

Qualified Retirement Plans

Practice Alert

May 2009

Relief for Employers Sponsoring Safe Harbor 401(k) Plans

A Safe Harbor 401(k) plan does not require non discrimination testing (the ADP / ACP test) with respect to salary deferrals as does the traditional 401(k) plan. To take advantage of this alternative plan design the employer must provide a required contribution of either 3.0% of compensation, the so called non-elective contribution, for all eligible employees, (age 21, one year of service and full time) or a matching contribution capped at 4.0%. Regulations have, in the past, allowed a plan to eliminate the matching safe harbor contribution under some circumstances but not the non-elective contribution. Considering the current economic climate IRS has proposed regulations that would allow employers to suspend the non-elective contribution if the employer qualifies for a substantial business hardship.

For purposes of these regulations a substantial business hardship would include the following:

1. The employer is operating at a loss
2. There is substantial unemployment in the employer's industry
3. The sales and profits of the industry are depressed or declining
4. It is reasonable to expect the plan to continue after the planned suspension

If the employer is eligible to take advantage of the suspension the plan must satisfy the nondiscrimination test required for a traditional 401(k) plan for the entire year and:

1. Provide all employees with a notice of the suspension
2. Provide that the suspension is effective no earlier than the later of 30 days after the employees are given the notice of suspension or the date the plan amendment is adopted
3. Provide all eligible employees a reasonable opportunity in advance of the effective date of the suspension to change their deferral election
4. Amend the plan to provide that the nondiscrimination test (the ADP / ACP test) will be satisfied for the entire plan year in which the suspension takes place
5. Fund the safe harbor non-elective contribution through the effective date of the amendment suspending the non-elective contribution

Since a Safe Harbor 401(k) plan also satisfies the Top Heavy rules under IRC §416 a suspension of the Safe Harbor rules due to the elimination of the non-elective contribution would now require the plan to satisfy the Top Heavy rules. This is a technical matter and should be analyzed by the plan's Third Party Administrator.

These proposed regulations are meant to provide the employer with an alternative to terminating their 401(k) plan if they can no longer fund the Safe Harbor contribution. The regulations are effective for plan amendments adopted after May 28, 2009.

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