ASC ALERT

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Actuarial Systems Corporation



# IRS Issues Guidance on SECURE Act Changes to Safe Harbor 401(k) Plans

The Internal Revenue Service (IRS) has issued guidance on changes for safe harbor 401(k) plans under the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act). Section 103 of the SECURE Act eliminates certain safe harbor notice requirements and allows for retroactive adoption for 401(k) plans that provide for safe harbor nonelective contributions. Section 102 of the SECURE Act increases the 10 percent cap for Qualified Automatic Contribution Arrangement (QACA) safe harbor 401(k) plans. In IRS Notice 2020-86, the IRS provides helpful, but not comprehensive, guidance on these SECURE Act rules. The IRS is requesting comments on the Notice so changes or further clarifications may be forthcoming.

## Safe Harbor Notices

The SECURE Act eliminated the requirement to provide safe harbor notices for traditional and QACA safe harbor §401(k) plans that provide for only a safe harbor nonelective contribution. Notice 2020-86 confirms this change and clarifies several other issues:

- Traditional safe harbor 401(k) plans[1] that provide a safe harbor nonelective contribution, but also intend to pass the ACP safe harbor, still must provide safe harbor notices.
    - The ACP safe harbor provides that a plan is not required to satisfy the ACP test if it meets certain conditions (i.e., matching contributions may not be made with respect to elective deferrals in excess of 6% of compensation, discretionary matching contributions may not exceed 4% of compensation and rate of match may not increase as the rate of deferrals increase).
- Traditional safe harbor 401(k) plans that provide a safe harbor nonelective contribution and matching contributions which are not intended to satisfy the ACP safe harbor are not required to provide safe harbor notices. Such plans must perform the ACP test.
- QACA safe harbor 401(k) plans[2] that provide a safe harbor nonelective contribution are not required to provide safe harbor notices, even if the plan provides for matching contributions.
- The SECURE Act does not change any other notice requirements applicable to safe harbor 401(k) plans, including the annual notice applicable to EACAs and the effective opportunity notice.
- Safe harbor 401(k) plans must continue to provide the so-called "maybe-not notice" if they want to preserve the opportunity to reduce or suspend safe harbor contributions (other than for operating at an economic loss).
    - Generally, safe harbor notices have included this "maybe-not notice" statement. Since some safe harbor plans are no longer required to provide a safe harbor notice, a separate "maybe-not notice" will be necessary. Because some employers may have interpreted the new safe harbor notice rules as eliminating the "maybe-not notice" requirement, Notice 2020-86 provides special relief allowing employers to send out the notice by the later of (1) 30 days before the beginning of the plan year, or (2) January 31, 2021.
- The so-called "maybe notice" is not required for a 401(k) plan that is amended retroactively to adopt the safe harbor nonelective contribution design, unless the plan intends to satisfy the ACP test safe harbor.
    - The regulatory "maybe notice" rules require an employer to provide contingent and supplemental notices in order to retroactively amend a non-safe harbor 401(k) into a safe harbor nonelective contribution 401(k) plan.

**ASC Insight:** The new safe harbor notice requirements can be quite confusing, even after the IRS guidance in Notice 2020-86. For the 2021 safe harbor notices, some practitioners advised employers to continue to provide safe harbor notices as they have done in the past, including for plans providing for safe harbor nonelective contributions. Employers may wish to continue this practice in the future since there is no harm in providing safe harbor notices. Employers that want to avoid providing safe harbor notices will need to be sure that their plans meet the nuanced rules under Notice 2020-86.

See the table provided with this ASC Alert for examples of how different plan designs may be impacted by the new safe harbor notice requirements.

[1] A traditional safe harbor 401(k) plan is a 401(k) plan that satisfies the rules under Code §401(k)(12) by either providing for a 3% of compensation nonelective contribution or a safe harbor matching contribution.

[2] A QACA safe harbor 401(k) plan is an automatic enrollment 401(k) plan that satisfies the rules under Code §401(k)(13) by either providing a 3% of compensation nonelective contribution or a QACA safe harbor matching contribution.

## Retroactive Adoption of Safe Harbor Plan

The SECURE Act added new rules to permit an employer to amend its 401(k) plan after the beginning of a plan year to add a safe harbor nonelective contribution for the plan year, provided that:

1. the plan did not provide, at any time during the plan year, for safe harbor matching contributions for the plan year; and
2. the amendment is adopted before the 30th day before the close of the plan year. If the amendment is 30 days or less prior to the end of the plan year, but before the last day for distributing excess contributions for the plan year (generally, the end of the next plan year) the safe harbor nonelective contribution for that plan year must be at least 4% (rather than 3%).

This rule applies to both traditional and QACA safe harbor nonelective contribution plans. The retroactive adoption rules do not apply to the adoption of a safe harbor plan that provides for safe harbor matching contributions.

Notice 2020-86 clarifies certain rules applicable to the retroactive adoption rule. For example, if an employer amends its safe harbor nonelective plan to reduce or suspend safe harbor nonelective contributions, the employer may later readopt the safe harbor nonelective contribution design for the plan year.

Employers that retroactively adopt a safe harbor nonelective contribution plan for a plan year and make the required contribution after the due date of their tax return (including extensions) may not deduct the contribution for the prior tax year. For example, assume Corporation A (a C corporation with calendar tax and plan years) retroactively adopts a safe harbor 4% nonelective contribution plan for the 2020 plan year by the end of the 2021 plan year. Corporation A must make the safe harbor contribution by the due date of its 2020 tax return (i.e., October 15, 2021 (if extended)) to deduct the contribution for its 2020 tax year.

**ASC Insight:** Basically, the IRS is saying that the SECURE Act did not change the deduction timing rules. Practitioners will want to advise clients to make their retroactive adoption decision early enough to avoid unwanted deduction issues. Of course, employers who miss the deduction deadline for a tax year may still deduct the contributions for the tax year in which contributions are made, provided total contributions for the tax year are within the applicable deduction limit.

Employers utilizing the retroactive adoption rule do not need to amend their plans until the delayed amendment date (as provided in the SECURE Act and IRS Notice 2020-68). Generally, the delayed amendment date is the last day of the 2022 plan year.

**ASC Insight:** As an example, under the delayed amendment rule, if an employer retroactively adopts a safe harbor nonelective contribution plan for its 2020 or 2021 plan years, the formal plan amendment need not be executed until the end of the 2022 plan year. Of course, it should be clear that the employer intends to retroactively adopt a safe harbor nonelective contribution plan within the required timeframe. This can be done by using an operational checklist that states the employer's intent.

## Increase in Cap for QACA Safe Harbor 401(k) Plans

Effective for plan years beginning after December 31, 2019, employers may increase the maximum "qualified percentage" in their QACA safe harbor 401(k) plans up to 15%. The qualified percentage is the automatic (i.e., default) deferral percentage of compensation for employees that do not affirmatively elect a deferral percentage. For an employee's initial eligibility period, the qualified percentage must be at least 3% and not more than 10%. The SECURE Act did not change the maximum rate for the initial eligibility period.

Notice 2020-86 clarifies that employers that sponsor QACA safe harbor 401(k) plans are not REQUIRED to increase the qualified percentage. The qualified percentage may be any percentage of compensation, provided the percentage is applied uniformly, does not exceed the maximum percentage (10% for the initial eligibility period, up to 15% for subsequent years), and satisfies the minimum percentage requirements (generally 3% for the initial eligibility period).

Employers electing to increase the maximum qualified percentage have until the end of the 2022 plan year to amend their QACA safe harbor 401(k) plans for the SECURE Act changes, as confirmed in Notice 2020-86. The ultimate plan amendment will need to conform to the operational decisions the employer makes. One caution is for plans that incorporate the QACA cap by reference (i.e., the plan states that the qualified percentage will increase to the maximum allowed for QACA safe harbor plans). If an employer wishes to remove the incorporation by reference and provide for a qualified percentage below 15%, it must do so by the end of the 2022 plan year. Otherwise, the incorporation by reference will remain effective, retroactive to the 2020 plan year.

**ASC Insight:** Like many new laws and regulations, the SECURE Act provides practitioners with the opportunity to discuss plan design changes with clients. Although the QACA safe harbor 401(k) plan design has been less popular than the traditional safe harbor 401(k) plan design, employers should be made aware of their design options and the importance of effective implementation. For example, raising the maximum qualified percentage in a QACA safe harbor 401(k) plan to 15% would have a significant impact on automatically enrolled employees. Assessing this impact and timely communicating change are important so that employees are not "blindsided" by having higher amounts withheld from their compensation.

The incorporation by reference issue discussed above is not applicable to the ASC pre-approved QACA safe harbor 401(k) plans. The ASC plans require employers to elect a specific maximum qualified percentage. Until the SECURE Act Interim Amendment is released, this can be done by using an operational checklist that states the employer's intent.

# Application of New Safe Harbor Notice Rules to Different Plan Designs

| Plan Design | Is a Safe Harbor Notice Required?[1] |
|---|---|
| Non-safe harbor 401(k) plan | No |
| Traditional safe harbor nonelective contribution 401(k) plan with no matching contributions | No |
| Traditional safe harbor matching contribution 401(k) plan | Yes |
| Traditional safe harbor nonelective contribution 401(k) plan with matching contributions intended to satisfy the ACP safe harbor | Yes |
| Traditional safe harbor nonelective contribution 401(k) with matching contributions that are not intended to satisfy the ACP safe harbor (i.e., the plan will perform the ACP test) | No |
| QACA safe harbor nonelective contribution 401(k) plan with or without matching contributions | No |
| QACA safe harbor matching contribution 401(k) plan | Yes |
| Non-safe harbor 401(k) plan where employer may elect to convert to a safe harbor nonelective contribution plan after the beginning of the plan year (previously requiring a "maybe notice") and employer does not intend to satisfy the ACP safe harbor | No |
| Non-safe harbor 401(k) plan where employer may elect to convert to a safe harbor nonelective contribution plan after the beginning of the plan year (previously requiring a "maybe notice"), but employer intends to satisfy the ACP safe harbor | Yes |
| Traditional or QACA safe harbor nonelective contribution 401(k) plan that wishes to preserve the right to reduce or suspend contributions | No, but a plan must provide separate "maybe not" notice |
| Traditional or QACA safe harbor matching 401(k) contribution plan that wishes to preserve the right to reduce or suspend contributions | Yes (the safe harbor notice also should include the "maybe not" notice language) |

[1] The safe harbor notice refers to the notice required under Code §401(k)(12)(D) and Code §401(m)(11)(A)(ii). Other notice requirements, such as the annual EACA notice and the effective opportunity notice, still apply, if applicable.