

IRS Provides Guidance on SECURE 2.0 Act Changes and Further Extends Plan Amendment Deadline for Applicable Legislation

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IRS Notice 2024-2 (Dec. 20, 2023)

Available at <https://www.irs.gov/pub/irs-drop/n-24-02.pdf>

The IRS has issued a Notice with guidance on miscellaneous changes under the SECURE 2.0 Act and has extended the plan amendment deadline for certain legislation applicable to retirement plans. Here are highlights for 401(k) plans:

- **Automatic Enrollment for New Plans.** Automatic enrollment is not required for 401(k) arrangements established before December 29, 2022. A qualified 401(k) arrangement is established on the date the plan terms providing for a cash or deferred arrangement are adopted originally, even if they are effective after the adoption date. The Notice also addresses the effects of events such as mergers and spin-offs of plans with or without qualified cash or deferred arrangements established before December 29, 2022. For example, two 401(k) plans established before December 29, 2022, that are merged are not considered a new plan subject to the automatic enrollment requirements even if the merger takes effect after December 29, 2022. The Notice further provides that automatic enrollment rules apply to a starter 401(k) deferral-only arrangement for plan years beginning after December 31, 2024.
- **Small Employer Plan Credits.** The employer contributions credit added by the SECURE 2.0 Act (for qualifying small employers) is treated as a separate credit that is in addition to the credit for qualified startup costs associated with establishing and administering an eligible employer plan. When determining the employer contributions credit, an eligible employer plan is treated as being established on its effective date. To take the credit, an employer must have been eligible in the first employer contributions credit taxable year during the employer's five-year credit period and the year for which the credit is claimed. Thus, an employer with more than 100 employees for the taxable year preceding the first employer contributions credit taxable year during the five-year credit period is not eligible for the credit for the first time in a subsequent taxable year, even if the employer has fewer than 100 employees in a subsequent year. When determining the credit, employers can take into account contributions to individuals with self-employment income that exceeds the \$100,000 compensation limit because that limit applies to W-2 wages and not earned income.
- **Small Employer Military Spouse Credit.** Employers may only claim the military spouse retirement plan eligibility credit in a year during the three-year credit period in which they meet the eligibility requirements. The credit can be claimed, however, with respect to a military spouse who participated in a defined contribution plan before the employer amends the plan to become an eligible defined contribution plan or adopts another eligible plan in which the military spouse participates. The employer is first eligible for the credit for its taxable year that includes the later of the date on which the plan or amendment becomes

effective and the date on which the military spouse begins participation in the plan after amendment or adoption to become an eligible defined contribution plan.

- **Contribution Incentives.** A financial incentive is treated as a de minimis financial incentive that is excepted from the “contingent benefit” restriction applicable to 401(k) plans only if it does not exceed \$250 in value and is offered to employees who have not yet made a deferral election. Employers may stagger the financial incentives over multiple years so long as the combined value does not exceed \$250. For example, an employee could be offered a \$100 incentive to defer under the plan in the first year and another \$100 to defer in the next year. Matching contributions may never be considered de minimis financial incentives. The value of a de minimis financial incentive is included in employees’ gross income and wages and is subject to withholding in the same manner as any other employer-provided fringe benefit. [EBIA Comment: Under the fringe benefit rules, a \$250 gift card for employees deferring for the first time would be fully taxable and included in income as a cash equivalent.]
- **SIMPLE 401(k) Plan Contribution Limits.** SIMPLE 401(k) deferral limits that were increased by the SECURE 2.0 Act apply to an employer if, during the three-taxable year period preceding the first year that the employer maintained the SIMPLE 401(k) plan, neither the employer nor a controlled group member established or maintained a qualified plan, a 403(a) annuity plan, or 403(b) plan under which contributions were made or benefits accrued for substantially the same employees as may participate in the SIMPLE 401(k) plan. The limits automatically apply to eligible employers with no more than 25 employees who received at least \$5,000 of compensation for the preceding calendar year. Employers with more than 25 employees who received at least \$5,000 of compensation for the preceding year must make an election for the increased limits to apply. An employer makes an election by taking formal written action and should maintain documentation of the election. Employers must reflect the increased limits in the plan terms and notify employees. An election to apply the increased limits is effective until revoked.
- **Early Terminal Illness Distributions.** A “terminally ill individual distribution” that is excepted from the 10% additional penalty tax applicable to early distributions is defined as any distribution to an employee on or after the date on which the employee has been certified by a physician as having an illness or physical condition reasonably expected to result in death in 84 months or less. There is no independent right to these distributions, and they must be permitted under some other plan provision allowing in-service distributions, such as hardship or disability distributions, and are includible in gross income. A “physician” generally means a doctor of medicine or osteopathy legally authorized to practice medicine and surgery. The certification must be furnished by the employee, and must include: (1) a statement of reasonably expected death in 84 months or less; (2) a narrative description of evidence used to support this statement; (3) the physician’s name and contact information; (4) the date the physician examined the individual or reviewed evidence, and the date the physician signs the certification; and (5) the physician’s signature, with an attestation. There is generally no limit on the distribution amount.
- **Correcting Automatic Contribution Errors.** The SECURE 2.0 Act added a correction provision for errors made by plans with automatic contribution features that covers improper exclusions and reasonable administrative errors “made in implementing an automatic enrollment or automatic escalation feature (or an affirmative election made by an eligible employee covered by such a feature).” The date by which the employer has to correct elective deferrals is the earlier of (1) the date compensation is first paid to the employee on or after the last day of the 9-1/2 month period after the end of the plan year during which an implementation error occurred, or (2) in the case of an employee who notifies the plan sponsor of the error, the date compensation is first paid to the employee on or after the last day of the month following the month in which the notification was made. Generally, employers must correct using the correction method in the most recent iteration of the IRS’s plan correction program—i.e., they also must make corrective contributions (adjusted for earnings) for any missed matching contributions and notify the employee within 45 days after correct deferrals begin. A corrective allocation of matching contributions (adjusted for earnings) is required within a reasonable period ending on the last day of the sixth month following the month in which correct elective deferrals begin (or, for terminated employees, would have begun). For automatic contribution errors that began prior to December 31, 2023, the reasonable correction period for matching contributions ends on the last day of the third plan year following the year in which the error occurred.

- **Amendments.** The deadline for amending a plan to reflect applicable provisions of the SECURE Act, the expanded Covid-based distribution options and 2020 minimum distribution requirement waiver under the CARES Act, qualified disaster distribution tax treatment under the Taxpayer Certainty and Disaster Tax Relief Act, the SECURE 2.0 Act, and any regulations under these laws, is extended to December 31, 2026. Collectively bargained plans have until December 31, 2028, and governmental plans generally have until December 31, 2029. Amendments made within these timeframes will not violate applicable anti-cutback rules.
- **Designated Roth Contributions.** Guidance is provided regarding employer matching or nonelective contributions that an employee elects to designate as Roth contributions. Generally, the rules for designated Roth elective contributions apply to designated Roth employer matching and nonelective contributions (e.g., elections must be made before the contribution is allocated to the employee's account and must be irrevocable). Employees must also have an effective opportunity to make or change their designations at least once during each plan year. Employees may only designate a matching or nonelective contribution that is fully vested when the contribution is allocated to their account. Designated Roth matching and nonelective contributions are not included in wages for income tax withholding purposes (and thus are reported on Form 1099-R instead of Form W-2), and are not subject to FICA or FUTA taxation.

EBIA Comment: There is much to digest here for those who work with 401(k) plans. Nevertheless, the plan amendment deadline extension should come as a welcome relief for 401(k) plan sponsors and service providers. The Notice is not intended to provide comprehensive guidance on all SECURE 2.0 Act provisions applicable to 401(k) plans, and the IRS states that it will continue to analyze the SECURE 2.0 Act's provisions in anticipation of future guidance. The Notice includes instructions for submitting comments, which are due on or before February 20, 2024. For more information, see EBIA's 401(k) Plans manual at Sections II.H ("Tax Credits: Small Employers and Certain Plan Participants"), VIII ("Contributions: Participant"), IX ("Contributions: Employer"), XII ("Distributions: Code Requirements and Design Choices"), XV ("Distributions: Hardship"), XXII.L ("SIMPLE Plan: Small Employer Alternative"), XXVII ("Plan Administration: Adoption, Amendment, Submission"), and XXXIV ("Correcting Plan Mistakes: Identifying and Fixing Common Errors").

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