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Employee Benefits Corner

IRS Grants Much-Needed Two-Year Grace Period to Get Roth Catch-Ups All Caught Up

By Elizabeth Thomas Dold and David N. Levine

On January 1, 2024, Section 603 of Setting Every Community Up for Retirement Enhancement (SECURE) 2.0 becomes effective, which mandates plan sponsors to provide Roth catch-ups for defined contribution plans that offer catch-ups and have at least one participant who earned $145,000 of Federal Insurance Contributions Act (FICA) wages in the prior year. This new mandate had plan sponsors and recordkeepers alike scrambling to understand the new rule and how to implement this new plan qualification requirement by year-end. This new rule raises a number of open questions, including if employers that do not offer Roth contributions in their plans have to comply with this new rule in order to retain catch-up contributions (which are a very popular plan design feature to help older Americans save for retirement). In addition, there was some confusion with the SECURE 2.0 Act technical conforming changes that caused concern that no catch-up contributions (regardless of pre-tax or Roth) would be permitted at all, beginning as of January 1, 2024.

Thankfully, the Internal Revenue Service (IRS) heard the industry call for help on this provision and issued Notice 2023-62. This Notice addresses the two most critical questions—(1) can we make catch-up contributions next year? YES, and (2) do I need to comply with the Roth catch-up rule for 2024? NO, the IRS provided a two-year grace period to implement the new rule. Moreover, the Notice previewed the IRS' initial thinking on a number of open issues that plan sponsors and recordkeepers have been asking all year. A closer look at what catch-up contributions are and what guidance is provided in the Notice is set forth below.

Background

Catch-up contributions were added to the Internal Revenue Code (Code Sec. 414(v)) in 2002 (with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)) and were intended to help employees nearing retirement age (and working moms that took some time off to raise their children) to ensure they had sufficient savings for retirement. This feature is available to 401(k) plans, 403(b) plans, and governmental 457(b) plans. This is an optional plan feature, but one that has become very popular over the years.

SECURE 2.0 provides a few favorable changes to expand catch-up contributions. But the focus of this column is the change to mandate Roth catch-up contributions for certain higher-paid employees beginning in 2024. Specifically, Section 603 of SECURE 2.0 added a mandatory Roth catch-up contribution requirement in Code Sec. 414(v)(7) for higher-income participants. The provision requires catch-up contributions made by participants with more than $145,000 in prior-year FICA wages (Code Sec. 3121(a)) from the employer sponsoring the plan to be made on a Roth basis beginning January 1, 2024. Plans with any such participant must offer *all* catch-up eligible participants (*i.e.*, those participants who will be age 50 years or older in a given year) the ability to make catch-up contributions on a Roth basis. So, while there is still no requirement to offer catch-up contributions, if plan sponsors want to continue to offer them, they need to comply with the new rules and require certain participants to only make Roth (that is, after-tax) catch-up contributions.

With such a short time frame to implement the new mandate, without any clear guidance on the new rule, and the interplay and coordination needed between payroll and the plan recordkeeper, and the various methods by which catch-ups are made or triggered under a plan (*e.g.*, as a result of a plan limit or Code rule, or as a result of a reclassification due to a nondiscrimination testing failure), it was going to be very difficult for everyone to be in full compliance with the new rule for January 1, 2024. It was even a larger ask for those plan sponsors (including governments) that never adopted the Roth 401(k)/403(b)/457(b) feature—having to choose between eliminating catch-up contributions or adding a new Roth program (which needs to be coordinated with payroll) in short order is a no-win situation.

The Relief

We are pleased to report the IRS heard the cry from the entire industry that we need more time and more guidance—Notice 2023-62[1] delivers on both fronts.

First, it expressly provides that the legislative changes under SECURE 2.0 (specifically the elimination of Code Sec. 402(g)(1)(C)) do not prohibit catch-up contributions beginning after December 31, 2023.

The IRS explains that if an eligible catch-up participant is subject to the new requirements of Code Sec. 414(v)(7)(A), then any catch-up contributions that are made to the plan on behalf of the participant must be designated as Roth contributions. However, if an eligible participant is not subject to these requirements, then any catch-up contributions that are made to the plan on behalf of the participant are not required to be designated as Roth contributions. In that case, the IRS explains that any catch-up contributions under Code Sec. 414(v) that are made to the plan on behalf of the participant that are not designated as Roth contributions are not includible in the participant's gross income because, in accordance with Code Sec. 414(v)(3)(A)(i), the limitations on elective deferrals under Code Sec. 401(a)(30) do not apply to those catch-up contributions.

The Notice also clarifies the impact of elective deferrals made in two or more plans. Specifically, if an individual makes elective deferrals to two or more plans during a taxable year (including plans maintained by unrelated employers), then those elective deferrals are aggregated for purposes of determining if we pass the Code Sec. 402(g) limit. Similarly, an eligible participant's elective deferrals made to two or more plans during a taxable year are also aggregated for purposes of applying the Code Sec. 414(v) catch-up limitation. Again, the elimination of Code Sec. 402(g)(1)(C) under the SECURE 2.0 Act does not change this result for taxable years beginning after December 31, 2023.

Bottom line—catch-up contributions remain available as a design option after 2023!

Second, and perhaps even more importantly, the Notice provides a two-year administrative delay for the Roth catch-up mandate. The administrative transition period runs from January 1, 2024, through December 31, 2025. During this period—

(1) catch-up contributions will be treated as satisfying these new Roth requirements of Code Sec. 414(v)(7)(A) (*i.e.*, mandating Roth catch-ups for participants with FICA wages over the threshold in the prior year), even if the contributions are not designated as Roth contributions. Therefore, plan sponsors can, for example, (1) elect to delay implementation of the Roth mandate and continue to simply offer pre-tax catch-up contributions for everyone, or (2) elect to implement the Roth catch-up mandate and breathe easier if they do not get the implementation 100% perfect.

(2) a plan that does not provide for designated Roth contributions will be treated as satisfying these new Roth requirements of Code Sec. 414(v)(7)(B) (*i.e.*, requires that all participants in a plan subject to these rules must have a Roth catch-up option). Therefore, plan sponsors that have plans without the Roth program do not need to rush to implement a Roth program in order to save catch-ups!

This relief is invaluable. But please note that this delay does not extend the effective date of the provision, nor does it provide relief for any other catch-up changes coming with SECURE 2.0.

Pending Guidance

Lastly, as listed below, the IRS was kind enough to signal what issues are on its to-do list to clarify with respect to properly implementing this new rule, and to provide insight on where they anticipate future guidance will come out. They also are soliciting comments to add to their list, including if relief should be provided for plans that do not have a Roth program (*i.e.*, for such plans, permit pre-tax catch-up contributions for only those under the FICA wage limit).

1. *FICA Wages*. Pending guidance will clarify the impact of a participant who does not have Code Sec. 3121(a) wages (*e.g.*, due to partner status, self-employed individual, state, or local government employee), with the current thinking that they would not be subject to the Roth catch-up mandate.
2. *Single Participant Election*. Pending guidance will clarify if the plan administrator and the employer will be permitted to treat an election by the participant to make catch-up contributions on a pre-tax basis as an election by the participant to make catch-up contributions that are designated Roth contributions, with the current thinking that a single election will be permitted.
3. *More than One Employer*. Pending guidance will address an applicable employer plan that is maintained by more than one employer (including a multiemployer plan), with the current thinking that an eligible participant's wages for the preceding calendar year from one participating employer would not be aggregated with the wages from another participating employer for purposes of determining the $145,000 (as adjusted) FICA wages limit. For example, if an eligible participant's wages for a calendar year were: (1) $100,000 from one participating employer; and (2) $125,0000 from another participating employer, then the participant's catch-up contributions under the plan for the next year would not need to be Roth catch-up contributions (even if the participant's aggregate wages from the participating employers for the prior calendar year exceed $145,000, as adjusted). Moreover, even if the eligible participant is subject to the Roth catch-up mandate because the participant's wages from one participating employer in the plan for the preceding calendar year exceed $145,000 (as adjusted), the current thinking is that elective deferrals made on behalf of the participant by another participating employer that are catch-up contributions would not be required to be designated as Roth contributions unless the participant's wages for the preceding calendar year from that other employer also exceed that amount.

Conclusion

Catch-up contributions are alive and well for 2024 forward, and now we have more time to properly implement the Roth catch-up mandate—through the end of 2025. And more guidance is pending to help plan sponsors, plan administrators, and payroll providers to properly coordinate a game plan and implement this new rule. Well done, IRS!

ENDNOTE

[1] *www.irs.gov/pub/irs-drop/n-23-62.pdf.*