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IRS Guidance on SECURE Act Provides More Detail on Changes to Safe Harbor Plans

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The Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act") made several changes to the rules for certain safe harbor 401(k) plans. One change increased the cap on automatic enrollment safe harbor plans to 15%. Another eliminated certain safe harbor notice requirements for plans that make safe harbor nonelective contributions and added new provisions for the retroactive adoption of safe harbor plans that make nonelective contributions. On December 9, the IRS issued Notice 2020-86 to elaborate on these changes as summarized below.

If you have any questions, please do not hesitate to contact your regular Groom attorney or the authors listed below:

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Safe Harbor Plan Requirements – In General

Safe harbor 401(k) plans that satisfy the conditions in Section 401(k)(12) of the Internal Revenue Code ("Code") are deemed to satisfy the average deferral percentage ("ADP") nondiscrimination test. An alternative safe harbor is available under Code Section 401(k)(13), but only applies to qualified automatic contribution arrangements ("QACAs"). A 401(k)(12) safe harbor plan can include an automatic enrollment feature, but is not required to do so, and is not required to satisfy the QACA requirements. If the safe harbor 401(k) plan includes a matching contribution formula, the matching contributions may or may not be subject to the average contribution percentage ("ACP") nondiscrimination test.

To qualify for one of the ADP safe harbors, a 401(k) plan must, among other things, provide a fixed safe harbor contribution and meet certain notice requirements. The employer must make either a safe harbor matching contribution or a safe harbor nonelective contribution. A safe harbor match is met by providing the basic match formula: 100% match on the first 3% of compensation deferred plus 50%

match on the next 2% of compensation deferred. Alternatively, the employer can make a safe harbor nonelective contribution of at least 3% of the employee's compensation.

To be a QACA, not only must the plan provide either safe harbor nonelective contributions or matching contributions, but participants also must be automatically enrolled and treated as having made an election to have a specified contribution made on his or her behalf under the plan. The default contribution percentage is a minimum of 3% (and increases by 1% for the next three years). Under a QACA, a participant may defer at a rate above 10% only by affirmative election. (Note, also, that an affirmative election – a specific amount or no contributions – ends the default election.) If the employer is making a matching contribution, the basic matching formula under the QACA safe harbor is 100% of the first 1% of compensation deferred by the employee, plus 50% of the next 5% of compensation deferred by the employee. The nonelective contribution is the same for a QACA as a 401(k)(12) safe harbor plan: 3% of an employee's compensation.

As a general rule, a safe harbor plan must be in place for an entire year and a safe harbor notice explaining the features of the plan must be provided within a reasonable period before the beginning of the plan year (or within a reasonable period before an employee becomes eligible to participate in the plan).

What the SECURE Act Changed

The SECURE Act increases the maximum amount of the automatic contribution from 10% to 15%.

The SECURE Act also permits a safe harbor plan with nonelective contributions to be adopted mid-year as long as it is adopted before the 30th day before the end of the plan year (or before the last day of the following plan year if it requires contributions in the amount of at least 4% of compensation) and as long as the plan did not include safe harbor matching contributions during the year.

Finally, the SECURE Act generally eliminated the safe harbor notice requirement for safe harbor plans (both traditional and QACA) that provide nonelective employer contributions.

All of the changes are effective for plan years beginning after December 31, 2019.

Notice 2020-86

Notice 2020-86 addresses some open questions regarding the expanded cap on QACA automatic deferrals, the mid-year adoption of a safe harbor plan with nonelective contributions, and the elimination of the safe harbor notice for these types of plans.

Automatic deferral maximum – The IRS makes it clear that employers are not required to lift the 10% cap on the automatic deferrals to 15%. However, if the plan only includes a reference to the maximum and wants to continue to apply the current 10% maximum, the plan must be amended by the SECURE Act amendment deadline (generally, the end of the 2022 plan year) to explicitly say so. If the plan is not timely amended, an "operational failure" will arise.

Safe Harbor Notice – The Notice also clarifies that the elimination of the safe harbor notice for traditional safe harbor plans that provide nonelective contributions does not apply if the plan also provides non-safe harbor matching contributions that are not required to satisfy the ACP test. Neither is the notice eliminated for eligible automatic contribution arrangements ("EACAs") that happen to have nonelective contributions that satisfy the traditional or QACA safe harbor requirements. Where the notice is not eliminated, the plan must provide a contingent and follow-up notice if previously required. Under the guidance, the notice *is* eliminated for a matching contribution QACA with nonelective contributions.

With the elimination of the safe harbor notice, how would a plan sponsor provide notice in order to preserve the right to make a mid-year reduction or suspension of nonelective contributions? Notice 2020-86 indicates any type of notice is okay and, for 2021 only, may be provided as late as January 31, 2021 (for calendar year plans).

Additional Employer and Plan Sponsor Considerations

- An employer may re-adopt a safe harbor plan mid-year even if it had previously reduced or suspended contributions in the same plan year.
- Safe harbor nonelective contributions are only deductible for the prior year if made by the tax return due date (with extensions), even though they can be made later that year in compliance with safe harbor requirements.
- Plans with a matching contribution that must provide a safe harbor notice and want to preserve the possibility of later changing to a nonelective contribution safe harbor must include contingent language in the notice, and must provide a follow-up notice if the plan is amended.

Comments are requested on Notice 2020-86 and any other related aspect of the SECURE Act. Comments are due by February 8, 2021.