

Treasury Proposes Regulations on Relief for Employers Sponsoring 401(k) Safe Harbor Nonelective Contribution Arrangements

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The IRS has issued guidance, in the form of proposed regulations, that would permit an employer suffering a *substantial business hardship* to suspend 3% safe harbor nonelective contributions to its 401(k) or 403(b) plan during a plan year provided the employer timely amends the plan and satisfies a number of other conditions. This *asap* will deal only with 401(k) issues.

ASPPA was concerned that, under prior regulations, the only alternative for an employer that could not afford to make the safe harbor nonelective contributions for the entire plan year was to terminate its 401(k) plan. In the current economy, many such plans would be terminated, unnecessarily depriving participants of the opportunity to save for retirement. ASPPA's Government Affairs Committee (GAC) submitted written comments to the Treasury Department and ASPPA's president testified at a hearing of the House Committee on Small Business regarding these concerns. On May 18, 2009, the Treasury Department published the much-anticipated proposed regulations which addressed several of GAC's concerns. The proposed regulations may be relied upon immediately. The full text of the proposed regulations is available at <http://edocket.access.gpo.gov/2009/pdf/E9-11481.pdf>.

Background – Prior Law

IRC §401(k)(12) provides for a safe harbor method under which a 401(k) plan is treated as satisfying ADP and ACP tests, if the arrangement satisfies certain contribution and notice requirements. A plan can satisfy the safe harbor employer contribution requirements by electing to make specified matching or nonelective contributions for all eligible NHCEs. Under prior Treasury Regulations, plans electing to use the 3% safe harbor nonelective contribution option as of the beginning of the year could not eliminate the employer contribution requirement mid-plan year without terminating the entire plan (Treas. Reg. §1.401(k)-3(e)). In contrast, a plan may suspend safe harbor matching contributions during a plan year, provided reasonable notice (30 days) is given to the employees and matching contributions are made through the notice period. (Also note that plans using the "maybe" notice for 3% safe harbor nonelective contributions may elect to make, or not make, the nonelective contribution as late as 30 days before the end of the plan year.)

Proposed Regulations

The proposed regulations permit an employer to reduce or suspend safe harbor nonelective contributions during a plan year, under rules generally comparable to the provisions relating to the reduction or suspension of safe harbor

matching contributions, with the additional condition that the employer incur a substantial business hardship. As a result, the proposed regulations provide the employer with an alternative to the option of terminating its safe harbor plan when the employer is affected by an economic downturn and finds itself struggling to make required safe harbor nonelective contributions.

Under these proposed regulations, a plan that reduces or suspends safe harbor nonelective contributions will not fail to satisfy IRC § 401(k)(3), provided that:

- all eligible employees are provided notice of the reduction or suspension;
- the change is effective no earlier than the later of thirty (30) days after eligible employees are provided the supplemental notice and the date the amendment is adopted;
- eligible employees are given a reasonable opportunity prior to the reduction or suspension of the safe harbor nonelective contributions to change their deferral elections;
- the plan is amended to provide that the ADP and/or ACP test will be satisfied for the entire plan year in which the reduction or suspension occurs, using the current year testing method; and
- the plan satisfies the safe harbor nonelective contribution requirement with respect to safe harbor compensation paid through the effective date of the amendment. Note that the annual compensation limit under IRC §401(a)(17) must be prorated through the safe harbor period for purposes of determining the employer contribution.

With respect to the notice requirement, the requirement is satisfied if each eligible employee is given a notice that explains: (1) the

consequences of the amendment reducing or suspending future safe harbor nonelective contributions; (2) the procedures for changing employee contribution elections; and (3) the effective date of the amendment.

Since the proposed regulations may be relied upon immediately, an employer can effectively suspend safe harbor nonelective contributions after amending the plan but no sooner than 30 days after providing the notice.

IMPORTANT: No Top Heavy Relief

It is important to note that the proposed regulations provide no relief with regard to top-heavy obligations. An employer suspending its safe harbor nonelective contribution *will* be required to satisfy its top-heavy minimum contribution requirements for the entire plan year. Depending on key employee annual additions prior to the suspension, the top heavy issue could work make the safe harbor suspension of no practical value – or, in fact, more costly. Due to potential differences in compensation and allocation requirements between safe harbor nonelective and top heavy contributions, it is recommended that careful consideration be taken prior to eliminating safe harbor nonelective contributions, as it is possible for top heavy requirements to exceed safe harbor nonelective contribution requirements.

Substantial Business Hardship Requirements

The proposed regulations condition relief from making safe harbor nonelective contributions on the employer having a substantial business hardship during the plan year. IRC §412(c) provides that the factors to be taken into account in determining whether an employer is experiencing a temporary substantial business hardship include, but are not limited to, whether or not: (1) the employer is operating at an economic loss; (2) there is substantial

unemployment or underemployment in the trade or business and in the industry concerned; (3) the sales or profits of the industry concerned are depressed or declining; and (4) it is reasonable to expect that the plan will continue and not be terminated only if the employer is permitted to reduce or suspend safe harbor nonelective contributions.

Since the Code does not make a distinction between the treatment of safe harbor matching contributions and safe harbor nonelective contributions, the requirement that the employer incur a substantial business hardship in order to take advantage of the relief with respect to a nonelective safe harbor contributions is unfortunate. ASPPA GAC will be reviewing the proposed regulations and offering comments to the Treasury and IRS on items which require clarification or improvement.

Conclusion

The proposed regulations will provide immediate relief to many employers affected by the economic downturn. The proposed framework will provide an important alternative for employers that might otherwise be compelled to terminate their 401(k) safe harbor nonelective contribution plans.