There's Relief in Sight: IRS Announces 2-Year Transition Period for Mandatory Roth Catch-Up Contributions

Insights
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In welcome news to employers, recordkeepers, and payroll providers, the IRS announced last week that it is giving more time to comply with mandatory Roth catch-up contributions under the SECURE Act 2.0. As you may know, employees who are at least 50 years old are currently able to make pre-tax "catch-up contributions" to their employer-sponsored retirement plans, including 401(k) plans – but that's slated to change for some participants. Under the SECURE Act 2.0, certain higher earners will soon be required to make such contributions to an after-tax Roth account. This provision takes effect on January 1, 2024, but the IRS just announced a two-year transition period, giving employers a pass until the beginning of 2026. What do you need to know about the pending change's impact on your organization's retirement savings plan and what four steps should you consider taking now?

What Happened?

Employees who participate in a 401(k), 403(b), or governmental 457(b) plan can generally save up to a certain amount on a pre-tax basis each year – and if permitted by the retirement plan, catch-up contributions are available to participants aged 50 and older who desire to contribute more that the annual deferral limit. The SECURE Act 2.0 Section 603, however, provides that participants whose wages exceeded $145,000 (indexed annually) in the previous year must make catch-up contributions on a Roth after-tax basis, eliminating the option to make pre-tax catch-up contributions.

This mandatory provision is required for plan years after December 31, 2023, which is seemingly around the corner. However, the IRS's recent guidance (Notice 2023-62) grants relief by providing for a two-year transition period for implementing these mandatory Roth catch-up contributions.

The Industry Pushes Back

As is typical with most "big" legislation, employers and industry professionals (such as payroll providers and recordkeepers) are left holding the bag when it comes to administration and compliance. And SECURE Act 2.0 is no different.

In response to the act's mandatory Roth catch-up contributions, several industry groups have filed letters with the Department of Treasury asking for clarification and transitional relief to give employers time to work with their retirement plan partners to overhaul their 401(k), 403(b), or governmental 457(b) plan documents, systems, and technology.

Additionally, the ERISA Industry Committee (ERIC) sent an open letter on July 19 to the IRS and the Department of Treasury requesting a two-year delay in the implementation of Roth catch-up contributions. This was just one of several public requests made by industry groups and businesses. And it seems the IRS had listened.

What Does This Mean for Employers?

The IRS notice provides generous administrative and operational relief to employers, recordkeepers, and payroll providers alike by formally addressing the following issues:

- The IRS provided a statutory explanation of why catch-up contributions will remain available under retirement plans despite an initial drafting error in SECURE Act 2.0 that seemingly eliminated catch-up contributions for plan years beginning after December 31, 2023.
- Under this new two-year transition period, all catch-up contributions will be treated as satisfying Section 603 of the SECURE Act 2.0, even if the contributions are not designated as Roth contributions but as pre-tax contributions for taxable years before January 1, 2026.
- Additionally, the IRS clarified that, even if a plan does not provide for Roth contributions (which is the case for many governmental retirement plans), Section 603 of the SECURE Act 2.0 will still be satisfied for taxable years before January 1, 2026.

The IRS is inviting written comments on Notice 2023-62 through October 24 before it offers additional guidance.

4 Steps Employers Should Consider Taking

While we wait on further clarification from the IRS on these mandatory Roth catch-up contributions, employers can breathe a sigh of relief for the next couple of years. However, here are four steps you should consider taking before the transition period expires:

1. Review your retirement plan provisions regarding Roth and catch-up contributions.
2. Work with your recordkeeper on any amendments necessary to implement this “Rothification” requirement.
3. Work with your payroll provider and recordkeeper on implementing systems that identify these highly paid employees – keeping in mind that the compensation threshold for this rule is different than other definitions of compensation, including that for “highly compensated employees,” which is $150,000 for 2023 (and indexed annually).
4. Implement any other process or procedures to help your business maintain operational compliance.

Conclusion

Stay tuned for updates as we monitor regulatory and departmental guidance regarding the administration and implementation of Section 603 of the SECURE Act 2.0. Fisher Phillips will provide updates as warranted, so make sure you are subscribed to Fisher Phillips' Insight System to get the most up-to-date information directly to your inbox. In the meantime, if you have questions, feel free to reach out to your Fisher Phillips attorney, the author of this Insight, or any attorney in our Employee Benefits and Tax Practice Group.

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