

Treasury Allows More Flexibility on Small-Business 401(k)s

By Jeff Plungis

May 22 (Bloomberg) -- Small businesses facing financial hardship won relief from the U.S. Treasury through new rules providing more flexibility to suspend contributions to employee 401(k) retirement accounts.

The rules, effective immediately, allow the companies to stop making payments to their so-called safe-harbor 401(k)s, without having to terminate the programs as previously required. Companies seeking the relief must show significant financial distress, such as the loss of money from low sales or a rise in health-care costs, the Treasury said in a statement today.

Small businesses have been scrapping retirement plans because they can't afford the annual contributions as earnings deteriorate in the worst recession in at least half a century, according to testimony this year before the House Small Business Committee. Treasury rules didn't provide alternatives for companies that can't make the payments, the committee was told.

"Every American deserves a safe and secure retirement," Treasury Secretary [Timothy Geithner](#) said in the statement. He said the rule changes "will help countless people feel a sense of security during troubled financial times."

In the kind of safe-harbor 401(k) plan used most often by small businesses, companies match employee contributions equal to 3 percent of annual compensation. The contributions are paid regardless of whether employees add their own money.

More than 250 companies have changed or suspended their matches this year while leaving their plans in place, according to the Washington-based [Pension Rights Center](#). A suspension allows employees to continue saving, and companies can resume matching contributions at any time.

Benefits Test

Safe-harbor plans permit businesses to avoid a requirement with regular 401(k)s: having to demonstrate that a firm's most highly paid employees, such as the owners of a small business, aren't reaping the lion's share of the retirement benefits.

Terminating the plans would result in "unnecessarily depriving affected employees of the opportunity to save," the [American Society of Pension Professionals and Actuaries](#) in Arlington, Virginia, wrote in a Feb. 20 [letter](#) to the Treasury.

Companies with fewer than 250 employees have been considering liquidating their safe-harbor 401(k) plans as earnings deteriorate, Stephen Dobrow, president of [Primark Benefits](#), a San Francisco-based retirement-plan adviser, told the House Small Business Committee in February. The U.S. economy shrank at an annual pace of 6.1 percent in the first quarter, following a 6.3 percent contraction in the fourth quarter.

Lump-Sum Checks

When retirement plans are closed, employees get a lump-sum check that they can cash or roll into an Individual Retirement Account. In most cases, if they cash the check, they'll be subject to income taxes and a 10 percent tax penalty.

If plans are terminated, employees don't have the opportunity to contribute their own money to the 401(k). Workers are then usually limited to \$5,000 of tax-deferred savings a year for a traditional IRA rather than \$16,500 per year permitted in a 401(k), according to IRS rules.

About 1.7 percent of companies that offer 401(k) options use this type of safe-harbor plan, according to an annual survey by the Profit-Sharing/401k Council of America of 1,011 plans representing 7.4 million employees and \$730 billion in assets.

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Last Updated: May 22, 2009 12:55 EDT