# Q1 2024 Legislation Update

## Congress releases SECURE Act 2.0 technical corrections discussion draft

On December 6, 2023, the committees of jurisdiction (in the Senate the Committee on Health, Education, Labor and Pensions (HELP) and in the House the Ways and Means Committee and the Education and the Workforce Committee) released a "discussion draft" of proposed technical corrections to the retirement plan-related portions of SECURE Act 2.0.

The issues addressed, some of which were raised in a May 2023 letter from Congressional leaders to the Department of the Treasury and Internal Revenue Service (IRS), are technical and are not intended to change the substance of SECURE Act 2.0 as enacted.

Some of the proposed technical corrections applicable to retirement plans would clarify the:

- Timing of increases in the applicable age for required minimum distributions (RMDs);
- That the limit on student loan repayments that qualifies for a match is increased (where applicable) by the catch-up contribution limit;
- Starter 401(k) plan contribution limit (currently $6,000 and indexed for inflation beginning in 2025) will be the same as the annual IRA limit (e.g., $7,000 in 2024);
- Initial ceiling on mandatory automatic contributions for new 401(k) plans would be limited to 10 percent until 2026 (after which it would be 15 percent);
- "Regular" limits on start-up credits would not apply to the increased start-up credits for smaller plans;
- The ability to make catch-up contributions remains intact for 2024 and beyond.

This release is only a discussion draft at this point and likely will be introduced as proposed legislation after consideration of public comments.

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## Automatic IRA Act of 2024

Rep. Richard Neal, D-Mass., ranking member of the House Ways and Means Committee, has re-introduced the Automatic IRA Act of 2024. The bill generally would require employers with more than 10 employees that do not sponsor a retirement plan to automatically enroll their employees in Individual Retirement Accounts (IRAs) (automatic IRAs) or other automatic contribution plans or arrangements, like 401(k) plans. Smaller employers would be eligible for the existing startup tax credit if they adopt a plan or a newly-proposed $500-for-three-year automatic IRA tax credit if they adopt an automatic IRA (whether under state or federal law).

Exemptions would apply for employers:

- With a current qualified retirement plan,
- With 10 or fewer employees,
- That have been in existence for less than two full years, or
- With governmental or church plans.

Note: This is a separate proposal than the Retirement Savings for Americans Act, which would establish a new savings program, “The American Worker Retirement Plan” that would give eligible workers access to federally-sponsored, portable, tax-advantaged retirement savings accounts.

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A summary of the Automatic IRA Act can be found here and outlines other requirements such as:

- Levels of contributions,
- Investments,
- Lifetime income requirements, and
- Credits for small employers.

If enacted, the legislation would apply to plan years beginning after 2026. The new credit for small employer automatic IRAs would apply to tax years beginning after 2024.

# Q1 2024 Regulatory Update

## DOL's automatic portability proposal

On January 29, 2024, the Department of Labor (DOL) released proposed regulations that, if finalized, will implement SECURE Act 2.0's statutory prohibited transaction exemption (PTE) for "automatic portability transactions" through "automatic portability providers" that meet certain conditions. Comments on the proposal are due by March 29, 2024.

When workers leave jobs with a retirement account balance valued between $1,000 and $7,000, retirement plans may cash-out and automatically rollover these benefits to default IRAs if the plan document allows it and the employees do not take action after receiving the required notices. The follow-on automatic portability transactions are facilitated by automatic portability providers that roll over workers' retirement savings from their IRAs to their new employers' retirement plans.

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The proposed regulations are detailed and include in-depth requirements to rely on the PTE. At a high level, in order for an automatic portability provider to receive compensation in connection with automatic portability transactions it will need to follow the DOL's proposed PTE and, subject to various requirements,

1. Acknowledge fiduciary status;
2. Satisfy the "reasonable compensation" standard of ERISA;
3. Restrict its use of data;
4. Offer open participation;
5. Satisfy notice and disclosure requirements;
6. Execute regular participant searches;
7. Ensure active monitoring by a designated plan fiduciary;
8. Execute transfers of assets timely;
9. Limit discretion by adopting procedures that "… set specific standards and timeframes;"
10. Undergo an independent audit annually;
11. Maintain a website with information on fees and compensation, recordkeepers it works with, and the number of plans and participants covered by each recordkeeper;
12. Forgo the use of contractual exculpatory provisions in cases where the automatic portability provider causes an improper transfer of assets;
13. Retain records for at least six years.

The PTE is in proposed form and may not be relied upon until finalization.

# Q1 2024 Regulatory Update

**IRS releases guidance on prohibited Pension-Linked Emergency Savings Account anti-abuse rules**

On January 12, 2024, the IRS released Notice 2024-22, providing guidance with respect to anti-abuse provisions for Pension-Linked Emergency Savings Accounts (PLESAs).

SECURE Act 2.0 created the opportunity for sponsors to include a (PLESA) in their defined contribution (DC) plans. PLESAs are short-term savings accounts established and maintained in connection with a DC plan and are treated as a type of designated Roth account. Highly compensated employees may not make PLESA contributions. PLESAs, generally, are subject to a $2,500 balance cap, but the plan may set a lower limit.

If a plan offers matching contributions, PLESA contributions must be matched in the same manner as regular contributions; (annual) matching contributions on account of PLESA contributions may not, however, exceed the account cap ($2,500 or, if the employer elects, a lower amount).

Participants must be able to withdraw amounts from their PLESAs at least once a month. With respect to withdrawals, the statute provides that "for purposes of any applicable limitation on matching contributions, any matching contributions made under the plan are treated first as attributable to the elective deferrals of the participant other than contributions to a PLESA."



The "abuse" with which the IRS believes sponsors may be concerned is that a participant could contribute to a PLESA and take distributions in a way that maximizes matching contributions received but maintain little to no contributions in the PLESA. For instance, a participant might manage to "buy" $2,500 in matching contributions using only PLESA contributions, then withdraw all those PLESA contributions during the year while still keeping the related matching contributions, thus effectively getting a $2,500 match with no long-term saving.

The statute provides that a plan "may employ reasonable procedures to limit the frequency or amount of matching contributions with respect to contributions to [a PLESA], solely to the extent necessary to prevent manipulation of the rules of the plan to cause matching contributions to exceed the intended amounts or frequency."

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With respect to possible plan anti-abuse measures, Notice 2024-22 states that the following would not be permitted. A plan may not:

- Forfeit matching contributions already made on account of participant contributions to a PLESA because of a participant's withdrawal from a PLESA;
- Suspend a participant's ability to contribute to a PLESA on account of a withdrawal from the PLESA; and
- Suspend matching contributions made on account of participant elective deferrals to the underlying DC plan.

Consequently, under Notice 2024-22, rules limiting the ability of participants to "game the PLESA system" will generally have to focus on restricting the frequency and amount of PLESA contributions, not on penalizing abuse. Additional guidance is expected on the operation of PLESAs, both from the IRS and the DOL.

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## IRS Notice 2024-02 Delivers Start of SECURE Act 2.0 Act Guidance

On December 20, 2023, IRS released Notice 2024-02 containing a slew guidance on 12 provisions of SECURE Act 2.0, including:

1. Expanding automatic enrollment in retirement plans
2. Modifications to plan start-up credits for small employer plans
3. Military spouse retirement plan eligibility credit for small employers
4. Small immediate financial incentives for contributing to a plan
5. Contribution limits for SIMPLE plans
6. Exception to the early distribution penalty tax for terminal illness withdrawals
7. Replacing SIMPLE retirement accounts with safe harbor 401(k) plans during a year
8. Market rate cash balance plans
9. A safe harbor for correction of employee elective deferral failures
10. Provisions relating to plan amendments
11. SIMPLE and SEP Roth IRAs
12. Optional treatment of employer matching or nonelective contributions as Roth contributions

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**A summary of selected segments of Notice 2024-02 follows.**

Optional treatment of employer matching or nonelective contributions as Roth contributions

SECURE Act 2.0 allows 401(k), 403(b) and governmental 457(b) plan sponsors to provide participants the option to receive matching or nonelective employer contributions as designated Roth contributions, effective as of December 29, 2022. With respect to this new provision, the notice provides the following guidance:

- Plan sponsors may, but are not required to, include in their plan any type of Roth contribution—employee elective, employer matching, or employer nonelective.
- If offered, and elected, an employee must designate an employer contribution as a Roth contribution no later than the time that the contribution is allocated to the employee's account. The election must be irrevocable, but the participant must be able to make (or change) the designation going forward at least once each plan year.
- Roth employer contributions are subject to taxation and separate accounting rules. They are included in the participant's income in the year they are allocated to the participant's account (even where the contribution is "deemed to have been made" for the prior year).
- Only fully vested employer contributions may be designated Roth employer contributions.
- Roth employer contributions are not subject to federal income tax withholding and are not wages for purposes of FICA or FUTA withholding.
- Roth employer contributions must be reported using Form 1099-R for the year in which the contributions are allocated to the individual's account. The total amount of designated Roth matching and Roth nonelective contributions that are allocated in that year are reported in boxes 1 and 2a of Form 1099-R, with code 'G' in box 7.
- Roth employer contributions are not included in the IRC Sec. 415 safe harbor definition of compensation.

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## Market Rate Cash Balance Plans

In short, Notice 2024-02 will allow cash balance plans that have not used market rate interest credits (e.g., returns on an S&P 500 Index fund) for funding purposes in the past because of IRS anti-backloading rules, to convert to a market rate prospectively without special grandfather rules.

SECURE Act 2.0 provided that cash balance plans using a variable interest crediting rate could use a reasonable assumption as to the rate of return (e.g., on a designated S&P 500 Index fund or the yield on designated fixed income securities) not to exceed 6%.

In implementing this provision, a critical question arose, if a plan did not use a market rate, could it – under the new SECURE Act 2.0 rule—simply switch (prospectively) to a market rate, or would it be required, under anti-cutback rules, to preserve the old fixed (or variable + a minimum) rate for prior accruals?

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Under Notice 2024-02, plans that either 1) are currently providing increasing pay credits or 2) are being changed to provide for increasing pay credits may do so prospectively, so long as they do not reduce a participant's "accumulated benefit" (that is, the balance in the participant's cash balance account).

These rules are very technical and can only be summarized here. They do, however, allow sponsors of plans with increasing pay credits significant flexibility in converting to market-based interest credits. If interested, sponsors should consult with their legal and actuarial advisors as to how best to go about doing so.

**Expanding automatic enrollment in retirement plans**

SECURE Act 2.0 provides that, effective for plan years beginning after 2024, 401(k) and 403(b) plans established after the law's enactment date of December 29, 2022, must default participants into the plan at a contribution rate of at least 3% of pay, escalating each year by 1% up to at least 10%. The new rule does not apply to plans adopted before the date of enactment, for the first 3 years of a new employer's existence, or to employers with 10 or fewer employees.

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**Notice 2024-02 provides that:**

- For purposes of the exception for plans established before the date of enactment, a plan is considered established on the date plan terms providing for the salary deferral elections are adopted initially. This is the case even if the plan terms are effective after the adoption date.
- If two plans, both of which qualify for the pre-enactment exception, are merged, the merged plan also qualifies for the exception. If a plan is spun off from a pre-enactment plan, the exception would continue to apply. Generally, when a plan that does qualify for the pre-enactment exception is merged with one that does not, the exception is lost. It may be possible, however, with respect to certain mergers under certain circumstances, to preserve the exception where the merged plan with the exception is designated as the ongoing plan.
- The automatic enrollment rules would apply to starter 401(k) plans.

# Q1 2024 Regulatory Update

### Tax credit for small plan coverage of military spouses

SECURE Act 2.0 provides a new small employer (i.e., < 100 employees) tax credit for DC plans that provide that military spouses are, within two months of hire, immediately eligible for and fully vested in employer nonelective and matching contributions. The tax credit is the sum of $200 per military spouse, plus up to $300 based on employer contributions, per year for three years.

- The small employer requirements must be met for each year for which the credit is claimed.
- Where an employer provides benefits that do not qualify for the military spouse credit and then either amends or adopts a plan that does qualify, the three-year credit period begins when a military spouse begins participation in that plan (or if later, in the case of an amendment, when the amendment is effective).
- While the credit is only effective for taxable years of the employer beginning after December 29, 2022, where the three-year credit period begins before 2023 (e.g., qualifying benefits are provided beginning with the 2022 year), the credit may be claimed for the portion of the three-year period that remains after 2022.

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**Small immediate financial incentives for contributing to a 401(k) or 403(b) plan**

SECURE Act 2.0 allows employers to offer de minimis financial incentives, not paid for with plan assets, such as low-dollar gift cards, to boost employee participation in workplace retirement plans.
Notice 2024-02 provides that:

- A financial incentive is considered de minimis "only if it does not exceed $250 in value."
- This special treatment is only available for employees who have no 401(k) or 403(b) salary deferral election in effect.
- The incentive may be given in installments.
- Matching contributions do not qualify as de minimis incentives.
- De minimis incentives are not subject to plan contribution rules. Thus, plan qualification and deductibility timing rules do not apply to them.
- De minimis incentives are remuneration, includible in gross income and wages and subject to employment tax withholding and reporting.