who make enhanced employer contributions on behalf of employees (either a 4 percent matching contribution or a 3 percent non-elective contribution). According to the Notice (pages 24 to 30):

- The increased limits apply automatically in the case of employers that have no more than 25 employees. [Q. E-2]
- For employees with more than 25 employees and no more than 100 employees, the increased limits only apply if the employer makes an election, by taking a formal written action before the annual notice to employees is provided, for the increased limits to apply. The election will remain effective until it is revoked by the employer, through a formal written action taken before the annual notice to employees is provided. [Q. E-2, E-4, E-7, E-8]
- An employer for whom the increased limits apply (whether automatically or by an election) must reflect the limits in the plan terms and must notify employees of the increased limits. The notice must be included in the annual notification to employees regarding the salary reduction agreement. If applicable, the notice must also notify employees of the increased matching or nonelective contribution. The employer should also notify the plan's financial institution and the payroll provider. [Q. E-4, E-6]

Section F: Exception to penalty on early distributions from qualified plans for individuals with a terminal illness (§326).

The SECURE 2.0 Act provides an exemption from the 10 percent early distribution penalty in the case of a distribution to a terminally ill individual, effective for distributions made after December 29, 2022. Participants generally are permitted to repay such distributions

into an eligible retirement plan within three years. Notably, the Notice (on pages 30 to 39) provides that:

- A terminally ill individual distribution may be made from a qualified retirement plan (including a DB plan), a 403(b) plan or an IRA. [Q. F-2]
- A plan is not required to allow a terminally ill individual distribution. [Q. F-10]
- The new provision does not create a new distributable event in a qualified plan. Rather, the employee must otherwise be eligible for a permissible in-service distribution (including a hardship distribution). [Q. F-12]
- A plan administrator or IRA trustee/custodian cannot rely on a participant's self-certification of eligibility; an employee must furnish to the plan administrator or IRA trustee/custodian a physician's certification meeting certain requirements. [Q. F-6, F-13]
- If a plan does not permit terminally ill individual distributions, an employee who meets the requirements and takes an in-service distribution may treat the distribution as a terminally ill individual distribution on their federal income tax return. [Q. F-15]

The Notice also includes a reminder that the Treasury Department and IRS intend to issue regulations under Code section 72(t), and notes that the regulation will provide guidance on the exceptions to the 10 percent additional tax that were added by the SECURE 2.0 Act.[5]

Note that a discussion draft of legislation containing technical corrections and other clarifications with respect to the SECURE 2.0 Act of 2022, has been circulated.[6] Among other things, the draft legislation would clarify that Section 326 creates a new distributable event.

Section G: Employers allowed to replace SIMPLE retirement accounts with safe harbor 401(k) plans during a year (§332).

Effective for plan years beginning after December 31, 2023, the SECURE 2.0 Act permits employers to terminate a SIMPLE IRA plan mid-year and replace it immediately with a safe harbor plan (i.e., a SIMPLE 401(k) plan, a plan using one of the 401(k) safe harbor formulas under Code section 401(k)(12) or (13), or a starter 401(k) plan). The Act also waives the limitation on distributions from a SIMPLE IRA during the first two years, in the case of a conversion to a 401(k) or 403(b) plan. According to the Notice (pages 39 to 44):

- An employer terminates a SIMPLE IRA plan by taking formal written action that specifies the termination date. [Q. G-1]
- When a plan is terminated, employees may not make salary reduction contributions with respect to any compensation paid after the termination date. The employer must make matching contributions (or nonelective contributions) based on the employee's salary reduction contributions made (or compensation earned) through the termination date. [Q. G-2]
- The employer must notify employees of the termination at least 30 days before that termination date. The employer should also notify the plan's financial institution and the employer's payroll provider. [Q. G-3]
- If a participant takes a distribution from a terminated SIMPLE IRA within their first two years of participation, the participant may roll over the distribution to a 401(k) or 403(b) plan. [Q. G-4]
- When a SIMPLE IRA plan is replaced mid-year by a safe harbor 401(k) plan, contributions limits are determined by the weighted average of the limits for the two plans, depending on how many days of the year each plan was in effect. [Q. G-6]
- If the employer establishes a safe harbor 401(k) plan midyear to replace the SIMPLE

IRA, the employer must furnish a safe harbor notice to employees that describes the contribution limits for the transition year. [Q. G-7]

Section H: Cash balance plans (§348).

Effective for plan years beginning after the date of enactment, the SECURE 2.0 Act modifies cash balance plan rules to effectively permit larger pay credits for older, longer-service workers without violating the anti-backloading requirements of Code section 411(b). The Notice provides guidance on how to amend a cash balance plan to take advantage of the special rule of section 348.

Section I: Safe harbor for corrections of employee elective deferral failures (§350).

The SECURE 2.0 Act creates a new safe harbor for reasonable administrative errors in implementing automatic enrollment or automatic escalation features in qualified plans, 403(b) plans, 457(b) plans, and IRAs. Under the safe harbor, the error must be corrected by the first pay date on or after the last day of the nine and ½ month period after the end of the plan year in which the error occurred (or, if earlier, the first pay date on or after the last day of the month following the month in which the employee notifies the plan sponsor of the error), the employer must make a corrective allocation of any missed matching contributions and satisfy certain notice requirements, and the error must be corrected similarly for all similarly situated participants in a non-discriminatory manner. The correction may be made after the participant has terminated employment and even if the error is identified by the IRS. The provision is effective for errors with respect to which the correction deadline falls after December 31, 2023. According to the Notice (pages 51 to 57):

- New Code section 414(cc) applies with respect to any errors for which the date referred to in Code section 414(cc) is after December 31, 2023.[7] The Notice explains that "the date referred to in section 414(cc)" means the earlier of:
    a. the date of the first payment of compensation made by the employer to the employee on or after the last day of the 9½-month period after the end of the plan year during which an implementation error with respect to the employee first occurred, or
    b. in the case of an employee who notifies the plan sponsor of the error, the date of the first payment of compensation made by the employer to the employee on or after the last day of the month following the month in which the notification was made. [Q. I-1]
- A plan sponsor may correct an implementation error by following the safe harbor correction method set forth in Appendix A, section .05(8), of Rev. Proc. 2021-30, for failures related to automatic contribution features in a section 401(k) plan or a section 403(b) plan.[8] [Q. I-2]
- A plan sponsor is permitted to correct an implementation error with respect to both active and terminated employees. [Q. I-3]
- If an individual affected by an implementation error would have been entitled to additional matching contributions, a corrective allocation of matching contributions must be made within a reasonable period. [Q. I-4]

Section J: Provisions relating to plan amendments (§501).

The SECURE 2.0 Act requires adoption of plan amendments on or before the last day of the first plan year beginning on or after January 1, 2025 (2027 in the case of governmental plans), or a later date prescribed by Treasury, as long as the plan operates in accordance

with such amendments as of the effective date of the legislative requirement or amendment. The SECURE 2.0 Act also conforms the plan amendment deadlines under the SECURE Act, the CARES Act, and the Taxpayer Certainty and Disaster Tax Relief Act of 2020 to these new dates. The Notice extends these deadlines as follows (pages 57 to 63).

Qualified Plans

- The deadline to amend a qualified plan generally is December 31, 2026.
- The deadline to amend a collectively bargained plan is December 31, 2028.
- The deadline to amend a governmental plan (as defined in Code section 414(d)) is December 31, 2029.

403(b) Plans

- The deadline to amend a 403(b) plan generally is December 31, 2026.
- The deadline to amend a 403(b) plan that is a collectively bargained plan of a tax-exempt organization is December 31, 2028.
- The deadline to amend a 403(b) plan that is maintained by a public school is December 31, 2029.

Eligible 457(b) Governmental Plans

- The deadline to amend an eligible governmental plan is the later of (1) December 31, 2029, or (2) if applicable, the first day of the first plan year beginning more than 180 days after the date of notification by the Secretary that the plan was administered in a manner that is inconsistent with the requirements of section 457(b) of the Code.

IRAs

- The deadline to amend the trust governing an IRA is December 31, 2026 (or such later date as the Secretary prescribes in guidance).

Section K: SIMPLE and SEP Roth IRAs (§601).

Effective for taxable years beginning after December 31, 2022, the SECURE 2.0 Act permits SIMPLE IRA and SEP IRA contributions to be made as Roth contributions (including employee deferrals to a SEP, to the extent permitted in a grandfathered salary reduction SEP (known as a SARSEP)). The Notice (on pages 63 to 68) provides:

- Employers are not required to offer employees a Roth contribution election [Q. K-1]
- A salary reduction contribution made to a Roth IRA is includible in the employee's gross income for the taxable year that includes the date on which the employee would otherwise have received the salary reduction contribution as wages or salary if the employee had not elected for the amount to be contributed to the SIMPLE IRA plan or SEP arrangement. [Q. K-4]
- An employer matching or nonelective contribution made to a Roth IRA is includible in the employee's gross income for the taxable year that includes the date on which the contribution is made to the Roth IRA. [Q. K-4]
- A description of how salary reduction contributions and employer matching and nonelective contributions to a Roth IRA should be reported. [Q. K-5]
    - Report salary reduction contributions made to a Roth IRA on Form W-2, Box 12, using Code F (for a SARSEP) or Code S (for a SIMPLE IRA), and include the same amount in Boxes 1,3, and 5.
    - Report employer matching and nonelective contributions made to a Roth IRA on

Form 1099-R for the year in which the contributions are made to the employee's Roth IRA, with the total reported in boxes 1 and 2a of Form 1099-R, using code 2 or 7 in box 7, and the IRA/SEP/SIMPLE checkbox in box 7 checked.

- The salary reduction contributions contributed to a Roth IRA are subject to income tax withholding, FICA, and FUTA taxes. [Q. K-6]
- Employer matching contributions and nonelective contributions that are made to a Roth IRA under a SIMPLE or SEP IRA are not wages (as defined in section 3401(a)) for purposes of federal income tax withholding under section 3402; are not wages (as defined in section 3121(a)) for purposes of FICA; and are not wages (as defined in section 3306(b)) for purposes of FUTA. [Q. K-6]
- For an employer who wants to make SIMPLE IRA plan or SEP arrangement contributions to a Roth IRA prior to the amendment of IRS forms and Listings of Required Modifications, an employer using any of Form 5304-SIMPLE, Form 5305-SIMPLE, Form 5305-SEP, Form 5305A-SEP, or a prototype plan document approved by the IRS, may continue to use (or begin to use) the form or document without amendment, until the IRS issues new forms or provides new guidance on prototype plan documents. [Q. K-7]

Section L: Optional treatment of employer matching or nonelective contributions as Roth contributions (§604).

Effective on December 29, 2022, the SECURE 2.0 Act allows sponsors of 401(k), 403(b), or governmental 457(b) plans to offer employer matching contributions and nonelective contributions on a Roth basis, at the election of the employee. The Notice (on pages 68 to 79) provides:

- A designated Roth matching contribution or designated Roth nonelective contribution is includible in an individual's gross income for the taxable year in which the contribution is allocated to the individual's account. [Q. L-2]
- A matching contribution or nonelective contribution may be designated as a Roth contribution only if the employee is fully vested in matching contributions or nonelective contributions at the time the contribution is allocated to the employee's account. [Q. L-3]
- Designated Roth matching contributions and designated Roth nonelective contributions are not included in wages, as defined in section 3401(a) of the Code, for purposes of federal income tax withholding under section 3402. [Q. L-5]
- Designated Roth matching contributions and designated Roth nonelective contributions contributed to a qualified plan or 403(b) plan are not included in wages, as defined in section 3121(a), for purposes of FICA, or as defined in section 3306(b), for purposes of FUTA. [Q. L-6; note that Q. L-7 and Q. L-8 separately address application of FICA and FUTA to Roth nonelective/matching contributions contributed to an eligible governmental plan]
- A description of the reporting obligations that apply to designated Roth matching contributions or designated Roth nonelective contributions allocated to an individual's account in a taxable year. The total amount of designated Roth matching contributions and designated Roth nonelective contributions that are allocated in a given year are reported in boxes 1 and 2a of Form 1099-R for the year of allocation, and code "G" is used in box 7. [Q. L-9]
- A qualified Roth contribution program may, but is not required, to include every type of designated Roth contribution. In other words, an employee generally may be permitted to designate an elective contribution as a Roth contribution without being permitted to designate a matching contribution or nonelective contribution as a Roth

contribution. Similarly, an employee generally may be permitted to designate a matching contribution or nonelective contribution (or both) as a Roth contribution without being permitted to designate an elective contribution as a Roth contribution. [Q. L-11]

Request for comment

Treasury and IRS invite comments and suggestions regarding the issues described in the Notice. In particular, they request comment, by February 20, 2024, on:

- Section 113 of the SECURE 2.0 Act with respect to a de minimis financial incentive that is provided by a party other than the employer; and
- Section 348 of the SECURE 2.0 Act with respect to whether there are situations under which a plan with a statutory hybrid benefit formula within the meaning of Treas. Reg. § 1.411(a)(13)-1(d)(4) that is not described in Q&A H-2 of the Notice would be amended pursuant to section 348 of the SECURE 2.0 Act, as described in section II.H of the Notice.

ICI intends to submit a comment letter noting additional questions not answered by the Notice (or raised by the Notice). If you have suggestions for the comment letter, please contact us.

Shannon Salinas
Associate General Counsel - Retirement Policy

Notes

[1] IRS Notice 2024-02 is available at https://www.irs.gov/pub/irs-drop/n-24-02.pdf.

[2] For a summary of the SECURE 2.0 Act, see ICI Memorandum No. 34795, dated January 12, 2023, available at https://www.ici.org/memo34795.

[3] For an overview of the letter, see ICI Memorandum No. 35218, dated March 28, 2023, available at https://www.ici.org/memo35218.

[4] New Code section 414A(c)(2)(B) provides that "[the pre-enactment plan exception] shall not apply in the case of an employer adopting after such date of enactment a plan maintained by more than one employer, and subsection (a) shall apply with respect to such employer as if such plan were a single plan."

[5] For a summary of the Treasury/IRS fall 2023 regulatory agenda, see ICI Memorandum No. 35565, dated December 21, 2023, available at https://www.ici.org/memo35565.

[6] The discussion draft, available at https://waysandmeans.house.gov/secure-2-0-act-technical-corrections-discussion-draft-released/, was released by House Committee on Ways and Means Chairman Jason Smith (R-Missouri) and Ranking Member Richard E. Neal (D-Massachusetts), along with House Committee on Education and the Workforce Chairwoman Virginia Foxx (R-North Carolina) and Ranking Member Bobby Scott (D-Virginia). Senate Finance Committee Chairman Ron Wyden (D-Oregon) and Ranking Member Mike Crapo (R-Idaho), along with Senate Committee on Health, Education, Labor and Pensions Chairman Bernie Sanders (D-

Vermont) and Ranking Member Bill Cassidy, M.D. (R-Louisiana), released an identical measure in the Senate.

[7] Section 350(b) of the SECURE 2.0 Act.

[8] Rev. Proc. 2021-30 is available at https://www.irs.gov/pub/irs-drop/rp-21-30.pdf (see pages 89-91).
