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Legal Developments

SECURE Act Changes to 401(k)/403(b) Safe Harbor Plans

This column explains the impact of the changes made to safe harbor plans by the SECURE Act.

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The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) made several notable changes to the rules for safe harbor plans, that is, plans that are not subject to Actual Deferral Percentage (ADP)/Actual Contribution Percentage (ACP) nondiscrimination testing. First, it lifted the cap on automatic deferrals to 15 percent (up from 10 percent) for Qualified Automatic Contribution Arrangement (QACA) plans. Second, it eliminated the annual notice requirement for plans with safe harbor nonelective employer contributions. Third, it expanded the ability to retroactively adopt safe harbor plans. IRS Notice 2020-86 explains the impact of these changes and is summarized below, in Question and Answer format.

Increased Cap on QACA Deferrals

For a QACA safe harbor plan, Internal Revenue Code (Code) Section 401(k)(13)(C) generally requires

that each employee eligible to participate be treated as having elected to make salary deferrals in an amount equal to a qualified percentage of compensation (unless they elect to contribute another amount or opt out of deferring).

What is the maximum qualified percentage of compensation? The maximum qualified percentage prior to the SECURE Act was 10 percent. Section 102(a) of the SECURE Act amended the Code to change the maximum rate to 15 percent (with a minimum of 3 percent and a maximum of 10 percent during the initial period of automatic contributions). This change was effective for plan years beginning after December 31, 2019.

Is a QACA plan required to increase the maximum qualified percentage? No. The qualified percentage under the QACA plan may be any percentage of compensation, as long as the percentage is applied uniformly, does not exceed the new maximum of 15 percent (or 10 percent for the initial period), and satisfies the minimums specified under the Code.

If the QACA plan incorporates the maximum qualified percentage by reference but the plan sponsor wants to retain the 10 percent limit, does the plan have an operational failure until the SECURE Act amendment is adopted? The plan's operations need to match plan language as of the end of the 2022 plan year (2024 for a governmental or collectively bargained plan), if the plan is amended retroactive to the first day of the plan year beginning after December 31, 2019. Therefore, each plan must be examined to see if the default top percentage for the QACA increase is as is desired, and then amend it if it is not. A timely amendment, if necessary, avoids an operational failure.

What plan amendment timing rules apply if an employer wants to adopt a higher qualified percentage? Similarly, plans that provide for an explicit percentage cap have until the end of the special SECURE Act amendment date to reflect the higher cap (generally the end of the 2022 plan year, as noted above). If implemented thereafter, the change is treated as a discretionary amendment and thus must be adopted by the end of the plan year in which the change is effective. Note that, as the change impacts elective deferrals during the year, it may be advisable to reflect the change in the safe harbor plan notice for the year, even if the amendment has not yet been adopted, as there are always added complexities for mid-year changes.

Annual Notice Requirements

Before the SECURE Act, the annual notice rules were relatively clear. Regardless of the type of safe harbor plan or contributions under the plan, a notice was required to be provided to employees eligible to participate in the plan. The notice informs eligible employees of their rights and obligations under the plan, and certain minimum benefits to eligible employees either in the form of matching or nonelective contributions. Following the SECURE Act, not all safe harbor plans are required to provide an annual safe harbor notice, as described in the Internal Revenue Service (IRS) Notice. The changes are effective for plan years beginning after December 31, 2019.

Does a traditional safe harbor plan still have to provide an annual notice? It depends. A traditional ADP safe harbor plan that provides for safe harbor nonelective employer contributions is no longer required to provide an annual safe harbor notice. However, a traditional ACP safe harbor plan is still required to provide an annual safe harbor notice (this is the case, regardless of whether the plan provides for ADP safe harbor matching contributions or safe harbor nonelective employer contributions). (As under existing rules, this can include a "maybe" notice if the employer has not yet decided to become a safe harbor plan.)

For example, if a traditional safe harbor plan provides safe harbor nonelective contributions to automatically pass ADP testing, but also provides non-safe harbor matching contributions that meet the requirements of Treas. Reg. 1.401(m)-3(d) (and, therefore, no ACP testing), an annual notice is required. But if this same ADP safe harbor plan instead provides for non-safe harbor matching contributions that are not designed to meet these regulations (and, therefore, are subject to ACP testing), no annual notice is required.

Does a QACA Plan still have to provide an annual notice? No, the SECURE Act eliminated the safe harbor notice requirement under 401(k) and 401(m) where the plan makes safe harbor nonelective contributions.

Does an EACA Plan still have to provide an annual notice? Yes. The SECURE Act did not change the annual notice requirement for Eligible Automatic Contribution Arrangements under Code section 414(w).

Does the SECURE Act make any other changes to safe harbor plans? No. For example, a cash or

deferred arrangement must provide employees with an effective opportunity, based on all the relevant facts and circumstances—including the adequacy of notice of the availability of a cash or deferred election—to make (or change) a cash or deferred election at least once during each plan year.

How do you satisfy the relief provision for safe harbor notices that indicate that the plan may be amended mid-year to reduce or suspend safe harbor nonelective contributions? The statement can be contained in a notice that otherwise satisfies the requirements for a safe harbor notice (and need not be an actual safe harbor notice).

Can a safe harbor plan reduce/suspend safe harbor nonelective contributions mid-year and later retroactively adopt safe harbor nonelective contributions for the entire plan year and avoid ADP/ACP testing and top-heavy rules? Yes. A retroactive plan amendment under Code Sections 401(k)(12)(F) and 401(k)(13)(F) is not affected by a prior reduction or suspension of safe harbor nonelective contributions during the plan year. Note that the requirements of Treas. Reg. Section 1.401(k)-3(e)(4) or 1.401(m)-3(f)(4) still apply to a plan that terminates and has a final plan year of less than 12 months.

Retroactive Safe Harbor Design

The SECURE Act expanded the ability to retroactively adopt a safe harbor plan design. Specifically, Section 103(b) of the SECURE Act added new Code Section 401(k)(12)(F) to permit a plan to be amended after the beginning of a plan year to provide safe harbor nonelective contributions for the plan year, provided that: (1) the amendment is adopted before the 30th day before the close of the plan year (or before the last day under Code Section 401(k)(8)(A) for distributing excess contributions for the plan year, if the safe harbor nonelective contributions for the plan year is at least 4 percent of each employee's compensation); and (2) the plan did not provide, at any time during the plan year, for safe harbor matching contributions.

SECURE Act Section 103(c) likewise added new Code Section 401(k)(13)(F), which provides similar rules for QACA safe harbor plans. These rules apply to plan years beginning after December 31, 2019.

When are retroactive safe harbor contributions deductible? For retroactive safe harbor 4 percent nonelective contributions made after the tax filing deadline for the prior taxable year (including extensions), the amounts are not deductible for the prior taxable year per Code Section 404(a)(6). Instead, they are deductible for the taxable year in which they are contributed to the plan, to the extent otherwise deductible under Code Section 404.

Do I comply with the Code or the existing regulations for a retroactive safe harbor design? Follow the revised Code provisions of Section 401(k)(12)(F), 401(k)(13)(F), or 401(m)(12), and not the existing regulations under Treas. Reg. Sections 1.401(k)-3(f) and 1.401(m)-3(g). However, for a traditional safe harbor design under Code Section 401(m)(11), the rules under Treas. Reg. Section 1.401(m)-3(g) (including both the contingent and follow-up notice requirements under Treas. Reg. 1.401(k)-3(f)) continue to apply.

What amendment timing rules apply to the retroactive safe harbor design? The amendment deadline set forth in Notice 2020-68 (generally the end of the 2022 plan year) applies, even if it is later than the deadline under Sections 103(b) or 103(c) of the SECURE Act. Thereafter, the amendment deadline under Sections 103(b) or 103(c) of the SECURE Act apply to these discretionary plan amendments.

403(b) Plans

A 403(b) plan can have a safe harbor design for purposes of passing ACP testing.

Does Notice 2020-86 apply to 403(b) plans? Yes. Notice 2020-86 applies on similar terms to 403(b) plans that apply the Code Section 401(m) safe harbor rules pursuant to Code Section 403(b)(12).

Conclusion

Safe harbor plans provide important nondiscrimination and top-heavy relief, and they just got a bit easier to implement and administer following the SECURE Act. For those with safe harbor plans, take a look and see if there are any changes that are worthwhile making, and in any event check the plan terms and operations to make sure any necessary plan amendment is adopted by the deadline (generally the end of the 2022 plan year). For those doing annual testing, don't forget to consider a safe harbor design option if testing is becoming problematic. ■