



IRS Allows Mid-Year Reduction of 401(k) Plan 3% Safe Harbor Non-elective Contributions

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Under current law, a 401(k) plan that adopts a 3% safe harbor nonelective contribution to avoid ADP and ACP testing must do so before the beginning of the plan year; the contribution must remain in effect throughout the full 12-month plan year. The IRS has issued proposed regulations, however, allowing employers to reduce or eliminate safe harbor nonelective contributions midyear in the event of a business hardship. The proposed regulations, issued May 18, 2009, provide that a plan with a safe harbor nonelective contribution provision may be amended mid-year to reduce or eliminate the safe harbor contributions if:

- The employer incurs a substantial business hardship (as described below).
- The amendment is adopted after May 18, 2009.
- All eligible employees are provided a supplemental notice 30 days prior to the effective date of the amendment explaining the consequences of the amendment, the procedures to change elective deferral contribution elections and the effective date of the amendment.
- Employees must be given a reasonable opportunity after receipt of the notice and before the effective date of the reduction or suspension to change their elective deferrals.
- The Plan must be amended to provide that the ADP and ACP tests will be satisfied for the entire plan year using the current year testing method.
- The requirements for the safe harbor must be satisfied through the effective date of the amendment.

In order to meet the requirement that the employer incurs a substantial business hardship, the proposed regulations state that business hardship is determined by taking into account factors that include, but are not limited to:

- whether the employer is operating at an economic loss.
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- whether there is substantial unemployment or underemployment in the trade or business and in the industry concerned.
- whether the sales and profits of the industry concerned are depressed or declining.
- whether it is reasonable to expect that the plan will continue after the reduction or elimination.

The proposed regulations also apply to “automatic contribution arrangements” and parallel the relief already provided for mid-year reduction of suspension of safe harbor matching contributions. The proposed regulations state that they may be relied upon by employers pending the issuance of final regulations.