AMERICAN BENEFITS COUNCIL

June 7, 2023

A Delayed Effective date is Needed to Preserve Catch-Up Contributions for Older Workers

What is the Problem?

Unless transition relief is granted as soon as possible, many retirement plan participants will lose the ability to make catch-up contributions at the end of this year. Specifically, a vast number of plans and employers will not be able to comply with the new requirement, effective for 2024, that workers who earned over $145,000 in the preceding year from the current employer must make their catch-up contributions on a Roth basis. *For many of these plans, unless this requirement is delayed very quickly (i.e., this summer), their only means of compliance will be to eliminate **all** catch-up contributions for 2024. If a delay is not announced until, for example, the fourth quarter, it will be too late to prevent this adverse result, since compliance systems need to be designed well before the effective date.*

What are Catch-Up Contributions?

In recognition of the fact that workers may not have adequately saved for retirement early in their careers, workers who are age 50 or older are eligible to make additional contributions above the regular contribution limits. These contributions help employees nearing retirement bolster their savings and "catch up" on savings opportunities that may have been missed or unaffordable earlier in their careers.

Why Would Many Plans Be Forced to Eliminate Catch-Up Contributions?

Beginning on January 1, 2024, for retirement plan participants who earned more than $145,000 in FICA wages in the prior year from the current employer, SECURE 2.0 newly requires all age-based catch-up contributions to be made as Roth contributions. This means that, in order to comply with the provision's wage threshold, employers must coordinate their payroll systems with plan operations and, if their plans currently do not include a Roth feature, they must add a Roth feature. Under the universal availability requirement for catch-up contributions provided under regulations, if a plan allows catch-up contributions, the contribution opportunity must generally be

made available to all catch-up eligible participants. Therefore, if these required changes are not implemented by January 1, 2024, many plans will be unable to comply with the new Roth catch-up requirement and will be forced, as a back-up, to eliminate catch-up contributions for all participants, regardless of wages. This new requirement affects 401(k) plans, 403(b) plans, and governmental 457(b) plans.

What Relief Is Needed to Prevent This?

To ensure that this change does not unintentionally result in the elimination of catch-up contributions, the American Benefits Council (the "Council") is seeking a two-year delay of the Roth catch-up requirement described in Section 603 of SECURE 2.0, plus (1) any time necessary to give state and local governments the opportunity to consider and enact needed legislation, and (2) any additional time to avoid requiring changes during the term of a collective bargaining agreement or other applicable binding agreements.

Ideally, Congress would pass legislation that provides our requested relief. Accordingly, the Council is asking Congress to provide such relief as expeditiously as possible.

However, even if Congress does not act, the Department of the Treasury and the Internal Revenue Service (IRS) have the authority to unilaterally provide the necessary relief. Although such unilateral action should only be taken in extraordinary circumstances, this is clearly one of those circumstances, due to the extremely adverse and unintended effects of not doing so. And Treasury and the IRS have exercised this authority on multiple occasions before. For instance, as written, the Affordable Care Act required large employers to, for 2014, offer health insurance to employees or pay a tax penalty for 2014. However, on July 9, 2013, through Notice 2013-45, the IRS effectively provided a one-year delay of the tax penalties that would otherwise have been imposed on employers for 2014. Treasury and IRS should take comparable action with regard to the Roth catch-up requirement.

Why Is More Time Needed?

While plans, employers and their service providers are making tremendous efforts to be ready for the January 1, 2024, effective date, many employers and plans will likely be unable to operationalize these changes in time. ***Obviously, any new rule requires new administrative work to implement. But the Council has been struck by the overwhelming input from the retirement community that this particular task simply cannot be done in time by a vast number of plans.***

Payroll/Plan Coordination

The $145,000 wage threshold that is integral to the mandatory Roth catch-up requirement necessitates coordination among employers, plan administrators, payroll providers, recordkeepers, and plan consultants. That work is underway, but indications are clear that, in many cases, full coordination is simply not possible by January 1, 2024. This coordination is particularly challenging (1) for certain employers that are comprised of multiple corporate entities and/or use multiple payroll providers (including following a recent acquisition), (2) for other employers (such as governments) that have never needed to coordinate this payroll information, and (3) for multiemployer plans where participants often work for multiple employers during the course of a year.

Processes do not exist that would enable plans to determine by January 1, 2024, the exact amount of prior year wages; on the contrary, this determination can take a few weeks. And in some cases, plans need to know immediately as of January 1 what type of catch-up contribution to make, such as plans that generally limit contributions to a specified percentage of compensation.

It is important to note that plan sponsors (with support from their payroll providers) will be primarily responsible for implementing these requirements, so the compliance burden is primarily shouldered by employers and not the plan's third-party administrator. As a result, an off-the shelf Roth catch-up contribution solution is not expected to be available, and implementation will require the plan's sponsor to invest significant time and resources.

Payroll Changes Will Vary by Employer

Employers need extra time to implement the required changes because the payroll systems update is not a "one size fits all" change, but rather a change that varies by employer. Identifying and implementing the appropriate changes will depend on a variety of plan-specific issues, including whether the plan provides for a separate catch-up Roth contribution election or permits single elections that do not specify Roth contributions but that can result in Roth catch-up contributions. (There are also questions about the extent to which the latter approach is permissible.)

Adding Roth Contributions and Participant Communications

A significant portion of the plans impacted by this requirement do not currently offer a Roth feature, and adding such a feature is neither a simple task, nor can it be done quickly in many cases. Not only does it require design and operational changes at the plan level, because Roth contributions change how employee wages are taxed and reported, it also requires additional coordination among plans, employers, and payroll

providers, as well as significant work in explaining this concept to an entire workforce, many of whom may not have ever made Roth contributions. Education will be necessary for participants not just on a new Roth feature at a basic level, but on the even more complex changes to catch-up contributions. These operational and education challenges regarding Roth contributions are similar to, but distinct from, the challenges that have been created by the challenges of administering the $145,000 wage threshold.

Governmental Plans

Many governmental retirement plans are governed by state or local statutes, and the Roth catch-up requirement will require an amendment to those statutes. In some cases, it simply will not be possible for these legislative bodies to adopt the necessary amendments before January 1, 2024.

Multiemployer Plans

As a threshold issue, Section 414(v)(7) does not apply to multiemployer plans. Section 414(v)(7)(A) is specific that it applies to "an eligible participant whose wages (as defined in Section 3121(a)) for the preceding calendar year ***from the employer sponsoring the plan*** exceed $145,000." (emphasis added) Multiemployer plans are not sponsored by an employer. Rather, they are sponsored by joint Boards of Trustees consisting of union representatives and employer representatives that cover employees of multiple unrelated employers.

If the government takes a different view on the applicability of Section 414(v)(7) to multiemployer plans, it is important to understand that contributions to multiemployer 401(k) plans are the product of the collective bargaining process, where the resulting collective bargaining agreements ("CBAs") typically reflect that the employer has agreed to make available to participants the ability to defer wages into a 401(k) account, sometimes specifically stating that the deferrals are on a pre-tax basis. Since very few multiemployer plans currently permit Roth contributions, this new requirement will place additional administrative and payroll burdens on employers that were not contemplated as part of the collective bargaining process. This may require that the CBA be reopened to deal with the new requirements. Reopening CBAs before their term to deal with one issue often upends carefully negotiated agreements and has an incredibly disruptive effect on the relationship between management and labor. This leads to a necessity for a delayed effective date to coincide with the expiration of the existing CBAs. However, ultimately, the most likely outcome of this alternative view that Section 414(v)(7) applies to multiemployer plans is that multiemployer trustees will eliminate catch-up contributions for all participants because of the extreme increased complexity.

Significant Guidance Is Also Needed

Apart from these significant operational issues, there are fundamental interpretive questions that require guidance from Treasury and the IRS in order to fully implement Section 603. For example, for a variety of reasons, including prior-year wage adjustments made after current-year retirement savings deductions have begun, employers will contribute pre-tax elective deferrals to plans which are later determined to be required to be treated as Roth catch-up contributions. In that case, the statute provides no guidance on whether such contributions may remain in the plan (including if participant consent is needed to recharacterize pre-tax deferrals into Roth catch-ups), whether they are subject to withholding (and if so, how such withholding is to be made), whether and how the taxable portion should be reported, and the year in which the taxable amount should be included in income. There are also issues on the reverse question — catch-up contributions that were treated as Roth but should have been pre-tax — how should these be corrected?

Additional essential questions that need to be addressed before implementation is feasible include confirmation that Roth contributions may be treated as catch-up contributions if made prior to the date that an IRS or plan limit is reached, and that pre-tax contributions may be recharacterized as Roth catch-up contributions for nondiscrimination purposes (as permitted under regulations). Finally, it is important to note that pending guidance it appears that participants in certain plans could be immediately eligible to make catch-up contributions (for example, plans that limit deferrals to less than 75% of the participant's compensation), and without additional implementation time it is highly unlikely that these plans could have their systems fully implemented as of January 1, 2024.

Plans also need guidance on whether they can require that all catch-up contributions be made on a Roth basis in order to avoid the very challenging task of implementing the $145,000 threshold immediately each year. Guidance is also needed to confirm an exemption from Section 414(v)(7) for Puerto Rican participants, since Roth options are not permitted for them. And we also need confirmation that the rule does not apply to participants who do not receive any FICA wages.

Even if all employers and their payroll and plan recordkeeper service providers were able to surmount the operational issues described above, it is critical to obtain guidance (including an opportunity to provide comments on the proposed rules) on these and other interpretive issues in order to fully implement Section 603. The additional time requested would also provide Treasury and IRS, and the regulated community, the time to provide, digest, and implement such guidance.