



Pension Analyst

Compliance Bulletin

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New rules allow employers to suspend nonelective contributions to Safe Harbor Plans due to business hardship

On May 18, 2009, the IRS published rules allowing sponsors of Safe Harbor Plans, including Qualified Automatic Contribution Arrangements (QACAs), to suspend or reduce nonelective contributions before the end of the plan year due to business hardship. These rules provide an attractive alternative to plan termination, which had been the only option for sponsors of Safe Harbor Plans providing required nonelective contributions that needed to reduce or eliminate their ongoing obligations during this time of economic distress.

Currently, the rules are only proposed, which means that they are subject to change when they are finalized. However, the IRS will allow plan sponsors to follow them in their current form until they are finalized and will impose any new or more stringent requirements only on a prospective basis. The new rules may be applied to plan amendments adopted after May 18, 2009.

Basic Safe Harbor Plan rules

Under the Internal Revenue Code and IRS regulations plans can satisfy 401(k) and 401(m) nondiscrimination requirements without performing actual deferral percentage (ADP) or actual contribution percentage (ACP) tests, if they contain specific provisions and provide appropriate notices to plan participants. These are commonly referred to as Safe Harbor Plans. "Safe Harbor Plans" include 401(k) and 403(b) plans that meet the design rules established by the Small Business Job Protection Act of 1996 (the [Traditional Safe Harbor](#)), as well as the newer [Qualified Automatic Contribution Arrangements \(QACAs\)](#).

All of these safe harbor designs require the sponsoring employer to make either nonelective or matching contributions. With limited exceptions, these contributions must be made for an entire 12-month plan year.

Impact of current economic crisis

As the global economic crisis has worsened, many sponsors of Safe Harbor Plans have looked to reduce their funding obligations and liabilities. Until now, only sponsors that made the required matching contributions were able to reduce or suspend those contributions during the plan year. Sponsors that made required nonelective contributions were forced to either finish out the plan year before reducing or suspending their contributions or terminate the entire plan. The new rules allow certain sponsors making nonelective contributions to also reduce or suspend those contributions during the plan year.

The new rules

An employer that has incurred a substantial business hardship may now reduce or suspend a Safe Harbor nonelective contribution during the plan year, as long as specific requirements are met. (*Note: An employer may reduce or suspend a Safe Harbor matching contribution, regardless of whether it has incurred a substantial business hardship.*)

When determining whether a "substantial business hardship" has occurred, the IRS considers factors such as (but not limited to) whether:

- The employer is operating at an economic loss;

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- There is substantial unemployment in the employer's industry;
- The sales and profits of the industry are depressed or declining; and
- It is reasonable to expect the plan to continue only if the contribution reduction or suspension occurs.

If this type of hardship situation exists and the plan sponsor wishes to reduce or suspend its contributions to the plan, the sponsor must provide a supplemental notice to all eligible employees, which:

- Explains the consequences of the amendment that reduces or suspends the future Safe Harbor contributions;
- Identifies the effective date of the amendment; and
- Describes the procedures for employees to change their pre-tax deferral and, if applicable, employee post-tax contribution elections.

Employees must have a reasonable opportunity following the receipt of this notice to change their deferral and contribution elections before the nonelective contribution is reduced or suspended.

The plan document must be amended to reflect this change, and the amendment may be effective no earlier than the later of:

- 30 days after the supplemental participant notice is provided; or
- The amendment adoption date.

The amendment must provide that the ADP test (and, if applicable, the ACP test) will be performed and satisfied for the entire plan year in which the amendment is effective, using the current year testing method. Since Safe Harbor nonelective contributions cannot be conditioned on an employee completing 1000 hours of service during a plan year or being employed on the last day of the plan year, employees will be entitled to receive contributions based on compensation received through the amendment effective date. As a result, the annual compensation limit must be appropriately prorated. In addition, once the amendment is adopted, the plan will be subject to the standard top-heavy rules and minimum contribution requirements for the entire plan year.

Next steps

The IRS has asked the public to submit comments on the proposed rules by August 17, 2009, and has scheduled a public hearing for September 23, 2009. Prudential will participate with various industry groups to prepare and submit appropriate comments.

Plan sponsors that want to reduce or suspend their Safe Harbor Plan nonelective contributions should contact their Prudential Retirement representative to coordinate the required activities. These activities include the preparation of plan amendments for those plans that use Prudential's Plan Document Service, subject to our standard amendment preparation fee. Sponsors of plans that do not use our Plan Document Service will need to work with their document providers to obtain the appropriate amendments. Upon request, Prudential can also draft the required participant notice and provide distribution support. A separate fee may apply to the provision of these additional services.

Plan sponsors, in consultation with their plan's legal counsel, must determine whether they have incurred a substantial business hardship that makes them eligible to reduce or suspend these contributions.



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