

From the IRS Spring 2009 issue of Retirement News for Employers:

Do You Have a Safe Harbor 401(k) Plan? Ahhh...Relief

The IRS, on May 18, 2009, published [proposed regulations](#), *Suspension or Reduction of Safe Harbor nonelective Contributions*, that would amend Regulations under Code §§401(k) and 401(m). These proposed regulations provide employers incurring a [substantial business hardship](#) an alternative to terminating their §401(k) safe harbor plans.

Employers meeting certain requirements can reduce or suspend required safe harbor nonelective contributions without losing their plan's qualified status.

Background

Plans that contain a [qualified cash or deferred arrangement](#) (CODA) allow eligible employees to make a cash or deferred election with respect to their wages, meaning, these employees get to choose whether part of their wages are contributed as elective contributions to the plan or paid to them in cash. A qualified CODA must satisfy certain nondiscrimination requirements, including either the [actual deferral percentage](#) (ADP) test or one of the safe harbors under §401(k)(11), (12) or (13). A plan that allows employee contributions or provides for employer matching contributions is required to satisfy another nondiscrimination requirement called the [actual contribution percentage](#) (ACP) test or one of the safe harbors under §401(m)(10), (11) or (12). Generally, a plan that meets the safe harbor requirements is also exempt from the [rules for top-heavy plans](#).

A plan that that intends to be a §401(k) safe harbor plan must:

- adopt a safe harbor plan before the beginning of the plan year that specifies whether the employer will make matching or nonelective contributions;
- maintain the safe harbor plan throughout a full 12-month plan year subject to certain exceptions (explained below);
- notify each eligible employee within a reasonable period before the beginning of each plan year of his or her rights and obligations under the plan; and
- make either matching or nonelective contributions at least as great as the rates required by its safe harbor.

There are two exceptions to the general requirement that an employer maintain a §401(k) safe harbor plan throughout a full 12-month plan year. An employer may:

1. amend a plan to reduce or suspend safe harbor matching contributions on future employee elective contributions for a plan year, or
2. terminate its safe harbor plan during the plan year.

Requirements for reducing or suspending §401(k) safe harbor matching contributions:

An employer must amend the plan to provide for the reduction or suspension and to satisfy all applicable nondiscrimination tests for the entire plan year. The effective date of the amendment cannot be earlier than 30 days after the plan notifies eligible employees of the suspension or reduction. Eligible employees must be given a reasonable opportunity to change their salary deferral elections after receipt

of the notice. The plan must make all safe harbor matching contributions up to the amendment's effective date and must prorate the §401(a)(17) compensation limits.

Requirements for terminating a §401(k) safe harbor plan during the plan year:

An employer must make all required §401(k) safe harbor matching contributions through the date of termination. It must demonstrate that the plan would have satisfied all the requirements for amending the plan to reduce or suspend safe harbor matching contributions (other than the requirement that employees have reasonable opportunity to change their elections).

Alternatively, the plan may terminate if the termination is in connection with a transaction described in §410(b)(6)(C) (minimum coverage requirement in certain situations involving acquisitions and dispositions) or if the employer incurs a *substantial business hardship* (comparable to a substantial business hardship under §412(c), previously under §412(d)).

Some factors taken into account to determine if an employer has suffered a *substantial business hardship* include whether:

- the employer is operating at an economic loss,
- there is substantial unemployment or underemployment in the trade or business and in the industry concerned, and
- the sales and profits of the industry concerned are depressed or declining.

Provisions of the proposed regulations:

The proposed regulations allow an employer that suffers a *substantial business hardship* to amend its plan to reduce or suspend the plan's safe harbor nonelective contributions if all the following requirements are satisfied:

- the plan is amended prior to the end of the plan year to reduce or suspend the safe harbor nonelective contributions;
- the plan as amended, provides that the ADP test (and ACP test if applicable to the plan) will be satisfied for the entire plan year in which the safe harbor nonelective contributions are reduced or suspended;
- all eligible employees must be given a "supplemental notice" that explains the reduction or suspension of future safe harbor nonelective contributions and its consequences, the procedures for changing employee elections and the effective date of the amendment;
- the reduction or suspension of the safe harbor nonelective contributions can occur no earlier than 30 days after giving eligible employees the supplemental notice and the amendment's adoption date, if later;
- all eligible employees must be given a reasonable period of time after they receive the supplemental notice (but prior to the reduction or suspension of the safe harbor nonelective contributions) to change their salary deferral elections; and
- the §401(a)(17) compensation limits must be prorated.

A plan that amends to reduce or suspend safe harbor nonelective contributions will be subject to the rules for top-heavy plans. These proposed regulations are effective for amendments adopted after May 18, 2009 but plans may rely on them pending issuance of final regulations. To the extent the final regulations are more restrictive than these proposed regulations, they will not be applied retroactively.