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LEGAL DEVELOPMENTS

IRS Grants Administrative Delay for Mandatory Roth Catch-Ups

This column discusses the clarification by the IRS of the three important points in Notice 2023-62 regarding Roth catch-up contributions.

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Beginning January 1, 2024, plan sponsors were going to have to provide mandatory Roth catch-up contributions for certain employees. This mandatory Rothification of catch-up contributions comes by way of Section 603 of Division

T of the Consolidated Appropriations Act, 2023, Pub. L. 117-328, 136 Stat. 4459 (2022) (SECURE 2.0 Act). However, without any Internal Revenue Service (IRS) guidance, many plan sponsors, recordkeepers, and payroll providers were struggling to understand the scope and proper implementation of this new provision (and even whether catch-up contributions were going to be permitted after 2023 in light of a glitch in the drafting of the legislative language implementing the change, which removed the clause permitting catch-up contributions to be tax-deferred. [IRC § 402(g)(1)(C), deleted pursuant to SECURE 2.0 § 603(b)] Thankfully, the IRS heard the call for help, and clarified the following three important points in Notice 2023-62:

1. Catch-up contributions will continue to be permissible after 2023;
2. Catch-up contributions can continue to be pre-tax contribution for 2024 and 2025; and
3. Pending guidance will clarify a number of open issues that will facilitate compliance with the SECURE 2.0 change.

The Law

Catch-up contributions under Internal Revenue Code (Code) Section 414(v) are a way for participants who turn age 50 (or older) during the year to make additional employee deferral contributions to their 401(a), 401(k), 403(b), and governmental 457(b) plans. For 2023, for example, 401(k) plan participants who are 50 or older can elect to defer an additional $7,500 into their employer's 401(k) plan to save for retirement. This provision was originally designed to help working mothers make up for any missed retirement savings while they stayed home to raise their children, and today, it is universally viewed as a very valuable benefit for all older employees, to help ensure their retirement savings will be sufficient for their lifetime.

But, beginning in 2024, plan sponsors that have at least one participant with FICA wages of $145,000 (indexed) for the prior year must: (1) offer all participants the option to elect catch-ups as Roth contributions (for example, taxed upfront but earnings may be tax-free if they meet the requirements for a qualified distribution); and (2) require participants with FICA wages for the prior year of at least $145,000 (indexed) to make any catch-up contribution as a Roth contribution (and not as a pre-tax contribution).

This new rule was particularly troubling for plan sponsors that had not previously adopted a Roth program and so were not otherwise offering Roth 401(k)/403(b)/457(b) contributions. Many governmental plans fall within that category. In particular, it seems as though such plans cannot offer catch-up contributions at all if they continue to eschew Roth contributions. The law requires that catch-up contribution opportunities be available universally to all participants. [IRC § 414(v)(4)(A)] If Roth contributions are not available, then participants with FICA wages in excess of $145,000 cannot make catch-up contributions, and the universality requirement of the Code would be violated.

The Relief

Catch-Up Contributions Are Permissible After 2023

The first thing the Notice does is explain that, regardless of the drafting of the SECURE 2.0 provisions and the apparently inadvertent elimination of Code Section 402(g)(1)(C), the IRS interprets the law as permitting catch-up contributions to continue to be made after 2023.

The IRS explains that the elimination of Code Section 402(g)(1)(C) does not change the existing catch-up rules. For example, if an eligible participant is subject to the new Roth requirements of Section 414(v)(7)(A), then any catch-up contributions that are made to the plan on behalf of such participant must be designated as Roth contributions. However, if an eligible participant is not subject to these requirements, then any catch-up contributions for such participant are not required to be designated as Roth contributions. In that case, any catch-up contributions under Code Section 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 under Code Section 402(g)(1)(A) (and do not exceed the limitation in Code Section 457(b)(2)) because, in accordance with Code Section 414(v)(3)(A)(i), the limitations on elective deferrals under Code Sections 401(a)(30), 403(b), and 457(b)(2) do not apply to those catch-up contributions.

Also, if an individual makes elective deferrals to two or more plans during a taxable year (including plans maintained by unrelated employers), then, under Code Section 402(g)(1)(A), those elective deferrals are aggregated for purposes of determining if the Section 402(g) limit is exceeded. 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 Section 414(v)(2) catch-up limit. The elimination of Section 402(g)(1)(C) of the Code under the SECURE 2.0 Act does not change this result.

Pre-Tax Catch-up Contributions Are Permitted for 2024 and 2025

Second, the Notice provides for an important two-year period of transition relief to comply with this new Roth catch-up provision. Specifically, the first two taxable years beginning after December 31, 2023 (that is, 2024 and 2025), will be regarded as an administrative transition period with respect to the requirement under Code Section 414(v)(7)(A) that catch-up contributions made on behalf of certain eligible participants be designated as Roth contributions. Therefore, until taxable years beginning after December 31, 2025: (1) catch-up contributions will be treated as satisfying the Roth requirements of Code Section 414(v)(7)(A), even if the contributions are not designated as Roth contributions; and (2) a plan that does not provide for designated Roth contributions will be treated as satisfying the Roth requirements of Code Section 414(v)(7)(B). This effectively gives plan sponsors and the industry two years to properly implement the new Roth catch-up mandate.

Pending Guidance Will Clarify a Number of Open Administrative Issues

Third, the Notice provides that additional guidance will be issued to address some of the open administrative issues, and gives insight on which way the IRS is currently leaning. These areas include:

1. *Workers Not Subject To FICA*. The IRS anticipates issuing guidance that the Roth catch-up mandate does not apply to a participant who does not have wages as defined in Code Section 3121(a) (that is, wages for purposes of the Federal Insurance Contributions Act (FICA)) for the preceding calendar year from the employer sponsoring the plan. For example, if an eligible participant did not have FICA wages because the individual was a partner (or other self-employed individual) receiving self-employment income or because the individual was a State or local government employee whose services were excluded from the definition of employment under section 3121(b)(7), then the Roth catch-up mandate does not apply to such a participant.
2. *Single Election*. The IRS anticipates issuing guidance that the plan administrator and the employer would 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 when they are required by the Code to be so. This should include both amounts that are contributed in excess of the Section 402(g) limit, as well as deferrals that are reclassified to be catch-up contributions because of a failed ADP test.
3. *Plan Maintained by More Than One Employer (including a multiemployer plan)*. The IRS anticipates issuing guidance 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 (whether related or unrelated) for purposes of determining whether the participant's wages for that year exceed $145,000 (indexed). 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 be subject to the Roth catch-up mandate (even if the participant's aggregate wages from the participating employers for the prior calendar year exceed $145,000, indexed).

Similarly, even if an 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 (indexed), 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.

Lastly, the IRS makes a general request for comments for areas that are not covered by Notice 2023-62, as well as requesting comments on whether the guidance should permit a plan that permits catch-up contributions, but does not include a qualified Roth contribution program to simply prohibit catch-ups for participants that meet the $145,000 limit (and not add a Roth program)—which would be currently prohibited under the existing universal availability rule (although the alternative results in mandating a Roth program to save catch-up contributions).

Thankfully, we have two years to work out the various details of this new Roth catch-up mandate. ■

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