



ERISA ALERT

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401(k) Plan Relief From Safe Harbor Contributions

If you are an employer facing financial difficulties in the current economic climate, here is some welcome news: the IRS has issued proposed regulations that provide relief for 401(k) plans that are obligated to make non-elective safe harbor contributions.¹ Prior to the proposed regulations, which you can rely on now, the only way many employers could relieve the burden of the non-elective contribution requirements associated with the safe harbor plan designs was to terminate their 401(k) plan.

Background

In 1999, Congress amended the Internal Revenue Code to allow 401(k) plans to adopt a safe harbor plan design to reduce the administrative burdens associated with performing the annual discrimination tests applicable to 401(k) plans (i.e., the average deferral percentage (ADP) test and the average contribution percentage (ACP) test). Employers that adopted the design are deemed as automatically satisfying the ADP and ACP tests. The principal component of the safe harbor plan design was the requirement to commit to one of two alternative mandatory contribution formulas:

(a) make a non-elective employer contribution equal to 3% of compensation for each eligible employer, or

(b) make a matching contribution equal to 100% of an employee's deferral up to the first 3% of compensation and 50% of an employee's deferral for the next 2% of compensation.

Once the non-elective contribution safe harbor plan design (i.e., contribution formula (a) above) was adopted, the employer was committed to the contribution for the duration of the year, unless they adopted the safe harbor on a contingent basis and notified employees before the beginning of the plan year. Existing IRS regulations allowed for the suspension of the safe harbor matching contribution plan design (i.e., contribution formula (b) above).

Proposed Regulations

After industry trade groups requested relief, the IRS issued proposed regulations to permit an employer sponsoring a 401(k) safe harbor plan design that incurs a substantial business hardship to reduce or suspend its non-elective safe harbor contributions to the 401(k) plan. The proposed regulations are effective for amendments adopted after May 18, 2009, and employers may rely on the proposed regulations pending the issuance of final regulations.

Under the proposed regulations, the employer must incur a substantial business hardship—such as operating at an economic loss, substantial unemployment in the employer's industry, and depressed or declining sales and profits in the employer's industry—to reduce or suspend non-elective contributions.

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If the employer has incurred a substantial business hardship, it can reduce or suspend non-elective safe harbor contributions if:²

- the reduction or suspension is effective at least 30 days after it is adopted and employees are notified;
- the employer gives employees a reasonable opportunity prior to the reduction or suspension to change their deferral elections;
- the employer amends the 401(k) plan to satisfy the ADP and ACP tests for the entire year; and
- the employer pays the non-elective safe harbor contributions through the effective date of the reduction or suspension.

The notice given to employees explaining the reduction or suspension of the non-elective contributions must explain: (i) the consequences of the amendment reducing or suspending the non-elective safe harbor contributions; (ii) the procedures for changing their deferral elections under the 401(k) plan; and (iii) the effective date of the amendment.

What To Do Now?

The proposed regulations provide an opportunity for employers sponsoring 401(k) plans with safe harbor plan designs to review the plans' contribution obligations and the associated costs. Reducing or suspending your safe harbor contributions will save you money, and Herrick can guide you through the process.

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¹Proposed Regulation §§ 1.401(k)-3 & 1.401(m)-3 (74 F.R. 23134, 5/18/09).

²The requirements for reducing or suspending the matching contribution safe harbor plan design during a year are similar to the requirements for reducing or suspending the non-elective contribution plan design except that the employer is not required to incur a substantial business hardship. See Treasury Regulation § 1.401(k)-3(g).