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401(k) PLANS

Taking Advantage of the Military Spouse Participation Credit for Small Plans

With creation of the SECURE 2.0 legislation, an additional benefit to employers providing accelerated participation and vesting to spouses of military personnel was also created in the form of a tax credit. Whether employers take advantage is conditioned upon ensuring the plan provisions are set up to qualify and employees are accounted for properly.

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In the last few years, the qualified plan world has seen more change—and there is more ink about the changes than we have seen in the prior 10 years. The changes that we believe have garnered the most coverage are the new choices of “carrots” or “sticks” that are available, particularly including new

and enhanced credits for small businesses, combined with strong momentum of state mandates to do *something* about offering workplace savings.

When we speak to a plan sponsor these new features conjure the image of a daytime talk show host, having hidden Internal Revenue Code (Code) Section 45E credits under the seats of everyone in the audience. A credit to start up your plan. A credit to stay compliant with SECURE 2.0 Section 101. A credit for helping your nascent plan avoid testing surprises via safe harbor. (“You get a credit; you get a credit!”) But a credit that is rarely mentioned is both intriguing yet byzantine in application: SECURE 2.0’s Section 112: Military Spouse Retirement Plan Credits.

Where Did You Last See It (and How Does It Work)?

Perhaps even more mysterious: the Military Spouse Credit is found in Code Section 45AA, so looking at our trusty Code Section 45E (where most of the other credits are located) you won’t find it! Under the Military Spouse Credit, there are two credits that could be payable to small employers (that is, those with 100 or fewer employees making \$5,000 or greater in the preceding year):

The first credit is available if a non-highly compensated employee (HCE) military spouse (who can certify that status by providing the name, rank, and service branch of the spouse) is permitted under the terms of the plan to participate within two months of the date of hire into the retirement plan. This will earn the sponsor \$200 a year for the *first year of participation, and the two succeeding taxable years.*

A second credit of \$300 is available towards employer contributions to a non-HCE Military Spouse. But lest this appears too easy to earn, there are substantial caveats. For the contributions to count towards the credit, the participant needs to have employer contributions allocated as if they already had two years of service, and any allocations must be immediately vested.

Certainly, the altruistic intent is appreciated; spouses of military service people may find themselves consistently relocated, repeatedly unable to remain with any employer long enough to become eligible for deferrals, let alone employer contributions. Savers faced with this situation may find themselves discouraged, if not outright denied the ability, to utilize their workplace savings. Particularly for small employers located near military installations, this could not

only show support for the community but encourage greater participation for a precarious population of the workplace.

From a recordkeeper’s perspective, a number of questions arise to ensure a feature like this is implemented without a hitch. First, to have an accurate count of which participants generate this credit, the sponsor would need to know the status of both new hires and existing employees, as the credit starts when participation starts; it is reasonable to expect some people will enter the plan anew if these plan provisions encourage some existing employees. Notice 2024-02, the so-called SECURE 2.0 Grab-bag Guidance, clarifies that the relevant participation start date is the later of the date on which the plan or amendment to add the Military Spouse Credit is effective or the date on which the spouse begins participating in the plan after it added the provisions to qualify for the credit. Therefore, an existing participant would generate the credit for the employer in the first three years after the plan was amended to meet the requirements for the credit. [Notice 2024-02, § C-2]

The Military Spouse Credit is unique in several aspects. The credit is tied to the participation date and not plan effective date, so, in theory, could be taken indefinitely so long as new military spouse employees enroll in subsequent plan years. This means each credited participant (who has fewer than three years of participation) needs to be tracked individually. The big what-if to us is applying a special 100 percent vested status to this group only, while potentially needing to track other vesting, possibly for multiple sources for all other employees. Finally, a fun nugget to consider: while there are logical maximum limits on the total credits earned (an all-NHCE, all-military-spouse company would be limited to \$500 x 100 or \$50,000, and would need employee turnover to continue earning new credits), it has the potential to be the largest credit to an employer over the first years of a plan, and then could continue indefinitely without any reductions or phaseouts.

Where Do We Start?

For an employer of a military spouse to take advantage of these options, the plan document must permit the special eligibility, participation, and vesting rules for military spouses either under the normal eligibility requirements (for example, if the plan provides generally for immediate eligibility and entry), or by amending the plan to specifically

permit special eligibility, participation, and vesting for the spouses, as discussed earlier in this column. Document amendments for changes related to SECURE 2.0 are not required by the Internal Revenue Service (IRS) until December 31, 2026, even for discretionary amendments. Therefore, it appears that you can go forward with applying the specific eligibility and vesting rules for military spouses to conform to SECURE 2.0 and the credit requirements, and you need only amend the plan to match what you did in 2026. On the other hand, if your change is broader, such that you are modifying these requirements for more than just the military spouses, it is likely a non-SECURE-related discretionary amendment, so that you should adopt it by the end of the year in which you make it effective. Start with reviewing the plan document and make sure to note the desired change so that plan provisions in your SECURE 2.0 restatement are correct or prepare the amendment before year end for a broader change, so that you will qualify for the tax credit.

Who Can Keep Track?

Unfortunately, this is one of the changes for which Congress had a wonderful intention, but that may be difficult to implement to get the desired outcome. At the writing of this column, we are unaware of any recordkeeper that has the ability to track a separate eligibility, enrollment, or vesting based on a military spouse code. At least for now, this will require a separate manual record by employee and manual adjustment to eligibility and participation if all participants are not already permitted to enter upon employment with 100 percent vesting for all sources.

A third-party administrator (TPA) that is taking care of plan compliance and administration may be the best service provider to assist the employer in reviewing the plan document for future required amendments, reviewing incoming census data for military spouse data provided by the employer, and calculating credits for appropriate military spouse participants. Even though administration software may not currently have specific coding available to allow special tracking, the TPA may be able to track multiple vesting schedules and multiple eligibility requirements or entry dates, perhaps for an additional fee. This

is something that they could incorporate into their services.

Who Processes the Credits?

The Military Spouse Participation, credit along with the other available tax credits for Small Employer Pension Plan Startup Costs and Small Employer Auto-Enrollment, are reported on Form 8881, which is filed as a supplemental schedule with the business tax return. However, questions on the Form include the number of eligible participating military spouse employees, and the dollar amount of contributions paid by the employer for these employees. An employer can do this tracking itself; however, if the TPA has the military spouse information, it may also be able to provide this information to the plan sponsor and its CPA. Perhaps the TPA could find an additional line of service in providing the data for each of the retirement plan tax credits to plan sponsor for its tax filings. Would it be too much of a reach for a TPA to provide a draft Form 8881, perhaps for an additional fee, if it already has most of the data on hand? In our experience, many CPAs do not know to ask their plan sponsor clients if they are eligible for any of the plan-related credits until they have been notified by their client's TPA that those items are available for the applicable year. We suggest that the TPA fee for preparation of the information may be covered by the additional tax credit received by the employer.

Conclusion

The Military Spouse Participation credit may be the least discussed tax credit made available by SECURE 2.0 legislation. It will take some additional manual tracking, as well as amendments to retirement plans, for the employer to qualify to receive the available credits, but the result may be of good benefit to the military spouse who moves frequently and has better opportunity to participate in a plan through these accommodations and for the employer who may take advantage of the credits available for providing the military spouse with those additional opportunities. Kudos to those who make it work for a sector of the population that have had difficulty saving for retirement in the past as their spouses serve our country! ■

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