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IRS Releases Notice 2024-2 to Provide Interim Guidance on SECURE 2.0 Provisions

On December 20, 2023, the IRS released Notice 2024-2, Miscellaneous Changes Under the SECURE 2.0 Act of 2022. This "grab bag notice" provides guidance on several SECURE 2.0 provisions but leaves others unaddressed. The IRS acknowledges that this notice is intended to provide interim guidance—and not comprehensive guidance—on particular issues to help financial organizations, employers, and individual taxpayers implement certain SECURE 2.0 Act provisions. Here are some of the more significant items that the notice addresses (with the SECURE 2.0 sections listed in the headings).

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Section 102: Start-up credit and contribution credit

CURRENT STATE

The new plan start-up credit has been increased to 100 percent of start-up costs (from 50 percent) for employers with no more than 50 employees. This credit applies for the first three years that the plan is in place. SECURE 2.0 added a credit for employer contributions. The credit applies to contributions made to employees who make no more than $100,000 per year, and contributions up to $1,000 per year are eligible. The credit gradually decreases for employers with more than 50 employees. The credit is 100 percent for the first two years, 75 percent for the third year, 50 percent for the fourth year, and 25 percent for the fifth year.

FURTHER CLARIFICATION/GUIDANCE

The Q&As clarify that an employer can qualify for both credits at the same time. The plan is treated as being established on the date that the plan becomes effective. But the employer can elect for the first start-up costs credits year to be the taxable year preceding the taxable year in which the plan becomes effective. This makes sense because the most significant costs of a new plan could be incurred before the plan becomes effective. The notice also clarifies that a contribution made for a previous plan year—but in the following year—is eligible for the credit for the year for which the contribution was made. The contribution is normally deemed to be made on the last day of the plan year.

TAKE SPECIAL NOTE

Other Q&As in this section relate to changes in the employer's number of employees. For example, a plan that has more than 100 employees initially will not become eligible for the credit, even if the employee count dips below 100 in later years. Most of the guidance in this section addresses these types of situations, which may not arise that often.

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Section 117: Increased contributions for SIMPLE plans

CURRENT STATE

Section 116 of the SECURE 2.0 Act permits the employer to make additional nonelective contributions (up to 10 percent of compensation of each employee eligible to participate, but initially limited to $5,000 with respect to each employee).

FURTHER CLARIFICATION/GUIDANCE

This section 117 increases both the annual salary reduction contribution/elective contribution limit and the limit on additional catch-up contributions beginning at age 50 for a SIMPLE IRA plan or a SIMPLE 401(k) plan for certain eligible employers. The increased limits are 110 percent of the otherwise applicable limits for 2024.

The increased limits apply automatically in the case of an eligible employer that has no more than 25 employees who received at least $5,000 of compensation for the preceding calendar year. For an employer that has more than 25 employees, the increased limits apply only if the employer makes an election for the increased limits to apply—and if the employer provides a higher matching or nonelective contribution. The matching contribution would have to be four percent and the nonelective contribution would have to be three percent.

Employers that must make the election for the increased limits (those with more than 25 employees) must make a formal written election and should maintain such documentation in the plan's records. The plan terms must also reflect the increased limits, and the employer must notify employees in the annual employer notification. Practically, the employer should also notify the payroll provider (and possibly the financial institutions involved) to expedite proper contribution processing.

According to the notice,

> *An employer election to apply the increased limits for a calendar year must be made before the employer provides the annual notice to each employee of the employee's opportunity to enter into a salary reduction agreement or to modify a prior agreement for that calendar year, as provided in Q&A G-1 of Notice 98-4.*

TAKE SPECIAL NOTE

On its face, this would seem to prevent an employer with more than 25 employees from instituting this provision for 2024 (unless we get some additional guidance that permits this). Finally, the election to increase the SIMPLE contribution limits is effective until it is revoked by the employer. As with electing to increase the limits, revoking the election requires formal written action, notifying employees in the annual notice, and retaining documentation in the plan's records.

Section 601: SIMPLE and SEP Roth IRAs

CURRENT STATE

The SECURE 2.0 Act permits employers to allow employees to elect to take SEP and SIMPLE deferrals and employer contributions as Roth contributions. (Because so few SAR-SEP plans exist, this summary will not address SAR-SEP deferrals.) Although this provision had been in effect since the beginning of 2023, no employers were known to have offered this option in the absence of clear IRS guidance. This should change now that the IRS has told us how to implement this section.

FURTHER CLARIFICATION/GUIDANCE

The notice clarifies that offering the option to characterize employee and employer contributions as Roth contributions is optional for employers. One IRS interpretation that may slow down adoption of these Roth provisions is that employers "must offer

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employees the same effective opportunity to make a Roth contribution election as the employees have to enter into a salary reduction agreement under the plan." The notice refers to IRC Sec. 408(p)(5) and Notice 98-4, which require a 60-day period before the beginning of each calendar year for employees to consider their deferral elections. Presumably, an employer could still allow employees to elect to take employer contributions as Roth contributions. But unless the IRS gives additional guidance, it appears that the option for employees to elect to make 2024 Roth deferrals through a SIMPLE IRA plan may have hit a snag.

Employers can make contributions to an employee's Roth IRA only if the employee has affirmatively elected this option. Roth deferrals are included in the employee's gross income for the year in which the employee would otherwise have received the deferral as wages or salary if no deferral election had been made. Employer matching or nonelective contributions to a Roth IRA are included in the employee's gross income for the taxable year in which the contribution is made to the Roth IRA—even if the employer takes a deduction for the contributions for the previous year.

Employers must report SIMPLE IRA Roth deferrals on IRS Form W-2, Wage and Tax Statement in Box 12, using Code S and must include this amount in Boxes 1, 3, and 5 ("Wages, tips, other compensation," "Social security wages," and "Medicare wages and tips," respectively). The employer must report employer matching and nonelective contributions made to a Roth IRA on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contracts, etc., with the total reported in boxes 1 and 2a, using code 2 or 7 in box 7, and the IRA/SEP/SIMPLE checkbox in box 7 checked.

TAKE SPECIAL NOTE

The salary reduction contributions contributed to a Roth IRA under a SIMPLE IRA plan or SEP arrangement are subject to income tax withholding, FICA, and FUTA taxes. Matching and nonelective contributions are excluded from wages, and so federal withholding for income tax, FICA, and FUTA does not apply. The notice cautions, however, that because employer contributions to Roth IRAs are subject to income tax, individuals may need to increase withholding or make estimated tax payments to avoid an underpayment penalty.

Pending the IRS's issuance of new forms or providing guidance on prototype plan documents, the notice states that existing employer-level forms may continue to be used. Although the notice does not explicitly state this, it appears that Roth contributions that are made through SEP or SIMPLE plans will be made using existing Roth IRA documents. This raises some questions. For example, because existing Roth IRA documents do not address special SIMPLE IRA rules (e.g., the two-year waiting period to avoid the 25 percent penalty on early distributions), should employees who receive Roth IRA contributions through a SIMPLE plan open a separate Roth IRA to segregate those assets if they haven't satisfied the two-year wait?

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Section 604: Matching and nonelective contributions as Roth contributions

CURRENT STATE

This section allows plan participants to elect to have employer matching and nonelective contributions be made as "designated Roth contributions." These contributions are included in gross income and are nonforfeitable at the time they are received. Although such contributions were available as of SECURE 2.0's enactment date, employers did not implement this provision (as far as we know) because of the lack of IRS guidance.

FURTHER CLARIFICATION/GUIDANCE

The notice clarifies that the rules for the new designated Roth matching contributions and designated Roth nonelective contributions are like the existing rules for designated Roth elective deferrals.

- Employees must designate matching or nonelective contributions as a Roth contribution before the contribution is allocated to the employee's account—and the election must be irrevocable (with respect to those contributions).
- Designated Roth matching and nonelective contributions must be included in the employee's income and must be separately accounted for (as with all Roth contributions). These contributions are included in the employee's gross income for the taxable year in which they are allocated to the employee's account, even if the employer deems them to have been deductible for the prior taxable year.
- Employees must have an "effective opportunity" to make or change the designation at least once during each plan year.

TAKE SPECIAL NOTE

Perhaps the most significant piece of guidance in this section resolves the concern about Roth matching and nonelective contributions being fully vested when contributed. The IRS takes a simple, workable approach: employees cannot designate a matching or nonelective contribution as a Roth contribution unless they are fully vested in that type of contribution at the time the contribution is allocated.

> **Example:** Altron Company's 401(k) plan has a five-year graded vesting schedule for nonelective (profit sharing) and matching contributions. Jesse has completed only three years of vesting service with Altron. Jesse is not permitted to designate employer matching or nonelective contributions as Roth contributions.

This approach resolves a concern that we expressed right after this provision became effective. The IRS acknowledges in this notice that the right to elect employer contributions as Roth contributions is considered a "right, benefit, or feature" that is subject to existing nondiscrimination rules. But it is exercising its authority to:

> *Provide any additional guidance that may be necessary or appropriate in applying the nondiscrimination requirements of section 401(a)(4), including additional safe harbors and alternative methods and procedures for satisfying those requirements. (Treas. Reg. Sec. 1.401(a)(4)-1(d)).*

Rights, benefits, and features provided under the plan must generally be made available in a nondiscriminatory manner. But the notice states that requiring full vesting before a participant can designate matching or nonelective contributions as Roth contributions will not violate this requirement. So while some employees may now have access to this new Roth option and others may not, the IRS is allowing it—perhaps because it is the simplest solution to a potentially thorny problem.

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As with employer contributions treated as Roth contributions in SEP and SIMPLE plans (discussed above), such contributions to qualified plans are not subject to withholding for income tax purposes or for purposes of FICA or FUTA withholding. Again, because income tax withholding does not apply, individuals may want to increase their withholding or make estimated tax payments to avoid an underpayment penalty. (Some different rules may apply to eligible governmental plans.)

Employer contributions that are treated as Roth contributions must be reported on IRS Form 1099-R as if they were in-plan Roth rollovers. That is, the total amount should be reported in boxes 1 (Gross distribution) and 2a (Taxable amount), with code "G" in box 7.

Although employer contributions that are treated as Roth contributions increase a participant's gross income for the year, they are not generally considered "compensation" for other purposes.

> **Example:** Chris's employer used a safe harbor definition of compensation. Chris makes $100,000 in compensation, and the employer makes a 10% profit sharing contribution that Chris elects to treat as a Roth contribution. The $10,000 employer contribution—although it increases Chris's gross income—will not increase Chris's compensation for other purposes. For example, it wouldn't require the employer to increase the profit sharing contribution.

The notice also clarifies that employers may choose to allow some Roth contribution options without necessarily allowing all of them. So an employer could allow Roth elective deferrals without giving employees the option of electing to treat employer contributions as Roth contributions. The converse could also apply, but this seems less likely. It seems more likely that, if employers allow employees to designate matching and nonelective contributions as Roth contributions, they will also allow Roth deferrals.

Section 332: Mid-year SIMPLE plan amendment to safe harbor 401(k) plan

CURRENT STATE

The SECURE 2.0 Act permits an employer to terminate a SIMPLE IRA plan at any point during the year if the employer adopts an ADP/ACP safe harbor plan (including a QACA) to replace the terminated plan.

FURTHER CLARIFICATION/GUIDANCE

The notice explains that the SIMPLE plan termination requires formal written action that specifies the date as of which the plan is terminated. No further deferrals may be made to the plan with respect to compensation paid after the termination date. The employer must notify employees of the termination of a SIMPLE IRA plan at least 30 days before the termination date. Distributions from a terminated SIMPLE IRA plan within the first two years of participation may be rolled over to a non-SIMPLE IRA plan, but only if it is either a 401(k) or 403(b) plan that is subject to the CODA distribution limits (e.g., death, disability, severance, 59½).

TAKE SPECIAL NOTE

When a SIMPLE IRA plan is replaced with a safe harbor plan mid-year, total combined deferrals under the two plans cannot exceed the weighted average for each of the plans. This amount is determined by applying the respective deferral limits of each plan to the number of days (out of 365) that each plan was in effect. The required notice to employees must contain this contribution limitation for the transition year.

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Section 350: Correcting auto-contribution errors (making a permanent fix)

CURRENT STATE

Current IRS guidance permits correction of errors that employers make relating to automatic enrollment and automatic escalation features. The guidance includes a safe harbor that allows for correction if a notice is given to the affected employee, if correct deferrals commence within certain prescribed periods, and if the employer makes any matching contributions that would have been made had the failure not occurred. But this relief was slated to expire at the end of 2023.

FURTHER CLARIFICATION/GUIDANCE

This section of the SECURE 2.0 Act makes this relief permanent. This provision adds new Section 414(cc) to the IRC:

> *Section 414(cc) provides that, if certain conditions are satisfied, a plan or arrangement will not fail to be treated as described in section 401(a), 403(b), 408, or 457(b) solely by reason of a corrected reasonable administrative error made (1) in implementing an automatic enrollment or automatic escalation feature with respect to an eligible employee (or an affirmative election made by an eligible employee covered by such a feature), or (2) by failing to afford an eligible employee the opportunity to make an affirmative election because the employee was improperly excluded from the plan (implementation error).*

An elective deferral error must be corrected by (generally) the earlier of 1) 9½ months after the end of the plan year in which the error occurred, or 2) if the employee notifies the employer of the error, by the last day of the month following the month in which the notification was made. Affected employees must be given a notice within 45 days after the date on which correct deferrals begin. Although employers are not required to give the affected employees the missed amount of deferrals caused by the error (typically through a qualified nonelective contribution), they must give them any matching contribution associated with the missed deferrals, and they must correct the error even for employees who have terminated employment.

TAKE SPECIAL NOTE

The safe harbor correction methods are detailed in the IRS's Employee Plans Compliance Resolution System (EPCRS) found in Revenue Procedure 2021-30. The corrective allocation of matching contributions (along with earnings) must be made within a reasonable period. Corrective amounts paid by the last day of the sixth month following the month in which the correct deferrals begin will be treated as having been made within a reasonable period.

Section 113: De minimis financial incentives

CURRENT STATE

SECURE 2.0 allows employees to receive a small incentive to encourage them to defer into a 401(k) or 403(b) plan, provided that the incentive is not paid for with plan assets.

FURTHER CLARIFICATION/GUIDANCE

The notice defines "de minimis" as not exceeding $250 in value. The incentive cannot be offered to those who are already deferring. But a series of incentives (e.g., a $100 gift card now and another $100 gift card at a later date for continuing to defer) is permissible.

TAKE SPECIAL NOTE

A matching contribution cannot be considered a de minimis financial incentive, nor is it subject to the rules that apply to a plan contribution. The incentive "constitutes remuneration that is includible in the employee's gross income and wages and is subject to applicable withholding and reporting requirements for employment tax purposes."

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Section 326: Terminal illness exception to 10% penalty

CURRENT STATE

This provision creates an exception to the ten percent early distribution penalty for those who have a terminal illness. IRC Sec. 101(g)(4)(A) defines "terminally ill individual" as an individual who has been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death in 84 months or less after the date of certification.

FURTHER CLARIFICATION/GUIDANCE

SECURE 2.0 changes the existing "24 months" in this text to "84 months" for purposes of this section.

A. F-6: A certification of terminal illness from a physician must include the following:

(1) A statement that the individual's illness or physical condition can be reasonably expected to result in death in 84 months or less after the date of certification;

(2) A narrative description of the evidence that was used to support the statement of illness or physical condition (as described in this F-6 (1));

(3) The name and contact information of the physician making the statement;

(4) The date the physician examined the individual or reviewed the evidence provided by the individual, and the date that the certification is signed by the physician; and

(5) The signature of the physician making the statement, and an attestation from the physician that, by signing the form, the physician confirms that the physician composed the narrative description based on the physician's examination of the individual or the physician's review of the evidence provided by the individual.

TAKE SPECIAL NOTE

Here are some additional points from the Q&A:

- A certification cannot be made after the recipient has taken the distribution.
- There is no limit on the amount that can be taken as a terminally ill individual distribution.
- The recipient may recontribute any portion of the distribution under "rules similar to recontributions of qualified birth or adoption distributions" (generally within three years).
- Qualified retirement plans are not required to permit terminally ill individual distributions.
- This provision provides an exception to the 10 percent penalty, but it does not provide an exception to the normal distribution requirements. So employees must otherwise be eligible for a permissible in-service distribution, such as a hardship or disability distribution. In this case, the individual would file an IRS Form 5329 to indicate the exception to the penalty.
- Self-certification of terminal illness is not permitted. (In the IRA context, the terminal illness exception would be claimed by the IRA owner on IRS Form 5329—as an attachment to Form 1040—and so financial organizations would not necessarily know about such a claim.)

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Section 501: Plan amendments

CURRENT STATE

The SECURE 2.0 Act generally set the amendment date for IRAs and other plans as the last day of the first plan year beginning on or after January 1, 2025. So for most calendar-year plans, the amendment deadline would have been the end of 2025. For collectively bargained plans and governmental plans, the deadline was generally two years later.

FURTHER CLARIFICATION/GUIDANCE

This section moves the deadline back. For qualified plans, the amendment deadline is generally December 31, 2026. For collectively bargained plans, it is December 31, 2028. And for governmental plans, it is December 31, 2029. For 403(b) plans, the rules are similar: for those plans not maintained by a public school the amendment deadline is December 31, 2026. For collectively bargained plans of IRC 501(c)(3) entities, it is December 31, 2028. And for plans maintained by a public school, it is December 31, 2029. For governmental 457(b) plans, the amendment deadline is generally December 31, 2029.

TAKE SPECIAL NOTE

For IRAs, the amendment deadline is December 31, 2026, or such later date as the Treasury Secretary prescribes.

The New DOL Fiduciary Rule: Balancing the Interests

For over a decade, the Department of Labor (DOL) has wrestled with how to protect retirement plan investors from advisors with conflicts of interest—while also avoiding regulations that may limit the access that investors have to competent advisers. And the rules have changed during this time. Litigation has blocked certain requirements from implementation, and policies have shifted with different federal administrations. As a result, many investors and advisers remain confused about the current situation.

Why Is Having a Fiduciary Rule Important?

Whether or not someone is considered a fiduciary is critically important because fiduciaries are held to the highest standard of care that the law imposes. Among other things, fiduciaries must subordinate their own interests to the interests of plan participants and beneficiaries and must act as prudent experts in fulfilling their duties. And there are consequences for failing to meet this high standard of care: fiduciaries can be held personally liable for breaching their obligations.

Consider this scenario: A plan participant or IRA owner wants to invest retirement plan assets wisely. Not knowing the best approach, the investor seeks advice from a financial professional that a friend recommended. After a detailed consultation, the adviser is hired and makes specific investment recommendations, which the investor follows. Of course, the adviser is compensated for the service provided. But what the investor may not know is that the financial professional could be getting incentives for making certain recommendations. This could create a conflict of interest for the adviser—one that may influence the adviser's judgment.

It is quite possible that the adviser perceives no conflict and makes recommendations based on the investor's best interest. But it could well be the case that the adviser either is ignoring sometimes subtle biases or is unaware of the possible appearance of impropriety or conflict. The investor may be placing considerable confidence in the relationship, not knowing of an adviser's potential conflict of interest. So the DOL and other entities have attempted to craft rules that protect consumers. But they also want to be careful not to create restrictions that end up making sound investment advice unavailable for most people. For example, more burdensome rules may lead to advisers becoming accessible only to those who are able to pay costs that average investors may not be able to afford.

A Brief History of the Fiduciary Rule

The Employee Retirement Income Security Act of 1974 (ERISA) has defined the term "fiduciary" for nearly 50 years. Then the DOL released regulations just after ERISA was enacted. But the retirement world has changed radically since then. Defined benefit pension plans were much more common then. And these days, 401(k) plans are the predominant plan type, especially in the private sector. Participant direction of plan investments is routine. And account balances have ballooned in many cases, making the eventual decision to roll over assets to an IRA—or not—especially important.

With all the changes to investing and retirement plans over the past 50 years, different federal and state agencies have attempted to govern fiduciaries, with varying degrees of success. But the reason for this lack of comprehensive guidance overseen by one entity is clear. For example, the SEC is charged primarily with creating rules for securities transactions, while state agencies make rules for insurance products. So the DOL is trying to craft broader protections that won't be based on the investment product. Rather, the rule looks at the relationship between the financial professional and the retirement plan investor, and at the level of trust that the investor has that the adviser's recommendations can reasonably be relied upon.

In 2016, after considerable effort and after years of proposals, the DOL released a final fiduciary rule. Without recounting all the details, a federal appeals

The New DOL Fiduciary Rule: Balancing the Interests

continued

court invalidated this rule, sending the DOL back to square one. Now the DOL, with its new rule, is trying to balance protecting retirement investors with the legitimate concerns of investment advisers. In addition, the DOL is attempting to construct a rule that will survive any anticipated legal challenge, which is almost sure to arise.

Who's An Investment Advice Fiduciary?

So on October 31, 2023, the Department of Labor (DOL) released proposed regulations defining "investment advice fiduciary." This definition is important because it dictates the standards under which many investment professionals must act when working with clients. It could require more diligence by these professionals because their clients will have more remedies if they fail to act with the appropriate standard of care.

The DOL's new rule defines an investment advice fiduciary as a person who

- provides investment advice or makes an investment recommendation to a retirement investor;
- provides this advice for a (direct or indirect) fee or other compensation; and
- makes the recommendation in one of these contexts:
    - the person has direct or indirect authority or control to buy or sell retirement assets for the investor;
    - the person regularly makes investment recommendations to investors as part of their business; or
    - the person acknowledges or represents that they are acting as a fiduciary.

The rule is "intended to protect the interests of retirement investors [including plan sponsors] by requiring investment advice providers to adhere to stringent conduct standards and mitigate their conflicts of interest." By creating a more uniform fiduciary standard, irrespective of the investment product, the DOL hopes to honor retirement investors' reasonable expectations when they get advice from financial professionals who hold themselves out as trusted advice providers.

What's Next?

After the normal regulatory comment period (which ended on January 2, 2024), the DOL will commence drafting a final rule. This could take many months, depending on numerous variables. And despite the DOL's good intentions—that the rule will benefit plan sponsors and other retirement investors without imposing unnecessary burdens on advisers—the rule will likely face court challenges. But at least the DOL seems to be making progress toward a workable, uniform fiduciary standard that expands protections for retirement investors.

Source: https://www.federalregister.gov/documents/2023/11/03/2023-23779/retirement-security-rule-definition-of-an-investment-advice-fiduciary