What's New In Washington: House Introduces Roth Rollover Bill

Promising news for clients who want to provide more rollover options to employees — a new bipartisan bill introduced in the House would permit employees to rollover money directly from Roth IRAs to a Roth account in an employer-sponsored plan. The bill, known as H.R. 6757 and introduced December 13th, is co-sponsored by U.S. Representatives Linda T. Sánchez (Democrat, California) and Darin LaHood (Republican, Illinois), who both serve on the House's Ways and Means Committee.

Interest in using Roth accounts for retirement savings has been increasing in recent years. According to a 2020 report by the Investment Company Institute, an estimated 20.5% of U.S. households (roughly 26.3 million) owned Roth IRAs in 2020, up from 19.4% in 2019. Investors prize Roth IRAs for their ability to grow tax-free over time, leading to more favorable retirement savings outcomes. Sponsors and retirement industry leaders are hopeful that the bill would allow individuals to consolidate retirement savings, reduce duplicative fees, and improve the likelihood of Roth savings portability.

The bill also, though, leaves a number of open issues that may present issues for employees:

1. **What about the five-year holding period?** To obtain favorable tax treatment, an individual must wait five years before taking a withdrawal from a designated Roth account. Changing the Roth savings vehicle may re-start this 5-year holding period, creating a trap for unwary participants. The bill does not address this issue.

2. **What about withdrawal options?** Roth IRAs permit exceptions to the general early withdrawal penalty for events such as a first-time home purchase, birth or adoption expenses, and college expenses. While some of these exemptions are often mirrored in employer-sponsored plans, the bill does not add these general exemptions for employer-sponsored plans, providing a potential downside for participants.

This proposal is still in the bill stage — meaning there have been no changes to the law and no requirements or options have changed for clients. However, the current lack of portability for Roth accounts and the potential changes are extremely relevant, particularly for plans who may be considering a new auto-portability service (authorized under SECURE 2.0). Now is a great time to give your clients a heads-up about potential issues and opportunities.

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Best Practices: Correcting LTPTE Errors

Given the meager 25 days between the issuance of proposed guidance and the effective date of the long-time part-time employee (LTPTE) rules, it is likely that many clients who are impacted by the LTPTE rules will have one primary follow-up question on their mind: what do we do if we failed to enroll LTPTEs on time? The answer here will depend on the client.

Has the IRS provided any special correction options? No. The proposed guidance doesn't provide any special procedures for correcting LTPTE-related enrollment errors. This means that clients should continue to rely on the IRS's Employee Plans Compliance Resolution System and choose to correct under either the Self-Correction Program (SCP) or the Voluntary Correction Program (VCP). The good news—the SECURE 2.0 Act of 2022 (SECURE 2.0) expanded SCP to make more plans and errors eligible for self-correction (that is, correction without the need for costly filings with the IRS). Under this expanded SCP option, clients may self-correct virtually any "inadvertent failure" that is identified before a plan is selected for audit by the IRS. An error may generally be categorized as an "inadvertent failure"—and therefore eligible for SCP correction—if: (1) it was made despite standards and practices in place to prevent errors and (2) it is corrected within a reasonable time after the error is identified (generally within 18 months).

Ok, so what is the correction? Clients can generally correct by making a qualified nonelective contribution (QNEC) on behalf of the individual who was improperly excluded. The amount of the QNEC will be based on the amount of the missed deferral opportunity, plus earnings. The amount of the QNEC related to the missed deferral opportunity will depend in part on whether clients have chosen to automatically enroll LTPTEs, when the error is corrected, and whether the client follows the procedures to secure a reduced QNEC.

For clients who have chosen to automatically enroll LTPTEs: Thanks to SECURE 2.0, plan sponsors may be able to correct deferral errors (such as a failure to enroll an employee who should have been automatically enrolled in the plan's deferral feature) without making a corrective contribution at all. Generally, no corrective contribution is required if an LTPTE who was covered by an automatic enrollment feature isn't enrolled or given a deferral opportunity if the error is corrected within nine and half months after the end of the year in which the error first occurred (that is, by the extended Form 5500 filing date) *and* the client follows certain procedures, including timely providing a notice to affected employees. If the procedures are not followed, a QNEC equal to 50% of the missed deferrals, plus earnings will be required. *For clients who have chosen to not automatically enroll LTPTEs:* If your client's plan does not have automatic enrollment or they chose not to automatically enroll LTPTEs, correction may still be very favorable, but they need to catch the error much more quickly.

The general rule is that deferral errors may be corrected by making a QNEC equal to 50% of the missed deferrals, plus earnings. This may be reduced in some cases as follows:

1. For errors that are corrected within three months after the error first occurred (provided certain other requirements are met), no QNEC is required for missed deferrals if the employee is still employed and the client follows certain procedures, including timely providing a notice to affected employees. If an employee terminates employment before the correction notice is provided, that employee must receive the 50% QNEC.
2. For errors that that are corrected by the end of the third plan year after the error first occurred (provided certain other requirements are met), the plan sponsor may correct by making a QNEC equal to 25% of the missed deferrals, plus earnings. Plan sponsors must, however, provide notice of the error to affected participants no later than 45 days after the date the correct deferrals begin.

In all cases, if the affected employees would have received matching contributions, a QNEC will be owed for those missed contributions as well. However, in the case of LTPTEs, they are only required to be allowed to defer salary, so they generally will not be eligible for company contributions and generally won't require the making of an additional corrective contribution for missed company contributions.

Takeaway: Overall, though, clients should be encouraged to learn that there are favorable correction options available for errors—including LTPTE errors—that are caught and remedied quickly. Reach out to clients now to ensure they are aware of the LTPTE rules and have taken steps to comply with the proposed guidance, including identifying and correcting any inadvertent errors as quickly as possible. Remember that SCP is only available for errors that occur despite standards and practices in place to facilitate compliance — meaning that intentional or willful disregard of the rules will mean that clients will likely need to correct under VCP instead. Further, any errors need to be documented in accordance with recent IRS guidance. Your TPA partner can help identify impacted participants and assist with corrections.

Hot Topic:
IRS Releases Proposed LTPTE Guidance

Beginning January 1, 2024, part-time employees who have worked at least 500 hours for three consecutive 12-month periods must be eligible to partic-ipate in at least the deferral feature of most 401(k) plans. On November 24, 2023 — a meager 25 working days be-fore the effective date of the LTPTE rules — the Treasury and IRS released a proposed regulation implementing the LTPTE rules under SECURE 1.0 and SECURE 2.0. Here's what you need to know:

Applicability: As a reminder, the LTPTE rule generally ap-plies to 401(k) plans as of January 1, 2024 (and 403(b) plans as of January 1, 2025). The rule does *not* apply to other defined contribution plans, like 457 plans or SIMPLE IRA plans. It also does not apply to collectively bargained plans. The IRS did however clarify that it does apply to plans that are not subject to Code Section 410 requirements (such as governmental plans and non-electing church plans). The proposed regulation applies to plan years beginning on or after January 1, 2024, and employers may rely on it until other guidance is issued.

The gist of it: 401(k) plans can no longer have a service condition that prevents an employee from making salary deferrals if he or she has worked at least 500 hours for three consecutive years. Employees who do not meet the nor-mal year of service requirement (whether based on hours or elapsed time), but who do meet this new minimum ser-vice requirement, are called long-term part-time employ-ees (LTPTEs). IRS confirmed that non-service conditions —such as excluding hourly employees, salaried employees, or highly-compensated employees — are still permitted so long as they are *not* functioning as disguised service condi-tions. Exclusions of "part-time employees" and "seasonal employees" generally are service conditions and there-fore generally *are* subject to the new rules. The proposed regulation confirmed that these 12-month periods that are counted for LTPTE service begin on the hire date and may later shift to the plan year. The proposed regulation confirmed that the special rules applicable to LTPTEs ap-ply only to employees who enter the plan because of the LTPTE rules — and do not apply to employees who begin participating under broader eligibility provisions.

Who is impacted: Plans that do not have an hours-based service condition, such as plans that permit employees to defer immediately or after 60 days are not impacted by the rule. Plans that impose a longer service condition (regardless of whether it is hours-based or elapsed time) for any group of employees will be impacted by the rule. This generally includes plans that exclude "part-time employees" and "seasonal employees."

Two options: Plans that are impacted by the new rule generally have two options.

First: You can keep your plan's existing service conditions, with the caveat that anyone who meets the LTPTE definition will be allowed to make deferrals to the plan. On one hand, this limits the number of part-time workers who are eligible for the plan (which might reduce administration cost) and ensures nondiscrimination testing and top-heavy minimum contributions are not impacted. On the other hand, though, this imposes significant administrative burdens to track hours and the employee's status as an LTPTE. Additionally, the proposed regulations require LTPTEs to be credited with vesting for performing 500 hours, which creates administrative burdens and, if these employees begin receiving an employer contribution subject to a vesting schedule, may significantly increase the cost of the plan. These complexities in administration have the potential to cause operational issues, which may also increase the cost of the plan.

Second: The proposed regulation confirms that you can modify the plan's existing service condition to avoid the downside of the LTPTE rules by ensuring all employees are eligible to make salary deferrals before they meet the LTPTE definition. On one hand, this simplifies administration and avoids the LTPTE rules all together — reducing the likelihood of plan errors and avoiding the potentially costly vesting rules that apply to LTPTEs. On the other hand, though, such a change may impact nondiscrimination testing for non-safe harbor plans, may increase required company contributions, and may increase the number of plan accounts in both cases (which, in turn, could increase audit and administration costs).

⇨ **Action item:** Make sure you are conforming operations to the new rule. Work with your TPA partner to help analyze the impacts of your options related to plan design.