January 17, 2024

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Re: Notice 2023-62 – Guidance on Section 603 of the SECURE 2.0 Act with Respect to Catch-up Contributions

Dear Mses. Morrison, Levy, and Soderstrom:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) to address the need for guidance related to the changes made to catch-up contributions as enacted in the SECURE 2.0 Act of 2022 (SECURE 2.0), signed into law on December 29, 2022, as part of the Consolidated Appropriations Act of 2023.[1] Specifically, we appreciate the two year extension to implement the mandatory Roth IRA catch-up provision.

On August 25, 2023, Treasury and the IRS issued Notice 2023-62 (the "notice") related to the changes to catch-up contributions made by SECURE 2.0. This letter is in response to the Notice and the related request for comments. Specifically, the AICPA provides comments in the following areas related to the proposed regulations:

I. Timing of Application of Roth Treatment to Catch-up Contributions and Related Federal Income Tax Withholding Issues

II. Coordination with Actual Deferral Percentage Test Corrections

III. Calculation of Wage Limitations for Employees Receiving Wages from More than One Employer in a Controlled Group

IV. Potential Reversal of Roth Designation

[1] P.L. 117-328.

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Background

Catch-up contributions are authorized by section 414(v)[2] of the Internal Revenue Code (IRC) and are additional elective deferral contributions which may be contributed by individuals who have attained age 50 by the end of the year. Prior to the passage of SECURE 2.0, eligible participants were permitted to make catch-up contributions on a pre-tax basis, or, if the plan had a Roth contribution provision, to elect to make them on a Roth basis. The Roth designation was optional on the part of the participant, and available only if the plan originally permitted Roth contributions.

Effective for years beginning after December 31, 2023, SECURE 2.0 requires participants whose Federal Insurance Contributions Act (FICA) wages in the previous year exceed $145,000, to make their catch-up contributions on a Roth basis (with no option for pre-tax treatment of such contributions). SECURE 2.0 also provides that plans that offer catch-up contributions are required to add a Roth contribution feature to their plan.

I. Timing of Application of Roth Treatment of Catch-up Contributions and Related Federal Income Tax Withholding Issues

Overview

Section 414(v)(7) mandates Roth treatment for all catch-up contributions made by an individual whose FICA wages for the previous year exceed $145,000. Any elective deferral contribution, including catch-up contributions, made on a Roth basis are not excludable from an individual's gross income. Therefore, the amount of an individual's wages subject to withholding would include any Roth elective deferrals contributed during the period.

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance stating that federal income tax withholding with respect to a participant's mandatory Roth catch-up contribution is not required before February 1 of the year in which the amount is contributed.

Analysis

In order for an elective deferral to constitute a catch-up contribution, the amount must be contributed in excess of a statutory limit, an employer-provided limit or the actual deferral percentage (ADP) limit.[3] Based on the regulations governing catch up contributions, plans can be designed in one of two ways in order to accommodate catch-up contributions by participants. Under one plan design alternative, participants' initial deferrals are considered "regular" deferral contributions until the participant has deferred an amount equal to the section 402(g) limit for the year. After reaching this limit, subsequent deferrals are considered catch-up contributions. Alternatively, a participant can designate a portion of each deferral contribution during a period

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[2] Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.
[3] Treas. Reg. § 1.414(v)-1(b)(1).

as part regular deferral and part catch up contribution.[4] Under this design alternative, if the participant does not reach one of the limits described previously, contributions initially designated to be catch up contributions will be treated as regular elective deferrals.

Based on the second plan design, a plan participant may make catch-up contributions from the beginning of the plan year. If the plan operates on a calendar year basis, the catch-up contribution designation can apply to deferrals made during January. If the participant received more than $145,000 in FICA wages in the prior year, the statute could be read to apply mandatory Roth treatment to these contributions. However, the employer may not know at the time of the contribution whether this individual is subject to the Roth mandate, as their Form W-2, which would report FICA wages, is not required to be issued prior to January 31 of the following year, which is after the date that these deferral contributions are made.

> <u>Example</u>
>
> Employer X sponsors a 401(k) plan that operates on a calendar year basis. The plan permits elective deferrals on both a pre-tax and a Roth basis as elected by the participant. The plan permits employees to make catch-up contributions, and to make a regular deferral election and a separate catch-up election, which will be applied to each paycheck. Employer X pays its employees bi-weekly, with paychecks delivered every other Friday. In 2026, the first year that the Roth catch-up mandate applies, Employer X's payroll dates are Friday, January 9, 2026, and Friday, January 23, 2026.
>
> Participant A, an employee of Employer X, is paid $8,000 each biweekly pay period and elects to contribute both regular deferrals and catch-up deferrals. Participant A's regular deferral election is 10% of compensation and the catch-up deferral election is 2% of compensation, both elected on a pre-tax basis.
>
> Participant A receives a Form W-2 on Monday, February 2, 2026, identifying FICA wages paid by Employer X for 2025 in excess of the limit under section 414(v)(7). As a result, the deferrals made due to the 2% in compensation catch-up election ($160 from each January paycheck and $320 in total) would be required to be treated as Roth contributions. As a result of the Roth treatment, those amounts would be included in the amount subject to federal income tax withholding under current guidance.

In the example, we suggest not requiring the employer to withhold federal income taxes on the portion of the elective deferral that is considered a catch-up contribution and contributed during January. Under our recommendation, federal income tax withholding on the amount equal to the individual's Roth catch-up contribution would not be required until February, by which time the employer would have the relevant information to know that the employee's prior year FICA wages exceeded the limit that triggers mandatory Roth treatment of catch-up contributions.

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[4] Treas. Reg. § 1.414(v)-1(e)(1)(ii).

II. Coordination with Actual Deferral Percentage Test Corrections

Overview

Certain highly compensated employees may be eligible for catch-up contributions but not elect to make catch-up contributions. These individuals may find that a portion of their regular elective deferrals for a year are designated as catch-up contributions, based on the results of the plan's Actual Deferral Percentage (ADP) test. Some individuals in this situation would be subject to the Roth mandate and would be required to retain their deferrals in the plan.

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance allowing an elective deferral which is treated as a Roth catch-up contribution due to being recharacterized based on the failure of the ADP test, to be taxable to the participant in the year of recharacterization.

Analysis

A catch-up contribution is an elective deferral that exceeds either a statutory limit, a plan limit, or an ADP test limit.[5] The ADP test limit is equal to the highest amount of elective deferrals that can be retained by the plan by any highly compensated employee under the rules of section 401(k)(8)(C).[6] An individual who did not elect to make deferrals in excess of the section 402(g) statutory limit is deemed to make catch-up contributions if their deferral exceeds the ADP test limit.

<u>Example</u>

Employer Y sponsors a 401(k) plan. The plan operates on a calendar year basis. Participant B, a "highly compensated employee" for the year, is over age 50 and makes elective deferral contributions for 2024 equal to $23,000, the limitation under section 402(g) in effect for the year.[7] Since the amount elected is not in excess of the section 402(g) limit for the year, the individual has not made any catch-up contributions for the year.[8]

After the end of the year, Employer Y performs the ADP test on the plan for the 2024 plan year and discovers that the plan has failed the test. Employer Y corrects the failed test by refunding "excess contributions" to highly compensated employees, the amounts determined in accordance with applicable regulations,[9] including Participant B's excess contributions in the amount of $3,000.

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[5] Treas. Reg. § 1.414(v)-1(b)(1).
[6] Treas. Reg. § 1.414(v)-1(b)(1)(iii).
[7] Notice 2023-75.
[8] Treas. Reg. § 1.414(v)-1(b)(1)(i). In this example, the individual's elective contributions are not catch-up contributions because the individual did not make contributions in excess of the statutory limit.
[9] See Treas. Reg. § 1.401(k)-2(b)(2) for rules related to the calculation of corrective distributions for a failed ADP test.

If the participant in the example above is not above age 50, the applicable regulations would both allow and require that the $3,000 of excess contributions (along with related earnings) be distributed to Participant B (and others with excess contributions) if the test is being corrected by refunds. However, in this case, Participant B is over age 50, and thus, eligible to contribute catch-up contributions.

Based on the ADP test limit, it is possible that a participant who did not elect to make a catch-up contribution, due to limiting deferrals to the regular section 402(g) limit, may inadvertently have catch-up contributions. If such an individual is a highly compensated employee and the plan is subject to the ADP test, the ADP test will be applied considering all of the individual's deferrals. If the plan fails the ADP test for a year, a portion of the individual's deferrals may be characterized as excess contributions.[10]

Plans that fail the ADP test may correct the test by refunding excess contributions. However, if a catch-up contribution eligible participant is identified as a participant who should receive a refund, the regulations require that the amount to be refunded be retained by the plan and recharacterized as a catch-up contribution, unless the participant has already contributed the full amount of regular and catch-up contributions allowed for the year. The retention, rather than distribution, of excess contributions by a catch-up contribution eligible participant is required. Such a contribution will become a catch-up contribution only upon obtaining an ADP test result depicting that the plan failed and that identifies a catch-up eligible participant with excess contributions. If this participant is subject to the Roth mandate based on prior year's FICA wages, the contribution will become a Roth contribution.

Under the rules applicable to the ADP test, if an individual receives a refund of pre-tax elective deferrals in order for the plan to correct its failed ADP test, the refunded amount is taxable to the individual in the year received, and not the year of the contribution. If an individual is catch-up contribution eligible and has a pre-tax contribution converted to a Roth contribution, the contribution will become taxable. The taxation (as well as the reporting) for an individual in this situation should follow the tax and reporting treatment that applies to an individual who receives a refund as part of an ADP test correction.

III. Calculation of Wage Limitations for Employees Receiving Wages from More than One Employer in a Controlled Group

Overview

Section 414(v)(7)(A), as added by section 603(a) of SECURE 2.0, provides that section 414(v)(1) catch-up contribution deferrals of 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, must be designated as Roth contributions.

Section V.3 of the notice states that future guidance will address the treatment of an applicable plan maintained by more than one employer. The notice indicates that the guidance would

[10] Treas. Reg. § 1.401(k)-2.

provide that the wages from the preceding calendar year from one participating employer would not be aggregated with the wages from another participating employer for purposes of determining whether the participant's wages for that year exceed $145,000 (as adjusted). However, it is not clear whether the reference to "participating employer" refers solely to the legal entity paying the wages, or if it includes wages paid by a different legal entity under the aggregation rules of sections 414(b), (c), (m), or (o).

Recommendation

The AICPA recommends that future guidance issued by Treasury and the IRS in relation to Section V.3 of the notice, clarifies that for purposes of determining if an employee's participating wages exceeds $145,000 (as adjusted), only wages from the employee's specific common law employer in the previous year are included, and only if it is a participating employer in the plan.

Analysis

The requirement for catch-up contributions to be contributed on a mandatory Roth basis applies to a participant "whose wages (as defined in section 3121(a)) for the preceding calendar year from the employer sponsoring the plan exceed $145,000."[11] The legislative text clearly requires that, for purposes of identifying wages in excess of the limit, the plan should consider only wages received from the sponsor of the plan. Wages received from an entity which is not a sponsor of the plan are not considered and do not cause an individual to be subject to the Roth mandate, with respect to a different employer that sponsors the plan.

However, it is unclear whether the "the employer sponsoring the plan" under the new provision is determined on a separate entity basis, or whether the aggregation rules of sections 414(b), (c), (m), and (o) apply. Our interpretation of the statute suggests that "the employer sponsoring the plan" is determined on a separate entity basis, even if separate legal entities are aggregated under one of the provisions, which is supported by the following:

- The mandate is tied to the amount of FICA wages the individual received in the prior year from the employer sponsoring the plan. An individual's FICA wages in a year are determined based only on wages received from one entity and the aggregation rules do not apply for this purpose. If an individual works for one entity, and during the year, transfers to work for another entity, the individual will receive two separate Forms W-2 for the year, and their wages reset for purposes of determining whether the individual has received wages in excess of the FICA wage base for the year.

- It is common for separate entities that are aggregated for purposes of the requirements applicable to qualified plans to participate in the same plan. However, each entity will typically adopt the plan separately in its own right. In the pre-approved plan program, it is common for adoption agreements to identify one entity as the "sponsor" of the plan. In those plans, other entities may participate in the plan through the separate adoption as a participating employer. The need for separate adoption indicates that each entity is

[11] P.L. 117-328.

viewed as a separate employer, even though all employers are participating in the plan. If the aggregation rules applied for this purpose, the statutory language would refer to "the employers participating in the plan." The first example in Part V 3 of the notice is consistent with this interpretation.

- In the case of aggregated employers, it is possible for one entity within the aggregated group to not participate in the plan. If an individual is working for the non-participating employer, the individual is not considered to be receiving wages from the "employer sponsoring the plan." The legislative text is clear that this individual is not subject to the Roth mandate if, in the following year, the individual works for an employer that is sponsoring or participating in the plan. The second example in Part V 3 of the notice reflects this interpretation.

Based on the above analysis, we interpret the notice as applying the FICA wage requirements which trigger the Roth mandate on an entity-by-entity basis, and not on a controlled group basis, which is consistent with the statutory language. However, due to the potential for confusion, we request that the IRS and Treasury include clarifying language in future guidance.

IV. Potential Reversal of Roth Designation

Overview

If a plan participant designates a portion of their periodic deferrals as catch-up contributions,[12] but does not end up contributing deferrals equal to the statutory limit, the regulations characterize a portion of the catch-up contributions as regular contributions.[13] This treatment could result in a mandatory Roth designation applying to deferrals that are properly characterized as regular elective deferrals for the year, and thus, not subject to the Roth mandate.

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance stating that an individual who has deferrals characterized as Roth contributions as a result of not contributing deferrals equal to the regular limit be permitted to have them designated as regular deferrals.

Analysis

Under the existing regulations, there is the potential for Roth designations to apply to amounts not characterized as catch-up contributions in a plan that uses a design described in Treas. Reg. § 1.414(v)-1(e)(ii).

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[12] Treas. Reg. § 1.414(v)-1(e)(1)(ii)(A).
[13] Treas. Reg. § 1.414(v)-1(h), Example 2.

Example

Participant C is eligible for Plan Z and is subject to the Roth mandate pursuant to section 603 of SECURE 2.0. Plan Z is designed to allow a participant to make a separate catch-up election, as described in Treas. Reg. § 1.414(v)-1(e)(1)(ii)(A). Participant C is paid $10,000 each biweekly pay period and elects to defer 5% of pay, or $500. In addition, Participant C elects an additional contribution, as a catch-up equal to a pro-rata amount of the catch-up contribution limit in effect, which is $7,500 for purposes of this example. Thus, Participant C's total deferral election each pay period is $500 + ($7,500/26), for a total of $788.46. Of this amount, $288 is characterized as a catch-up contribution at the time it is initially contributed.

Participant C discontinues all elective deferrals after receiving 13 paychecks. Thus, Participant C has contributed a total of $10,250 of elective deferrals. Since this total amount is less than the section 402(g) limit for the year, the regulations would treat this entire amount as a regular elective deferral.

In this example, the employer would have characterized the $288.46 contributed each pay period initially as a Roth contribution, regardless of the participant's traditional or Roth election. Since these amounts will subsequently be characterized as regular contributions and not catch-up contributions, guidance is needed to address whether the amounts initially characterized as Roth catch ups can be treated as traditional elective deferrals, assuming that the participant's election was to make elective deferrals as traditional deferrals.

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We appreciate your consideration of these comments and welcome the opportunity to discuss them further. If you have any questions, please contact Tom Pevarnik, Chair, AICPA Employee Benefits Taxation Technical Resource Panel, at (202) 879-5314, or tpevarnik@deloitte.com; Kristin Esposito, AICPA Director – Tax Policy & Advocacy, at (202) 434-9241, or kristin.esposito@aicpa-cima.com; or me, at (830) 372-9692, or bvickers@alamo-group.com.

Sincerely,

Blake Vickers, CPA, CGMA
Chair, AICPA Tax Executive Committee

cc: Ms. Laura Warshawsky, Deputy Associate Chief Counsel, Internal Revenue Service