

Employee Benefit ■ Plan Review

IRS Issues Guidance on SECURE 2.0 – What Plan Sponsors Need to Know

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A number of months ago, approximately one year after Congress enacted the Setting Every Community Up for Retirement Enhancement Act of 2022 (SECURE 2.0), the Internal Revenue Service (the IRS) released Notice 2024-2 (the Notice) providing much needed guidance, in the form of questions and answers, on 12 of the 90 new provisions added by SECURE 2.0.

This article offers a brief overview of the key provisions of the Notice affecting Section 401(k) and Section 403(b) retirement plans.

AUTOMATIC ENROLLMENT/ AUTO-ESCALATION

Section 101 of SECURE 2.0 mandates that Section 401(k) and Section 403(b) plans with a cash or deferred arrangement established after December 29, 2022 (the date of enactment of SECURE 2.0) must include an auto enrollment feature and an auto-escalation feature, effective for plan years beginning after December 31, 2024.

The Notice clarifies that a Section 401(k) plan is considered to be established on the date the plan terms setting forth the cash or deferred arrangement are initially adopted, even if those terms become effective after the adoption date. For example, if an employer adopted a Section 401(k) plan in October

2022 with an effective date of January 1, 2023, the plan would be exempt from the auto-enrollment and auto-escalation requirements of SECURE 2.0.

In contrast, a Section 403(b) plan is considered to be subject to the provision if established after December 29, 2022, without regard to the date of adoption of the plan's terms.

The Notice also addresses the application of the auto-enrollment and auto-escalation requirements to plan merger and spin-off transactions. In general, the merger of two pre-enactment plans (those established before December 29, 2022) will not affect the pre-enactment status of the plans. However, if a pre-enactment plan is merged with a plan subject to the auto-enrollment/escalation requirements, the ongoing plan will be subject to the auto-enrollment/escalation requirements unless the pre-enactment plan is designated as the ongoing plan and certain other requirements are met.

SMALL IMMEDIATE FINANCIAL INCENTIVES

Section 113 of SECURE 2.0 allows employers to offer de minimis financial incentives, such as gift cards, not paid for with plan assets, to incentivize employees to participate in Section 401(k) and Section 403(b) plans. This provision is effective for plan years beginning after

December 31, 2022 and is optional for employers.

The Notice provides that a de minimis financial incentive:

- (1) Cannot exceed \$250 in value;
- (2) Can only be offered to employees for whom no election to defer under the plan is already in effect;
- (3) May be made in installments, including over more than one plan year, contingent on the employee continuing to defer; and
- (4) Is not treated as a plan contribution.

The Notice confirms that matching contributions do not qualify as a de minimis financial incentive.

The Notice further provides that a de minimis financial incentive is treated as taxable wages unless it satisfies an exception under the Code.

TERMINAL ILLNESS DISTRIBUTIONS

Section 326 of SECURE 2.0 creates a new exception to the 10% early distribution penalty tax for any distribution made to a terminally ill individual, effective for distributions made after December 29, 2022.

The Notice provides clarification for this new distribution option as follows:

- SECURE 2.0 provides an exception to the 10% early distribution penalty tax but does not create a new distribution right in Section 401(k) and Section 403(b) plans. Thus, the participant must be otherwise eligible for an in-service distribution, such as on account of a hardship distribution or a disability.
- Self-certification is not sufficient to demonstrate that a participant is terminally ill. A participant must be certified by a physician as having a terminal illness.

- There is no limit on the distribution amount a participant may receive as a terminally ill individual distribution.
- If a qualified plan does not permit terminally ill individual distributions and a participant receives an otherwise permissible in-service distribution that meets the requirements of both the permissible in-service distribution and a terminally ill individual distribution, the participant may treat the distribution as a terminally ill individual distribution on their federal income tax return.

CASH BALANCE PLANS

Before the enactment of SECURE 2.0, a cash balance plan with a variable interest crediting rate that increased with the participant's age or service risked violating the anti-backloading provisions if the interest credit rate fell below certain levels. To avoid this risk, some cash balance plans included a minimum interest crediting rate to ensure that interest rates never fell below this floor.

Section 348 of SECURE 2.0 provides that cash balance plans can apply a "reasonable projection" of the interest crediting rates for purposes of the anti-backloading rules, subject to a maximum of 6%. Accordingly, cash balance plans no longer need to provide a fixed annual minimum interest crediting rate.

The Notice provides guidance on how and when to amend the plan to reduce or remove an existing interest crediting rate without violating the anti-cutback rules.

SAFE HARBOR CORRECTION OF EMPLOYEE ELECTIVE DEFERRAL FAILURES

Section 350 of SECURE 2.0 makes permanent the safe harbor for correcting employee elective deferral failures relating to the implementation of an auto-enrollment/auto-escalation feature or the failure to afford an eligible

employee the opportunity to make an affirmative election because the employee was improperly excluded from the plan, effective with respect to failures occurring after December 31, 2023.

The Notice:

- Clarifies that the effective date by which corrective deferrals must be made is the earlier of (1) the first pay date that is 9-1/2 months after the end of the plan year in which the failure first occurred or (2) the first pay date in the month following the month the employee notifies the employer of the error.
- Clarifies that the safe harbor correction method is also available for terminated employees and provides that the notice to terminated employees can exclude (1) the statement that appropriate amounts have begun to be deducted and contributed to the plan and (2) an explanation that the affected terminated participant may elect an increased deferred percentage to make up for the missed deferral opportunity.
- Provides that an individual affected by the implementation error who would have been entitled to additional matching contributions had the missed elective deferrals been made must receive a corrective allocation of matching contributions (adjusted for earnings) by the last day of the 6th month following the month in which correct deferrals begin (or with respect to a terminated employee, would have begun but for the termination of employment).
- Provides that, for automatic contribution errors that began on or before December 31, 2023, a corrective allocation of matching contributions (adjusted for earnings) must be made by the end of the third plan year following the year in which the error occurred.

OPTIONAL TREATMENT OF EMPLOYER CONTRIBUTIONS OR NONELECTIVE CONTRIBUTIONS AS ROTH CONTRIBUTIONS

Section 604 of SECURE 2.0 provides that plan sponsors of defined contribution plans, Section 403(b) plans, and governmental Section 457(b) plans may permit participants to designate matching or nonelective contributions as Roth contributions, effective for contributions made after December 29, 2022.

The Notice provides:

- In order to designate matching or nonelective contributions as Roth contributions, the participant must be fully vested in such employer contributions at the time they are allocated to the participant.
- The Roth designation must be made no later than the date the contributions are allocated to the participant's account.
- The participant must have the opportunity to make (or change)

the Roth designation at least once during each plan year.

- Designated Roth contribution amounts are to be reported on IRS Form 1099-R as an in-plan Roth conversion and includible in the participant's gross income in the taxable year in which the amounts were allocated to the participant's account. Such contributions, however, are not considered wages for purposes of income tax withholding, FICA or FUTA (although special FICA rules apply to eligible governmental plans).

PLAN AMENDMENT DEADLINE EXTENSION

The Notice further extends, by one-year, the plan amendment deadline to reflect the recent law changes, including the SECURE 1.0 Act, certain provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and SECURE 2.0. The deadline to adopt the required

or discretionary amendments are as follows:

- Non-governmental plans – no later than December 31, 2026.
- Collectively Bargained plans – no later than December 31, 2028.
- Governmental plans – no later than December 31, 2029 (possibly later for certain governmental Section 457(b) plans).

The Notice did not extend the amendment deadlines for Section 457(b) plans sponsored by a non-governmental employer. Absent IRS guidance, the deadline for amending such plans for recent law changes remains the last day of the 2025 plan year. 🌀

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