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January 2, 2024

Ms. Carol Weiser
Benefits Tax Counsel
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Ms. Rachel Leiser Levy
Associate Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

RE: Comment Letter on SECURE 2.0 and Related Guidance

Dear Ms. Weiser and Ms. Levy:

SECURE 2.0 has raised dozens of questions from practitioners and taxpayers alike. I am writing with respect to seven issues I have identified. My hope is that Treasury and the IRS issue regulations in response to these concerns. I fully understand that SECURE 2.0 guidance is a daunting project. I would be quite happy if the government issues guidance short of regulations, such as notices, to address the matters discussed herein.

I am a financial planner[1] and I advise clients concerning tax-advantaged retirement accounts. I wrote a book, Solo 401(k): The Solopreneur's Retirement Account, in 2022 addressing Solo 401(k)s. I blog about tax planning and financial independence at fitaxguy.com. An unsigned copy of this comment letter will be posted to fitaxguy.com on January 11, 2024.

References to "Section" below are to the Internal Revenue Code. References to "SECURE 2.0 Section" are to the section number of the provision within the SECURE 2.0 bill text.

[1] The views stated herein are solely those of the author. They are not the views of any current or former employer of the author and they are not the views of any of the clients of my financial planning firm.

Proposal One: Regulations Allowing the Full Congressional Intent of SECURE 2.0 Section 317 to Be Achieved

It is clear that in enacting SECURE 2.0 Section 317, Congress intended for sole proprietors to be unconstrained by end-of-year deadlines in establishing and funding a Solo 401(k) for the first time. That is why the revised Section 401(b)(2) allows for establishment of a Solo 401(k) after year-end and for the sole proprietor to fund the Solo 401(k) with an employee contribution by the tax return filing deadline.

However, it is not abundantly clear what happens if the sole proprietor establishes a first-time Solo 401(k) during the calendar year but fails to fund it and/or elect to make an employee contribution prior to year-end. If SECURE 2.0's revision to Section 401(b)(2) is read to only apply to Solo 401(k)s established after year-end, a very odd result would obtain in which those sole proprietors establishing a first-time Solo 401(k) after year-end would get a better outcome than those who established one during the year.

Here are two examples to illustrate the issue.

Mike starts a sole proprietorship during 2024. He earns $40,000 in Schedule C profit. In February 2025, Mike establishes a Solo 401(k) and funds it with a $20,000 employee contribution for 2024 in March 2025.

Nick starts a sole proprietorship during 2024. He earns $40,000 in Schedule C profit. In December 2024, Nick establishes a Solo 401(k). If SECURE 2.0 Section 317 is interpreted to not apply (as Nick established the Solo 401(k) prior to year-end) and Nick is not aware of the requirement to either fund the Solo 401(k) prior to year-end or make a deferral election (to himself) prior to year-end, Nick is unable to make a 2024 employee contribution. As a result, Nick is limited to an employer contribution of less than $8,000 for 2024.

Why does Nick get a worse result than Mike due to opening the new Solo 401(k) **prior to** year-end?

My primary recommendation in this regard is to eliminate the deferral election required of sole proprietors under Treas. Reg. Sec. 1.401(k)-1(a)(6)(iii). By eliminating the required election, Mike and Nick get the same result with respect to their new Solo 401(k), consistent with Congressional intent. Eliminating the election requirement allows all sole proprietors to fund Solo 401(k) employee contributions after year-end (prior to the tax return filing deadline, including extensions).

Further, it is highly questionable as to whether the requirement for sole proprietors to make an election prior to year-end under Treas. Reg. Sec. 1.401(k)-1(a)(6)(iii) is valid under the meaningless gesture doctrine. Like Section 351(a)'s explicit requirement to receive stock in order to get nonrecognition is disregarded if receiving such stock would be a meaningless gesture,[2] Section 401(k)'s election requirement should be disregarded if it is a meaningless gesture.[3] As the sole proprietor is both employee and employer, making a deferral election with one's own self is a meaningless gesture.

Outside of an actual Solo 401(k) contribution, it isn't entirely clear how a sole proprietor makes the election: do they think it to themselves? Do they email themselves? Do they need to sign a document they present to themselves? Why would sole proprietors be required to think to themselves, email themselves, or sign a document to themselves (not to a separate legal entity or person) to obtain a tax benefit?[4]

The sole proprietor election contemplated by Treas. Reg. Section 1.401(k)-1(a)(6)(iii) is a meaningless gesture and should be eliminated. That this election creates a problem implementing SECURE 2.0 Section 317 in a rational way further demonstrates the need to revoke the election requirement for sole proprietors entirely and apply the meaningless gesture doctrine.

If the Treasury and IRS do not adopt my primary recommendation in this regard, I recommend as an alternative measure that the regulations allow any sole proprietors establishing a Solo 401(k) for the first time to make an employee deferral contribution by April 15th of the following year regardless of when the Solo 401(k) was adopted.

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[2] "[R]ecognizing that the issuance of additional stock would be a 'meaningless gesture,' the IRS and courts have consistently held that 'the exchange requirements of section 351 are met where a sole stockholder transfers property to a wholly-owned corporation even though no stock or securities are issued therefor' (Lessinger, 872 F.2d 519 (2d Cir. 1989); see also Rev. Rul. 64-155)." Jack Stringfield, *IRS Memo Addresses Holding Periods for Meaningless Gesture Transactions*, The Tax Adviser, February 1, 2021, accessible at https://www.thetaxadviser.com/issues/2021/feb/irs-memo-holding-periods-meaningless-gesture-transactions.html

[3] Section 401(k) requires the employee to elect with the employer to defer compensation in order to have a valid cash or deferred arrangement. In the case of a sole proprietor, the employer and the employee are one and the same. In the case of a wholly-owned corporation, there are two legal entities involved, the shareholder and the corporation. Thus, the meaningless gesture doctrine applies to a sole proprietor's 401(k) deferral election even more so than it applies to the issuance of stock by a wholly-owned corporation.

[4] Depending on the net income of the sole proprietorship, the election may need to be at least somewhat less than precise. For example, the sole proprietor may want to make the maximum possible employee deferral contribution, but may not know prior to year-end the net income from self-employment. This can happen due to late in the year revenue and expenses, accounting adjustments made after year-end, and tax elections made after year-end.

In a situation where that net income is near to or less than the Section 402(g) employee deferral limit, the election the sole proprietor makes to him/herself prior to year-end may be something to the effect of making "a deferral contribution to the maximum extent allowed by law."

Proposal Two: Clarification That the Restrictions of SECURE 2.0 Section 603 Do Not Apply to Self-Employment Income

SECURE 2.0 Section 603 restricts the ability of W-2 employees to make traditional deductible catch-up contributions to workplace retirement plans if their prior-year W-2 income is above a certain limit.

I recommend that the Treasury and IRS verify that those who are not paid wages under Section 3121(a) are not subject to the new rule. I believe that self-employed partners and sole proprietors are not subject to the rule, but there is at least some confusion on the point.[5]

Proposal Three: Issue a Safe Harbor List of Emergencies That Qualify as Emergencies Under SECURE 2.0 Section 115

SECURE 2.0 Section 115 authorizes penalty free distributions of up to $1,000 as an "emergency personal expense distribution." Emergency personal expense distributions can also be refunded to a retirement account within three years of the distribution.

I recommend that Treasury and IRS issue regulations including a safe harbor list of emergencies that make one eligible to take an emergency personal expense distribution without any further inquiry. I recommend that the safe harbors include:

- The taxpayer, their spouse, or their dependent has unreimbursed expenses or a loss of $400 or more involving any of the following: injury, illness, accident, car repair, home repair, or theft.
- The death of a spouse or dependent.
- An involuntary job loss that can be reasonably expected to reduce W-2 income by at least $400 over the next 30 days.
- A reduction in self-employment or W-2 income of at least 30% from the prior taxable year.
- Any situation reasonably described as an emergency as long as it causes at least $400 of (i) a loss of income or (ii) unreimbursed expenses or losses.

For this purpose, a loss should include liabilities to third parties occurring due to the event.

It is clear that Congress intended for emergency personal expense distributions to be beneficial to taxpayers. This is not an area that should cause significant disputes between the IRS and

[5] See New York City Bar Comment Letter on SECURE 2.0 Guidance Priorities, page 4, available at https://s3.amazonaws.com/documents.nycbar.org/files/20221192_CommentLetterSecure2.0.pdf

taxpayers. Treasury and the IRS should write regulations under SECURE 2.0 Section 115 to reduce uncertainty and reduce potential disputes between taxpayers and the IRS.

Proposal Four: Regulations Providing that No Amended Tax Return is Required if the Qualified Distribution is From a Roth Account and Would Be Tax and Penalty Free if it Were a Nonqualifed Distribution

The **payback provisions** (SECURE 2.0 Sections 115, 314, 326, and 331 and SECURE 1.0 Section 113) contemplate taxpayers filing amended returns to claim refunds with respect to income tax paid on qualified distributions that are paid back to a retirement account within the three year payback period.

Many households have Roth IRAs.[6] When one takes a distribution from a Roth IRA[7] prior to turning age 59 ½, it is tax and penalty free to the extent of any previous annual contributions and Roth conversions at least five years old. Further, those who are age 59 ½ and have owned a Roth IRA for at least five years can take any amount from their Roth IRA tax and penalty free.

Thus, many of the distributions qualifying for the payback provisions would have simply been tax and penalty free distributions from a Roth IRA.

Treasury and the IRS should issue regulations clarifying that no amended tax return is required, including no amended Form 8606 Part III, to report a payback if the entire distribution would have been fully tax and penalty free regardless of the payback provision rules.[8]

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[6] According to the Investment Company Institute, 32.3 million American households owned Roth IRAs in 2022. See The Role of IRAs in US Households' Saving for Retirement, 2022, page 4, available at https://www.ici.org/system/files/2023-02/per29-01_0.pdf

[7] A qualified birth or adoption distribution can be taken from an "applicable eligible retirement plan" as defined by Section 72(t)(2)(H)(vi)(I). It provides "[t]he term "applicable eligible retirement plan" means an eligible retirement plan (as defined in section 402(c)(8)(B)) other than a defined benefit plan."

Section 402(c)(8)(B) defines an "eligible retirement plan" to include "an individual retirement account (within the meaning of section 408(a))."

A Roth IRA is an individual retirement account within the meaning of Section 408(a). That is demonstrated by Section 408A(b), which provides that a Roth IRA is an "individual retirement plan" as defined by Section 7701(a)(37). Section 7701(a)(37) provides that an individual retirement plan is an individual retirement account within the meaning of Section 408(a). Thus, a Roth IRA is an IRA and is an "applicable eligible retirement plan" under Section 72(t)(2)(H)(vi)(I). See also Treas. Reg. Sec. 1.408A-1 Q&A 1(b).

[8] Such as a distribution of previously made Roth IRA annual contributions. See Treas. Reg. Sec. 1.408A-6 Q&A 1(b) and 8(a).

The Form 5498 filed by the financial institution can adequately report the payback to both the IRS and the taxpayer.

The regulations should extend this treatment to designated Roth account distributions that would be fully and penalty free regardless of payback provision qualification, such as those occurring when the taxpayer has a loss in their designated Roth account or those occurring after the taxpayer has turned age 59 ½ and has owned the designated Roth account for at least five years.

Proposal Five: Include Qualified Disaster Recovery Distribution Repayments In Regulations Issued Under Section 72(t)(2)(H)(v)

SECURE 2.0 Section 331, establishing qualified disaster recovery distributions, does not cite to Section 72(t)(2)(H)(v). The other payback provisions in SECURE 2.0 (SECURE 2.0 Sections 115, 314, and 326) all cite to Section 72(t)(2)(H)(v), the payback provisions for qualified birth or adoption distributions.

SECURE 2.0 Section 331 is similar in mechanics to the other payback provisions. To make all five provisions more administrable for the IRS and user-friendly for taxpayers, Treasury and the IRS should issue regulations under Section 72(t)(2)(H)(v) applicable to all five payback provisions, including qualified disaster recovery distributions.

Proposal Six: Verify That a Person Older Than Age 59 ½ Can Do a Three Year Payback

All five payback provisions provide two specific tax benefits to taxpayers. First is the forgiveness of the 10 percent early withdrawal penalty on the qualified distribution. The second benefit is to be able to refund the qualified distribution in order to (a) obtain a tax refund and (b) keep the amounts invested for retirement.

Attaining the age of 59 ½ ends the need for the first benefit. However, those age 59 ½ and older still need retirement savings and should still receive the benefit of a potential tax refund. Regulations should verify that those over the age of 59 ½ can receive the benefit of the five payback provisions and refund qualified distributions to a retirement account.

Some may question this considering that the payback provisions are found in Section 72(t)(2), which generally provides exceptions to the 10 percent early withdrawal penalty. That placement reflects a common-sense decision to keep the exceptions to the 10 percent early withdrawal penalty consolidated together and does not reflect any intention to deny the benefits of the payback provisions to those over the age of 59 ½.

Proposal Seven: Excuse the Excess Contribution Penalty if the IRS Disagrees With Three Year Payback Qualification

The 3 year payback rules inadvertently created a significant risk for taxpayers: excess contribution penalties if the IRS disagrees with the taxpayer and determines the taxpayer did not qualify for the relevant provision.[9] The payback into the retirement account becomes an excess contribution if the IRS prevails in its view that a distribution did not qualify.

The 3 year payback rules are intended to help, not hurt, taxpayers. Further, the tax law is complicated, even for professionals. American taxpayers should not be subject to penalties when they attempt to interpret laws Congress intended to help them.

I recommend that the Treasury and IRS issue regulations that, at least initially, waive any excess contribution penalties taxpayers might be subject to if they recontribute amounts to a retirement account erroneously believing they qualify for one of the payback provisions.

For purposes of applying any retirement account excess contribution penalty, the recontribution to the retirement account (an excess contribution) should be deemed to have been made on the date of the final determination (i.e., an IRS determination the taxpayer agrees to or a final determination made by a court). If the regulations provide this rule, the taxpayer would have the ability to withdraw the excess contribution penalty free under the normal remedial procedures, and would only owe ordinary income tax on the growth attributable to the excess contribution.

I would be happy to discuss the proposals made and issues raised in this letter at your convenience. Please email me at sean@mullaneyfinancial.com to arrange for such a discussion.

Sincerely,

Sean W. Mullaney

[9] For example, Section 4973 imposes a 6 percent annual penalty on excess contributions to traditional IRAs and Roth IRAs.