Patterson Belknap Webb & Tyler LLP

Employee Benefits and Executive Compensation Alert October 26, 2020

SECURE ACT Update: Changes to Safe Harbor Notice Rules, New Birth or Adoption Distributions, and Increased Penalties for Missed Filings

The Setting Every Community Up For Retirement Enhancement Act of 2019 (the "SECURE Act"),[1] made sweeping changes to retirement plan rules. As described in our prior alert, available here, certain provisions took effect immediately and were required to be implemented by retirement plans shortly after the passage of the SECURE Act.

As part of our series of continuing updates on certain other aspects of the SECURE Act that may impact (or provide opportunities for) employers that sponsor retirement plans, this alert briefly summarizes certain changes under the SECURE Act relating to safe harbor notices, a new birth or adoption distribution event, and the increased penalties for certain failures to file retirement plan returns.

401(k) Safe Harbor Notice and Amendment Rules Regarding Nonelective Contributions

401(k) plan sponsors electing safe harbor status have been required to send out notices to all eligible participants within a reasonable period prior to the start of each plan year for which safe harbor status is to apply. The SECURE Act eliminated this notice requirement for safe harbor plans that satisfy the safe harbor contribution rules by making nonelective employer contributions of at least 3% of covered compensation. Safe harbor notices are still required, however, for plans that satisfy the safe harbor rules through matching contributions.

Further, the SECURE Act provides that for plans that wish to obtain safe harbor status through the making of nonelective safe harbor contributions, so long as the plan had not, during the plan year, provided for safe harbor status through matching contributions, plans may be amended to so provide (1) any time before the 30th day before the end of plan year or (2) on or after the 30th day before the end of the year, but only if the amendment is made by the end of the following plan year and the nonelective employer contribution rate is at least 4% of covered compensation.

These SECURE Act changes apply to plan years beginning after December 31, 2019.

Qualified Birth or Adoption Distributions

Under the SECURE Act, 401(k) plans, other 401(a) defined contribution plans, 403(b) plans and governmental 457(b) plans may permit qualified birth or adoption distributions to be made. While generally taxable, qualified birth or adoption distributions from a qualified defined contribution plan or IRA are exempt from the additional 10% early withdrawal tax that might otherwise apply, even if the withdrawal occurs before the participant is 59½ years old. The withdrawal eligible for that treatment is capped at a maximum of $5,000, per birth or adoption, and must be made during the one-year period beginning on the date on which the child is born or on which the adoption (for a child under the age of 18) is finalized.

An individual is permitted to receive qualified birth or adoption distributions with respect to the birth or adoption of more than one child (such as twins or triplets), provided that the distributions are made during the applicable one-year period. The $5,000 cap described above applies to all plans maintained by the employer or any member of the employer's controlled group. The cap also applies on an individual basis, meaning that each parent may separately

[1] The SECURE Act was passed as Division O of the Further Consolidated Appropriations Act, 2020.

withdraw up to $5,000 from an eligible retirement plan or IRA that permits such distributions without triggering the 10% early distribution tax.

Qualified birth or adoption distributions may be recontributed to a plan eligible to receive a rollover contribution from the distributing plan, or to an IRA – with such recontribution treated like an eligible rollover contribution. The employer plan from which the distribution was made must accept the repayment if the participant is otherwise eligible to make rollover contributions to the plan. While IRS guidance has been issued generally treating a recontribution of a qualified birth or adoption distribution like a rollover, additional guidance has not yet been issued regarding appropriate tax protocols to apply if that recontribution occurs after the year of the qualified birth or adoption distribution.

Employers are not, however, required to permit in-service distributions for qualified birth or adoption distributions as plan amendments to permit such distributions may be implemented on an optional basis. The SECURE Act's provisions regarding qualified birth or adoption distributions apply on and after December 31, 2019.

Plan Amendment Deadlines

Qualified birth or adoption withdrawal plan amendments (retroactive to the first day as of which the changes were first operationally implemented) will not be required to be adopted any earlier than the last day of the first plan year beginning on or after January 1, 2022 (or the last day of the first plan year beginning on or after January 1, 2024 for certain collectively bargained and governmental plans).

Increased Penalties for Failure to File Retirement Plan Returns

Deferred Compensation Plan Filings (Forms 5500)

IRC Section 6058 requires that employers maintaining most pension, annuity, profit-sharing or other funded deferred compensation plans file annual reports disclosing plan information with respect to the qualification, financial condition and operation of such plans. Plan administrators of defined benefit plans subject to the minimum funding requirements under IRC Section 412 must file annual actuarial reports. Both requirements are met by filing a Form 5500 disclosing the required information. A failure to file the Form 5500 may result in a civil penalty (which may be waived if it is shown that such failure is due to reasonable cause). Under prior law, the civil penalty that could be imposed by the IRS could be up to $25 for each day during which the failure continued, up to a maximum of $15,000. SECURE Act Section 403 provides for a material increase in this penalty: up to $250 per each day during which the failure continues, subject to a maximum of $150,000.

In addition to IRS penalties, the Department of Labor (the "DOL") may also impose penalties for a failure to file a timely Form 5500. As of this year, DOL penalties can be imposed up to $2,233 per day, with no maximum (this amount was unchanged by any SECURE Act provisions, but did increase from $2,194 in January 2020). However, the DOL also provides significant relief from the potential DOL penalties through its Delinquent Filer Voluntary Compliance Program ("DFVCP"). The program encourages plan administrators to self-correct violations of law and provides for substantially reduced and capped penalties for late Form 5500 filers. While the DFVCP pertains to DOL penalties, the IRS will generally also waive its late filing penalties for Form 5500 filers who qualify for DFVCP relief.

Pension Plan Annual Registration and Notification of Change of Status

Plan administrators of plans subject to the vesting requirements of ERISA must file registration statements with respect to certain plan participants with deferred vested benefits. Those statements are filed via form 8955-SSA.

Failure to file a registration statement will generally result in a civil penalty of up to $1 for each participant, multiplied by the number of days in which the failure occurs, subject to a maximum penalty of $5,000. The SECURE Act has increased the potential civil penalty to be up to $10 per applicable participant, with a maximum penalty of $50,000.

Plan administrators must also notify the IRS of any registration changes, including but not limited to, a change in the plan name or the name or address of the plan administrator on Form 8822-B. Failure to provide this information can result in a penalty of up to $1 for each day during which the failure continues, subject to a maximum penalty of $1,000. The SECURE Act has increased the potential civil penalty to be up to $10 per each day of failure and a maximum penalty of $10,000.

Withholding Notices

Typically, distributions from tax-advantaged employer-sponsored retirement plans and IRAs are subject to withholding requirements, except in the case of certain distributions where payees may elect not to have withholding apply. In such cases, plan administrators or IRA custodians must provide payees with notice of their right to make withholding elections. Failure to provide notice can result in a civil penalty of up to $10 for each failure, subject to a maximum penalty of $5,000 for all failures during any calendar year. The SECURE Act has increased the civil penalty to be up to $100 per failure and a maximum penalty of $50,000 for all failures during any calendar year.

These SECURE Act changes apply to all returns (including extensions) and statements required to be filed, and notifications required to be provided, after December 31, 2019.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

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