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IRS GUIDANCE FOR SECURE ACT PROVISIONS FOR SAFE HARBOR PLANS

By: Susan M. Wright, CPA, APM
President, Coastal Retirement Consultants, LLC

On December 9, 2020, the IRS issued Notice 2020-86 (the Notice) providing guidance on the changes made under the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) with respect to safe harbor plans (including 401(k) and 403(b) plans). Specifically, the Notice provides guidance on §102 of the SECURE Act, which increased the maximum permissible automatic enrollment percentage under a QACA safe harbor plan from 10% to 15%. In addition, §103 generally eliminated the safe harbor notice requirements for plans that provide safe harbor nonelective contributions and added new provisions permitting retroactive adoption of safe harbor nonelective contributions, provided certain conditions are satisfied.

The Notice states that the guidance is not intended to be comprehensive. Rather, it is intended to provide initial guidance for plan sponsors regarding the provisions under §§102 and 103 of the SECURE Act while the Department of Treasury and IRS work together to develop regulations that will more thoroughly address the new provisions.

Increased automatic enrollment percentage for QACA Safe Harbor Plans

Section 102 of the SECURE Act increased the maximum permissible automatic enrollment percentage under a QACA safe harbor plan from 10% to 15%. This change is effective for plan years beginning after December 31, 2019. A 401(k) or 403(b) plan can operationally implement the new provision, provided a conforming amendment is adopted no later than the last day of the plan year beginning on or after January 1, 2022 (i.e., December 31, 2022, for calendar year plans). Note that collectively bargained plans have until the last day of the plan year beginning on or after January 1, 2024, to adopt a conforming amendment. In either case, the SECURE Act permits the deadline to be extended by the Secretary of Treasury, but no such extension has been granted at this time.

The Notice confirms that plans are not required to increase the maximum automatic enrollment percentage to 15%. In addition, the Notice provides guidance when plan amendments are required because of the changes made by §102 of the SECURE Act:

> Plans that incorporate the maximum percentage by reference. The Notice addresses the requirements for plans that reference the maximum automatic enrollment percentage under IRC §401(k)(13)(C)(iii) (which would be very rare) rather than explicitly stating the plan's maximum limit as a percentage of compensation. In this situation, if the plan sponsor wants to retain the 10% maximum (or something less than 15% but more than 10%), the plan will not be treated as failing to operate in accordance with the terms of the plan document provided a conforming amendment is adopted by the applicable deadline, (i.e., by the last day of the first plan year beginning on or after January 1, 2022, for plans other than collectively bargained plans).
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> Plans that do not incorporate the maximum percentage. If a plan document states the maximum automatic enrollment percentage and the plan sponsor wants to increase that percentage (up to a maximum of 15%), then a plan amendment would be required. The plan sponsor can apply the new limit in operation now and would not need to adopt a conforming plan amendment until the applicable deadline for adopting a conforming amendment under

the SECURE Act (generally the last day of the 2022 plan year).

Plans that elect to increase the maximum automatic enrollment percentage after that deadline must be amended in accordance with the general rules that apply to discretionary amendments (see Rev. Procs. 2016-37 and 2020-40).

Elimination of the safe harbor notice requirement for plans that provide safe harbor nonelective contributions

Section 103(a) of the SECURE Act generally eliminated the safe harbor notice requirement for plans that provide for safe harbor nonelective contributions. While this was welcome news to providers, the reality is that the number of plans to which this applies may be relatively small, as explained below. This change is effective for plan years beginning after December 31, 2019. The Notice provides guidance on the following issues related to §103(a) of the SECURE Act:

Safe harbor nonelective contribution plans with matching contributions. The Notice clarifies that if a 401(k) plan provides for safe harbor nonelective contributions and matching contributions designed to meet the ACP safe harbor requirements, the plan still must satisfy the safe harbor notice requirements to be exempt from ACP testing. This is because the SECURE Act did not amend the notice requirement under IRC § 401(m)(11)(A)(ii). Accordingly, plans that provide for safe harbor matching contributions remain subject to annual safe harbor notice requirements.

If a 401(k) plan provides for safe harbor nonelective contributions and matching contributions that are not structured to meet the ACP safe harbor requirements, (e.g., if elective deferrals in excess of 6% are matched, the plan would not be subject to the safe harbor notice requirements).

Elimination of notice requirement for QACA safe harbor nonelective plans. The SECURE Act also eliminated the annual notice requirement for QACA safe harbor plans that provide for safe harbor nonelective contributions. Because of how the QACA provisions are drafted in the code, Notice 2020-86 points out that a QACA that provides for safe harbor nonelective contributions and a matching contribution intended to satisfy the ACP safe harbor requirements would not be subject to the safe harbor notice requirements previously discussed. As a practical matter, however, this distinction is irrelevant because the Notice also points out that the participant notice requirements still apply with respect to the automatic enrollment arrangement under IRC §401(k)(13)(E) regardless of whether the QACA provides for safe harbor nonelective or matching contributions.

Other requirements still apply to traditional and QACA safe harbor nonelective contribution plans. The Notice points out that §103(a) of the SECURE Act did not make changes to any other requirements that otherwise apply to traditional and QACA safe harbor plans. For example, a plan that includes an eligible automatic contribution arrangement still must satisfy the notice requirements under IRC §414(w)(4), and participants must still be provided the opportunity to make changes to their deferral elections at least once per year (as required under Treas. Reg. §1.401(k)-1(e)(2)(ii)).

Requirements to reserve the right to reduce or suspend safe harbor nonelective contributions mid-year. The Notice addresses the question of whether a plan (traditional or QACA) that provides for safe harbor nonelective contributions would be able to amend the plan mid-year to reduce or suspend safe harbor contributions if the employer did not provide the safe harbor notice (for the first plan year beginning after December 31, 2019), but nevertheless provided a notice (within a reasonable period prior to the beginning of the plan year) stating that the plan could be amended mid-year to reduce or suspend safe harbor contributions.

The Notice states that such a plan would not fail to satisfy the requirements under Treas. Reg. §§ 1.401(k)-3(g)(1)(ii)(A)(2) or 1.401(m)-3(h)(1)(ii)(A)(2) merely because the employer provided a notice (other than an actual safe

harbor notice) stating that the plan may be amended mid-year to reduce or suspend safe harbor contributions provided all of the other regulatory requirements are satisfied (e.g., if notice is provided 30 days in advance of the effective date of the change, the plan is amended to provide the ADP and ACP tests will be satisfied using the current year testing method).

The Notice also provides a special rule for the first plan year beginning after December 31, 2020, stating an employer will be deemed to have provided the reduction/suspension notice within a reasonable period prior to the beginning of the plan year so long as the notice is given to eligible employees by the later of (1) 30 days prior to the beginning of the plan year, or (2) January 31, 2021.

The result is that if a plan (traditional or QACA) provides for safe harbor nonelective contributions, and the employer wants to reserve the right to reduce or suspend safe harbor contributions mid-year, advance notice must be provided (generally, 30 days prior to beginning of the following plan year). The retention of this annual notice requirement (albeit smaller) is the biggest surprise in the Notice. The American Retirement Association will be submitting comments to the IRS requesting that this requirement be eliminated.

Retroactive Adoption of Safe Harbor Nonelective Contributions

Sections 103(b) and 103(c) of the SECURE Act permit a 401(k) or 403(b) plan to be amended retroactively to provide for safe harbor nonelective contributions. This change is effective for plan years beginning after December 31, 2019. The Notice provides guidance on the following issues related to §§103(b) and 103(c) of the SECURE Act:

Retroactive adoption of safe harbor nonelective contributions for same plan year as deduction. The Notice addresses whether a plan that was previously amended to reduce or suspend safe harbor nonelective contributions mid-year would be subject to ADP testing and the top-heavy requirements if that plan is later amended to provide for safe harbor nonelective contributions in accordance with IRC §§401(k)(12)(F) or 401(k)(13)(F).

The Notice states that the ability of an employer to retroactively adopt the safe harbor nonelective contribution provisions is not conditioned on whether the plan was previously amended to reduce or suspend safe harbor nonelective contributions during the same plan year. As a result, the plan would not be subject to ADP testing (and would be exempt from the top-heavy requirements if the necessary conditions are satisfied; e.g., if no contributions are allocated other than elective deferrals and safe harbor contributions, all eligible NHCEs are entitled to share in the safe harbor contribution). Unfortunately, this confirmation of the law may have been issued too late for some sponsors–the sponsor of a calendar year plan that wants to become a safe harbor plan for the 2020 plan year is subject to the increased 4% nonelective contribution.

Keep in mind, however, that retroactive adoption would not be permissible in the case of a safe harbor matching contribution that was reduced or suspended mid-year. This is specifically prohibited under IRC §§401(k)(12)(F)(ii) and 401(k)(13)(F)(ii).

Retroactive adoption of safe harbor nonelective contributions funded after the employer's tax return due date. The Notice states that if an employer retroactively amends a plan to provide for safe harbor nonelective contributions and funds those contributions after the due date of the employer's tax return (including extensions), the contributions would be deductible in the year the contribution is made (subject to that year's deduction limit). Note, however, that safe harbor contributions must be funded by the last day of the following plan year (i.e., the deadline for issuing corrective distributions to correct an ADP testing failure under IRC §401(k)(8)(A)).

The "maybe" safe harbor plan rules. The Notice clarifies that the SECURE Act did not eliminate the notice requirements under IRC §401(m)(11)(A)(ii) with regards to matching contributions. If a traditional 401(k) plan

provides for matching contributions otherwise intended to satisfy the ACP safe harbor requirements, the requirements under Treas. Reg. §1.401(m)-3(g) apply (allowing adoption of a 3% safe harbor nonelective contribution up to 30 days before the end of the plan year). As a result, if an employer wants to retroactively amend a plan to provide for safe harbor nonelective contributions (to satisfy the ADP test) and the plan permits matching contributions that would satisfy the ACP safe harbor requirements, the regulatory requirements under Treas. Reg. §1.401(m)-3(g) would have to be satisfied for the plan to be exempt from both ADP and ACP testing for the plan year (i.e., the contingent notice and follow-up notices would have to be provided). Further, the amendment would have to be adopted no later than 30 days before the last day of the plan year.

For example, the ABC 401(k) plan is not a safe harbor plan and it includes a discretionary matching contribution that would otherwise satisfy the ACP test safe harbor (e.g., only deferrals up to 6% of compensation are taken account, the maximum match is 4% of compensation and there are no allocation conditions on the match). ABC provides a maybe notice to participants prior to the start of the 2021 calendar plan year. While a maybe notice is not needed for the nonelective safe harbor, a maybe notice is required if ABC wants to preserve the ability to be an ACP test safe harbor for 2021. ABC could adopt an amendment to be an ADP test safe harbor plan using the 4% nonelective contribution up until the last day of the 2022 plan year. But, the ABC plan would not be an ACP test safe harbor plan if the amendment is adopted after December 1, 2021 (i.e., later than 30 days before the end of the 2021 plan year). See Q&A-12 of Notice 2020-86.

Deadline for adopting retroactive amendments under §§103(b) and 103(c) of the SECURE Act. Section 601 of the SECURE Act provides that conforming amendments generally do not need to be adopted until the last day of the 2022 plan year (there is an additional two years for governmental and union plans). Because of this provision, the Notice states that an employer can adopt a retroactive amendment permitting safe harbor nonelective contributions for a given plan year by the later of (1) the general deadline for adopting conforming amendments under section 601 of the SECURE Act (i.e., by the last day of the plan year beginning on or after January 1, 2022), or (2) by the date required under IRC §§401(k)(12)(F) and 401(k)(13)(F).

For example, an employer could elect to be a safe harbor for a 2020 calendar year plan but delay adopting a conforming plan amendment until as late as December 31, 2022. (If adopted in December, the employer would need to make a 4% nonelective contribution.) The employer would need to fund any safe harbor contribution no later than December 31, 2021.

Request for public comment

Treasury and IRS requested written public comments on the guidance provided under Notice 2020-86, as well as any other aspect of §§102 and 103 of the SECURE Act. Comments can be submitted electronically or by mail, and the deadline for submitting such comments is February 8, 2021. The American Retirement Association will be submitting comments.