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NRS
MAY | 2009
NEWSLETTER

## IMPORTANT CONSIDERATIONS WHEN REDUCING OR STOPPING 401(k) PLAN SAFE HARBOR CONTRIBUTIONS MID-YEAR

An employer who sponsors a 401(k) plan is permitted to establish a "safe harbor" contribution that allows for a "free pass" with respect to discrimination testing for salary deferral contributions. There are two different safe harbor contributions available: one involving a specific **matching** contribution based on each participant's salary deferral and the other a **non-elective** contribution paid to all participants regardless of how much they defer from their salary.

The question of reducing or stopping a safe harbor contribution in the middle of a plan year was probably given little or no attention when the decision was made to either match or make a non-elective employer contribution. However, more and more employers are finding that the type of safe harbor selected makes a big difference if the cash strapped employer wants to change contributions in the middle of the plan year.

**Safe Harbor Match Cessation Requirements:**

A matching safe harbor contribution can be reduced or stopped mid-year by following these steps:

- Provide participants a 30 advance notice that the safe harbor match will be reduced or stopped
- Permit participants to make changes in their deferral elections prior to changing the match
- Amend the formal plan document to change the match 30 days in advance
- Be sure to fund the match for deferrals made up to the cut off date
- Amend the plan to require discrimination testing *for the entire year* (but you can count the matching contributions to help pass the test) and use the "current year" testing method.

**Safe Harbor Non-Elective Cessation Requirements:**

A non-elective safe harbor contribution cannot be stopped in the middle of the year *unless the plan is terminated*.

**Comparison of Requirements:**

This stark difference in treatment for the two alternatives has plenty of people very concerned. This is understandable, particularly when you consider that an employer is not permitted to terminate and pay out a 401(k) plan if it maintains another defined contribution plan or establishes a new plan within 12 months after paying out the terminating plan.

The American Society of Pension Professionals & Actuaries ("ASPPA") sent appeals to both the IRS and Treasury in February 2009 urging more consistent treatment. Specifically, ASPPA urges a change in the regulations so that an employer can stop the 3% of pay non-elective contribution mid-year, provided employees are notified in advance, the plan is amended timely, and the plan undergoes discrimination testing for the entire year. Unofficial comments indicate some sort of relief may be announced in the very near future. This may be welcome news to many employers, but there is no indication that any retroactive relief will be forthcoming.

**A Trap for the Unwary:**

If an employer sponsors a 401(k) plan and makes no contributions other than safe harbor contributions, the plan is not subject to top heavy minimum requirements.

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With rare exceptions, if the safe harbor contribution is suspended in the middle of the year, top heavy minimums will apply and must be based on employee compensation *for the full year.* This can easily exceed a full year's match. For example, suppose a calendar year plan has a safe harbor matching contribution and does not intend to make any other contribution for 2009. The owner defers $7,500 into the plan by March 31, 2009. Effective April 30, 2009, the safe harbor match is eliminated. Due to prior year's profit sharing contributions to key employees, the plan is top heavy and must pay a contribution to all non-key participants equal to 3% of their entire 2009 compensation (less any matching contributions already paid).

## QUARTERLY FUNDING OF PENSION PLAN OBLIGATIONS

Defined benefit pension plans have a requirement to either pay their annual funding obligations quarterly or else pay an additional amount equal to interest (at a higher than usual rate) on the amounts that were funded after the quarterly dates. This requirement does not apply for plans that have assets in excess of liabilities. Most small plan employers fund their obligation on an annual basis; many because they do not have applicable funding amounts calculated that early. If quarterly funding applies and the employer does not contribute quarterly, plan participants must be advised.

### Funding Considerations:

It is important to note that funding on a basis less frequent than quarterly does **not** give rise to the 10% excise tax imposed on employers who fail to contribute the minimum required annual amount within 8 ½ months following the end of the plan year. However, the added interest does increase the amount of the (tax deductible) minimum payment.

### PBGC Complications:

Plans covered by the Pension Benefit Guaranty - Corporation ("PBGC") are required by law to report to the PBGC whenever quarterly payments are not made. Since 1997, the PBGC has routinely waived this requirement for plans with 100 or fewer participants. On February 20, 2009, the PBGC announced it was no longer going to waive the reporting requirement for small plans starting with 2009 plan years. This new reporting requirement represents an administrative burden for small employers of up to four reports per year. In addition, PBGC has the authority to levy hefty penalties for reporting failures. Once again, ASPPA has approached this governmental agency urging that they reconsider their position and return to waiving this requirement for small plans. Since the decision by the PBGC will also add significantly to *their* administrative burden, chances are good that the PBGC will relent.

NRS monitors developments that may have an impact on retirement plans and the employers who sponsor them.

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