

Updated Safe Harbor Special Tax Notice (402(f) notice) & Lifetime Income Illustrations: Key Points for Plan Fiduciaries

A Lexis Practice Advisor® Article by
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This article discusses the IRS's recent update to its safe harbor Special Tax Notice required to be provided to plan participants about to receive a distribution from a tax qualified plan as part of the election package. I.R.S. Notice 2020-62. The latest update addresses legislative changes made by the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) and the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The notice generally is intended to provide information to participants about the rollover opportunities for such distributions and other special tax provisions. The updated notice reflects the provisions of the law as of August 6, 2020 and should be used as soon as possible for upcoming plan distributions. It should be noted the Special Tax Notice is not required to be provided when the plan is making a qualified birth or adoption distribution or special coronavirus distribution. Changes made to the Special Tax Notice by the SECURE Act and CARES Act are discussed in more detail below.

Further out on the horizon, individual account plans (e.g., 401(k) plans) will be required to provide "lifetime income illustrations" on at least one benefit statement provided to participants during a 12-month period as a result of provisions included in the SECURE Act, passed in late December 2019. The U.S. Department of Labor's Employee Benefits Security Administration (EBSA) published an [interim final rule](#) laying out how plan fiduciaries can satisfy this requirement. This disclosure requirement will be effective one year after publication of the final rules. In the meantime, employers have the opportunity to comment on the rules to help shape the final provisions. Five key points that you should know about the interim final rule on lifetime income illustrations are described below.

Special Tax Notice

Internal Revenue Code (IRC) Section 402(f) requires that the plan administrator of a qualified plan is required, within a reasonable period of time before making an eligible rollover distribution, to provide the distributee with the written explanation described in Section 402(f) (the § 402(f) notice). I.R.C. § 402(f); Treas. Reg. § 1.402(f)-1. Generally, the notice must be given no later than 30 days prior to a distribution and not earlier than 180 days prior. Previously, the Internal Revenue Service (IRS) published two safe harbor explanations reflecting relevant law as of September 19, 2018: one addressing payments from non- Roth Accounts and the other for payments from Roth Accounts. A plan with both types of accounts will need to provide both notices or combine the notices to address all types of accounts. Plan administrators are permitted to modify the safe harbor notice to delete information that does not apply to the plan.

The updated notices address the following provisions of the SECURE Act and the CARES Act:

- **Treatment of distributions for birth or adoption.**

The elimination of the 10% early distribution penalty applicable to distributions that qualify for the birth or adoption exception.

- o The SECURE Act amended IRC Section 72(t) to permit an individual to receive up to \$5000 for a qualified birth or adoption distribution from an eligible retirement plan (other than a defined benefit plan). The distribution is not subject to the 10% additional tax typically applicable to distributions made before reaching age 59-1/2. The distribution will qualify to the extent it is made within the 1-year period beginning on the date on which the child is born or legally adopted.

- **Increase in the RMD age to 72.** The increase in the age at which required minimum distributions must begin from 70-1/2 to age 72 for employees born after June 30, 1949.

The updated notices also include minor modifications to improve their clarity. The IRS has stated that the safe harbor explanations will not satisfy Section 402(f) to the extent that law changes occur after August 6, 2020 that might change the explanations.

Practice Point

Employers should take steps to make sure the updated notices are being included in distribution packages going forward. Also, the notices provided by third party administrators should be reviewed to determine if extraneous information is included in the notice. Consider whether customizing the notice to eliminate provisions that do not apply will enhance participants' understanding of the applicable rules.

Employers must continue to be aware of law changes affecting distributions. Should changes occur, employers may need to revise their notices even before the IRS issues future updates.

Lifetime Income Illustrations

Background

Section 105 of the Employee Retirement Income Security Act of 1974, as amended (ERISA), requires administrators of defined contribution plans to provide participants with periodic pension benefit statements. ERISA §

105 (29 U.S.C. § 1025). Benefit statements must be furnished at least annually, or at least quarterly if the plan allows participants to direct their own investments in their individual accounts. Benefit statements indicate a participant's "total benefits accrued" (i.e., a lump sum amount) based on the participant's account balance in the plan. Section 105 of ERISA was amended by the SECURE Act to require plan administrators to include **two illustrations** of a participant's account balance converted to a lifetime income equivalent:

- One as a single life annuity (SLA) –and–
- Another as a qualified joint and survivor annuity (QJSA)

The illustrations must be provided at least annually. The SECURE Act also directed the Department of Labor to prescribe the assumptions necessary to convert an account balance into an SLA and QJSA and to issue model disclosures for lifetime income illustrations.

Overview of Assumptions for Lifetime Illustrations

The interim final rule sets forth the five assumptions that will be applied to the participant's account balance to calculate the lifetime income illustrations. [DOL, Fact Sheet, Pension Benefit Statements – Lifetime Income Illustrations.](#)

Note that even though the lifetime income illustrations are required to show the form of payment as annuities, EBSA has emphasized that neither the interim final rule nor the SECURE Act requires defined contribution plans to offer an annuity distribution option.

Where in-Plan Annuities Offered

Defined contribution plans that offer in-plan distribution annuities through a contract with a licensed insurer may use the interim final rule's assumptions to calculate the lifetime income illustrations, or the actual terms of the plan's insurance contract, provided that the illustrations assume that: (1) payments commence on the last day of the statement period, (2) the participant is age 67 (unless older) on such date, and (3) the participant has a spouse the same age.

Model Language

To ease the burden on plan administrators, the interim final rule includes model language that may be used to explain what the lifetime income illustrations mean, and the assumptions used to calculate those illustrations.

Practice Point

Plan administrators who desire to use the model language have flexibility to either:

- Insert the model language into their existing pension benefit statements, without disturbing the existing format and presentation of those statements –or–
- Insert into or attach the “Model Benefit Statement Supplement” included in the interim final rule to their pension benefit statements.

Relief from Liability

Plan fiduciaries that use the regulatory assumptions and the model language prescribed by the rule, or language that is substantially similar in all respects, will not be held liable in the event participants are unable to purchase equivalent monthly payments.

Effective Date of Interim Final Rule

The interim final rule will be effective 12 months after the date of its publication in the Federal Register. As of this publication the interim final rule has not been published in the Federal Register. Comments on the interim final rule are due 60 days following publication in the Federal Register. Written comments, identified by RIN 1210-AB20, may be submitted at www.regulations.gov.

Related Content

Lexis Advance and Lexis Advance Tax

- Lexis Explanation IRC Sec. 402(f)
- Taxation of Executive Compensation § 8.17, “Reporting and Disclosure: Plan Administrator,” paragraph 8.17[2][c] (2020)
- I.R.S. [Notice 2020-62](#)
- 85 Fed. Reg. ____ (Sept. --, 2020); [Interim Final Rule](#)
- [DOL, Fact Sheet, Pension Benefit Statements – Lifetime Income Illustrations.](#)
- [DOL, News Release](#)

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- [Lifetime Income Benefit Rules for Defined Contribution Plans under the SECURE Act](#)
- [Required Minimum Distribution Rules for Defined Contribution Plans](#)
- [Retirement Plan Provisions of CARES Act](#)
- [SECURE Act Brings Numerous Retirement Plan Changes](#)
- [Qualified Retirement Plan Fundamentals](#)
- [Electronic Disclosure Rules \(ERISA Safe Harbors\)](#)
- [Eligible Rollover Distribution Notice \(Non-Roth Contributions\)](#)
- [Eligible Rollover Distribution Notice \(Roth Contributions\)](#)
- [ERISA Fiduciary Duties](#)
- [Investment Committee Issues for Defined Contribution Plans](#)

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Evelyn Traub is a partner in the Richmond office and focuses her practice on employee benefits. She represents large public and privately held companies and governmental entities in a broad array of employee benefits and executive compensation matters. She regularly advises on the design, implementation and administration of tax qualified retirement plans (including 401(k), 403(b), governmental 457, profit sharing, traditional and cash balance pension plans), non qualified retirement plan, (including SERPs and deferred compensation plans) and welfare benefit plans (including group health plans, MEWAs, severance plans and cafeteria plans). With more than 35 years experience, Evelyn brings an in-depth knowledge of the Internal Revenue Code, ERISA and other applicable laws, the governmental agencies that enforce them and extensive practical experience in addressing the day to day issues that arise in the design and administration of employee benefits.

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