

# Relief for Safe-Harbor §401(k) Plan Sponsors



In these uncertain economic times, many employers are looking for ways to reduce their commitment to discretionary benefit programs, including the qualified retirement plans they sponsor. Many plan provisions, however, are governed by inflexible regulations that leave struggling employers with few options for avoiding required contributions. For certain types of plans, the only option available to a plan sponsor wishing to suspend or reduce contributions during the year has been to take the drastic step of terminating the plan.

In recognition of these difficult decisions faced by plan sponsors, the Internal Revenue Service published proposed regulations to permit employers incurring a “substantial financial hardship” to suspend required safe-harbor contributions to their 401(k) plans.

## WHAT IS A SAFE-HARBOR §401(K) PLAN?

A safe-harbor §401(k) plan is designed to avoid nondiscrimination testing. If the employer commits to fund the safe-harbor contribution before the beginning of the plan year, the plan is deemed to automatically meet the nondiscrimination tests for both 401(k) and matching contributions.

Without the safe-harbor provisions, 401(k) plans must compare the employee deferrals (and any matching contributions) of the highly paid employees with those of the non-highly paid employees. If the average rates (contributions divided by pay) of the two groups are not within a specific range, the employer must take corrective action, either by returning deferred money to the highly paid, or by increasing employer contributions to the non-highly paid. The safe-harbor 401(k) plan offers assurance to the employer’s highly paid employees that they can contribute to the plan without fear of having their money returned to them after the end of the year on an after-tax basis.

In general, an employer that intends to maintain a safe-harbor §401(k) plan must:

- adopt the safe-harbor plan provisions before the beginning of the plan year;
- maintain the safe-harbor plan throughout the year;
- notify each eligible employee prior to the plan year of his or her rights and obligations; and
- commit to make either (i) a **nonelective** contribution of at least 3% of each non-highly compensated employee’s compensation, or (ii) satisfy a **matching** contribution requirement with respect to each non-highly compensated employee making elective deferrals.

**LONG BEACH OFFICE**  
111 West Ocean Boulevard  
Twenty-Second Floor  
Long Beach, CA 90802  
Telephone: (562) 435-1191  
FAX: (562) 495-1665  
Contact Richard Green

**IRVINE OFFICE**  
18201 Von Karman Avenue  
Suite 1060  
Irvine, CA 92612  
Telephone: (949) 271-2600  
FAX: (949) 660-5681  
Contact Therese Cheevers

[www.windes.com](http://www.windes.com)



**WINDES & McCLAUGHRY**  
**ACCOUNTANCY CORPORATION**  
*Employee Benefit Services*

EXCEEDING EXPECTATIONS SINCE 1926

## CURRENT REGULATIONS

Prior to these proposed regulations, there existed two exceptions to the general requirement that an employer must maintain a 401(k) safe-harbor throughout the plan year:

1. amend the plan to reduce or suspend safe-harbor *matching* contributions on future employee elective contributions for a plan year, or
2. terminate its safe-harbor 401(k) plan during the plan year.

Other than these exceptions, no change to the safe-harbor contributions is permitted after the beginning of the plan year, and termination is the only available method of stopping safe-harbor *nonelective* contributions.

---

## 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 provides that the nondiscrimination tests 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; and
- 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.

The determination of whether an employer has suffered a *substantial business hardship* is based on the facts and circumstances of each employer. Some of the factors considered 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.

---

## CAUTION FOR TOP-HEAVY PLANS

Most small 401(k) plans are top-heavy, which is defined as a plan where more than 60% of the assets are attributable to key employees (generally, the owners). Top-heavy plans must provide minimum contributions to non-key employees. One of the important advantages of safe-harbor contributions is that they automatically cover this minimum contribution requirement.

A plan that amends to reduce or suspend safe-harbor matching or nonelective contributions will be subject to the rules for top-heavy plans. If key employees make 401(k) contributions or receive an allocation of employer

contributions, a minimum employer contribution will be required for participants employed on the last day of the plan year. In addition, the plan will now be subject to nondiscrimination testing for the entire year. For these reasons, if the employer intends to suspend or reduce safe-harbor contributions, it is recommended that all highly paid and key employees stop their employee elective deferrals in order to minimize the required contributions that must be made to the non-highly paid employees.

---

### EFFECTIVE DATE OF PROPOSED REGULATIONS

The proposed regulations were issued May 18, 2009, and can be used immediately for qualifying employers. To the extent the final regulations are more restrictive than the proposed regulations, they will not be applied retroactively.

These new rules can provide flexibility to employers needing temporary relief due to current economic conditions, without being forced to abandon their long-term retirement plans. The decision to utilize this relief may have other costs and consequences. Terminating any 401(k) plan has additional ramifications because of the restriction of when a successor plan can be adopted. It is advisable to consult with your plan administrator before amending or terminating your 401(k) plan.

If you have any questions regarding these new rules, or about retirement planning in general, please contact Therese Cheevers at 949-271-2600 or [tcheevers@windes.com](mailto:tcheevers@windes.com)