



IRS Proposes Nonelective Contribution Relief for Safe Harbor 401(k) and 403(b) Plans

The IRS has proposed amendments to regulations under Sections 401(k) and 401(m) to give employers that have a substantial business hardship the opportunity to reduce or suspend safe harbor nonelective contributions as an alternative to terminating the plans. The proposed rules may be relied on immediately and any future guidance that is more restrictive will apply prospectively only.

Background

Under Sections 401(k) and 401(m) of the Internal Revenue Code, employers may set up design-based safe harbor plans that are treated as satisfying the ADP and ACP nondiscrimination tests. The safe harbor requirements include maintaining the safe harbor plan for *the entire 12-month plan year*, providing notices to employees, and making employer contributions (i.e., either qualified matching contributions (QMACs) or qualified nonelective contributions (QNECs)) to nonhighly compensated employees (NHCEs) at certain minimum levels. To satisfy the safe harbor requirements using QMACs, the employer must generally provide a 100% match on the first 3% of elective contributions and at least a 50% match on the next 2%. In lieu of QMACs, the employer can provide QNECs equal to at least 3% of compensation for all eligible NHCEs. An alternative design-based safe harbor using QMACs or QNECs can be provided under qualified automatic contribution arrangements (QACAs) under Section 401(k)(13), added by the Pension Protection Act of 2006 (see our April 7, 2009 [For Your Information](#)).

Under final regulations under Sections 401(k) and 401(m) (see our January 18, 2005 [For Your Information](#)), an employer can amend a design-based safe harbor plan during a plan year to reduce or suspend QMACs without terminating the plan, subject to the following requirements –

- The effective date of the reduction or suspension must be no earlier than the later of 30 days after adequate notice is given to all eligible employees and the adoption date for the amendment.
- Employees must be given a reasonable opportunity to change their contribution elections.
- The plan must be amended to require that the ADP test (and ACP test, if applicable) will be satisfied using the current year testing method for the entire plan year in which the reduction or suspension occurs.
- The requirements for the safe harbor must be satisfied for the period through the effective date of the amendment.

Unlike QMACs, however, under the 2005 regulations, QNECs could only be reduced or suspended mid-year through a plan termination. Following such a mid-year termination, a plan would satisfy the safe harbor rules during the final plan year as long as it met the above requirements through the date of termination or the employer incurred a substantial business hardship comparable to that in Section 412(c).

IRS Proposed Regulations

The IRS has now issued [proposed regulations](#) that would allow an employer to amend its safe harbor 401(k) or 403(b) plan, including a QACA, to reduce or suspend QNECs during the plan year without terminating the plan. The general rules for the reduction or suspension of QMACs mid-year have not changed, but the conditions for doing so have been modified slightly and now apply for purposes of reducing or suspending both QNECs and QMACs. However to reduce or suspend QNECs, an employer must establish a substantial business hardship.

BUCK COMMENT. *Thus, the business hardship requirement does not apply for the reduction or suspension of QMACs, except possibly in cases of mid-year terminations.*

Substantial Business Hardship. The regulations indicate that a substantial business hardship for purposes of a mid-year QNEC reduction or suspension is comparable to that described in Section 412(c). The factors to be considered include, but are not limited to, whether –

- The employer is operating at an economic loss.
- There is substantial unemployment or underemployment in the employer's trade or business and in the industry concerned.
- The sales and profits of the industry concerned are depressed or declining.
- It is reasonable to expect that the plan will continue only if the nonelective contributions are reduced or suspended.

Conditions for Relief. In addition to establishing business hardship, the following conditions must be met –

- All eligible employees must be given a supplemental notice at least 30 days before the reduction or suspension occurs. The notice must explain the reduction or suspension and its consequences and the procedures for changing employee deferral elections. It must also include the amendment's adoption date and its effective date.
- The plan must be amended prior to the end of the plan year and the reduction or suspension must be effective no earlier than the later of thirty days after eligible employees are provided the supplemental notice and the date the amendment is adopted.
- All eligible employees must be given a reasonable time after receipt of the notice and prior to the suspension to change their salary deferral and employee contribution elections.

- The amendment must provide that the ADP test (and ACP test, if applicable) will be satisfied for the entire year in which the QNECs are reduced or suspended, using the current year testing method.
- The applicable Section 401(a)(17) compensation limit must be prorated to reflect the shorter contribution period for the year of reduction or suspension.
- If the plan is otherwise top-heavy, it is no longer exempt from the testing rules for top-heavy plans and must meet the top-heavy testing requirements for the year of reduction or suspension.

As noted earlier, the above conditions applicable to the reduction or suspension of QNECs as outlined in the proposed regulations also now apply to mid-year reductions or suspensions of QMACs.

Effective Date. The regulations are proposed to be effective for amendments adopted after May 18, 2009, and may be relied on until final regulations are issued. To the extent final regulations are more restrictive than the proposed regulations, they will be applied prospectively only.

Conclusion

The proposed regulations may provide a welcome alternative for employers who are financially strapped as a result of the current economic environment. Buck's consultants would be pleased to discuss whether they may offer relief in your company's situation.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.