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IRS Releases SECURE 2.0 Guidance; Extends Amendment Deadlines

by R. Sterling Perkinson

On December 20, 2023, the Internal Revenue Service ("IRS") issued Notice 2024-2, which provides guidance on some important provisions of the SECURE 2.0 Act of 2022 ("SECURE 2.0"). Notice 2024-2, is not comprehensive guidance for SECURE 2.0, nor for the SECURE 2.0 provisions that it addresses. The IRS notes that it continues to review SECURE 2.0 and anticipates issuing further guidance. However, Notice 2024-2 does answer a number of questions regarding certain SECURE 2.0 provisions described below. Perhaps as noteworthy, Notice 2024-2 extends the deadline for adopting amendments to reflect SECURE 2.0 provisions as well as a number of other legislative changes.

Grandfathering Rules for Automatic Enrollment Requirement

One of the most significant changes under SECURE 2.0 is a requirement that new 401(k) plans and 403(b) plans include an automatic enrollment feature starting with plan years beginning after December 31, 2024. SECURE 2.0 imposes minimum requirements for the automatic enrollment feature, including a minimum 3% contribution rate and a required automatic increase feature.

However, plans that were established prior to December 29, 2022 (the "SECURE 2.0 Enactment Date") are exempt from this rule. Notice 2024-2 clarifies that for purposes of this grandfathering rule, a plan is considered to be established when the plan was adopted (for example, the plan document was approved by the employer) even if the plan was initially effective after the SECURE 2.0 Enactment Date.

Notice 2024-2 also clarifies how the grandfathering rule will be determined in transactions involving plans:

Plan Mergers. When two or more grandfathered plans are merged, the resulting plan will also be grandfathered. However, if a grandfathered plan is merged with a non-grandfathered plan, the resulting plan will not be grandfathered unless (i) the plan merger occurs during the coverage testing transition period, which is the plan year following the plan year in which a corporate M&A transaction occurs that changed the controlled group, and (ii) the grandfathered plan is treated as the surviving plan.

Plan Spinoffs. A plan that is spun-off from a grandfathered plan will also be treated as a grandfathered plan.

Multiple Employer Plans ("MEPs"). Grandfathering in MEPs is determined on an employer-by-employer basis.

If a grandfathered plan is merged into a grandfathered MEP, then the employer's portion of the MEP will continue to be treated as grandfathered. But if a non-grandfathered plan is merged into a MEP, the employer's portion of the plan will not be treated as grandfathered, although grandfathering of other participating employers would not be affected.

Similarly, a plan created from spinning off an employer's portion of the MEP would continue to

be treated as grandfathered, as long as the employer's portion of the MEP was treated as grandfathered.

Notice 2024-2 does not address the merger of a grandfathered plan into a MEP established after the SECURE 2.0 Enactment Date. Accordingly, it is not clear in this case whether the employer's portion of the plan would continue to be treated as grandfathered under the MEP or if the automatic enrollment provisions would apply.

De Minimis Financial Incentives

Prior to SECURE 2.0, the "contingent benefit rule" prohibited employers from providing any incentives for enrolling in a 401(k) plan or 403(b) plan, other than matching contributions. SECURE 2.0 provides an exception that allows employers to provide "de minimis" financial incentives to employees for electing to contribute to a 401(k) plan or 403(b) plan. For example, a gift card provided to employees who enroll in the plan may qualify as a de minimis financial incentive.

SECURE 2.0 did not specify what kind of financial incentive would be "de minimis." Notice 2024-2 sets the maximum value of a de minimis incentive at $250 (without any inflation adjustment). This appears to be a one-time limit rather than an annual limit because Notice 2024-2 provides that it can be paid in installments over more than one plan year.

The financial incentive can only be provided to employees who are not already enrolled in the plan. This means that it could not be used to encourage participants who are enrolled to increase their contributions. Also, the financial incentive could not be provided to employees who have already enrolled to encourage them to remain enrolled or as a fairness principle so they are not penalized relative to other employees who had not previously enrolled. However, Notice 2024-2 does allow the financial incentive to be provided in installments over a period of time so that it can reward participants who were not previously enrolled at the time the financial incentive was first offered for remaining enrolled.

There are no exceptions to the tax rules for de minimis financial incentives. Accordingly, if the financial incentives are offered as a cash equivalent (such as a gift card), the value of the financial incentive is reportable as wages on a participant's Form W-2. However, it may be possible to provide the financial incentive as a flexible spending account credit or non-taxable fringe benefit.

Terminally Ill Individual Distributions

SECURE 2.0 created a new exception to the 10% additional tax on early distributions to individuals who are terminally ill. Terminally ill individual distributions are subject to income tax reporting, but like qualified birth or adoption expenses, participants who receive a terminally ill individual may recontribute the distribution to a plan that accepts the distribution within a 3-year period. Terminally ill individual distributions apply to 401(k) plans, 403(b) plans, other qualified retirement plans, and IRAs, but not to 457(b) plans.

Plan Provisions. Unlike other new exceptions to the 10% additional tax (such as qualifying birth or adoption expenses or domestic abuse withdrawals), there is no exception to the distribution restrictions that apply to 401(k) and 403(b) contributions on account of a terminal illness. Accordingly, a participant can receive a terminally ill individual distribution for 401(k) and 403(b) contributions only if they already qualify for a withdrawal, for example, because they have terminated employment or qualify for a hardship withdrawal.

A plan amendment recognizing terminally ill individual distributions may be desired in order to (1)

allow distributions within the scope of what would ordinarily be permissible (for example, a plan may permit terminally ill distributions with respect to employer contributions that are exempt from 401(k) and 403(b) distribution restrictions), (2) permit the recontribution of terminally ill individual distributions, and (3) facilitate proper tax reporting for affected participants.

However, if a plan does not provide for terminally ill individual distributions, employees may claim the terminally ill individual distributions on their personal tax returns.

Physician's Certification. To qualify as a terminally ill individual distribution, the participant must obtain a certification from a physician (*i.e.*, a doctor of medicine or osteopathy who is legally licensed to practice medicine) that the participant has a terminal illness or physical condition that is reasonably expected to result in death within 84 months. The certification must include specific required content regarding the physician's review. This certification must be obtained on or before the date that the distribution is made to qualify as a terminally ill individual distribution. A participant cannot self-certify that they have a terminal illness, even if the participant is a physician.

A plan that allows for terminally ill individual distributions must obtain the physician's certification, but does not need to obtain any underlying documentation.

If a participant receives a distribution that would otherwise qualify as a terminally ill withdrawal except that the plan does not provide for terminally ill withdrawals, the participant may treat the distribution as a terminally ill individual distribution on their individual tax return and retain a copy of the physician's certification (and any other supporting documentation) in their personal tax records.

Roth Employer Contributions

SECURE 2.0 permits employees to designate employer profit sharing and matching contributions as Roth contributions. However, prior to SECURE 2.0, plans could provide for an in-plan Roth rollover feature that permitted participants to convert any of their vested accounts (other than Roth accounts) to Roth accounts in the plan.

One of the key questions about the SECURE 2.0 Roth employer contributions provision was to what extent they differ from an in-plan Roth rollover provision in terms of tax reporting. Notice 2024-2 confirms that Roth employer contributions are reported for tax reporting consistently with in-plan Roth rollovers. For payroll purposes, Roth employer contributions are treated as though they had been contributed on a non-Roth basis and then immediately rolled into a Roth account through an in-plan Roth rollover by being reported on a Form 1099-R. As a result, no tax withholding will apply for Roth employer contributions, and so participants may need to voluntarily increase their tax withholding election or make estimated tax payments in order to avoid underpayment penalties.

The IRS has clarified that plans are not required to allow employer contributions to be contributed on a Roth basis, even if the plan allows elective deferrals to be contributed on a Roth basis. Similarly, a plan could allow employer contributions to be contributed on a Roth basis, but not elective deferrals. However, the availability of a particular type of Roth contribution is a "right or feature" subject to nondiscrimination testing requirements.

Cash Balance Plan Interest Crediting Rates

Effective for plan years beginning after Dec. 29, 2022, SECURE 2.0 includes an optional provision relating to the interest rates that may be used by cash balance pension plans to demonstrate compliance with

an anti-backloading rule. Prior to SECURE 2.0, IRS guidance required plans to use the current year's crediting rate to estimate all future pay credits for purposes of applying an accrual rule. SECURE 2.0 relaxes this requirement by permitting plans to use a reasonable estimate of future interest rates, subject to a maximum of 6%.

Notice 2024-2 clarifies what interest rates may be used and permits plans to be amended to reflect the newly permitted rates without violating the anticutback rules. Amendments may not take away interest credits that have already accrued (or that will accrue by the end of the interest crediting period in which the amendment is adopted or effective, whichever is later).

The IRS does not anticipate that amendments will be needed to statutory hybrid plans that are not cash balance plans, but requests comment on this point.

Amendment Deadlines

The amendment deadline for recent statutory changes (the SECURE Act, the SECURE 2.0 Act, section 104 of the Miners Act, sections 2202 and 2203 of the CARES Act, and section 302 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020) has generally been extended to December 31, 2026. For collectively-bargained and governmental plans, the new deadlines are December 31, 2028, and December 31, 2029, respectively.