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Internal Revenue Service

IRS Issues Proposed Regulations on Suspension or Reduction of Safe Harbor Nonelective Contributions to 401(k) Plans and 403(b) Plans

On May 18, 2009, the IRS released proposed regulations relating to certain cash or deferred arrangements and matching contributions under certain 401(k) and 403(b) plans. <http://edocket.access.gpo.gov/2009/pdf/E9-11481.pdf>. The proposed regulations are effective for amendments adopted after May 18, 2009. Pending issuance of final regulations, the proposed regulations may be relied upon. Further, if the final regulations are more restrictive than those proposed, the final regulations will be applied without retroactive effect.

A comprehensive summary of the proposed regulations appears in the Spring 2009 Edition of *Retirement News for Employers*, which is published by the IRS. http://www.irs.gov/pub/irs-tege/rne_spr09.pdf

Background

A 401(k) plan may decide to become a safe harbor plan, which may avoid the average deferral percentage (ADP) or average compensation percentage (ACP) tests. An employer may elect to make a “safe-harbor” contribution to its 403(b) plan as an alternative to passing the ACP nondiscrimination test applied to matching contributions. Two different contribution formulas are available to satisfy the safe harbor.

- Matching Formula - An employer matches 100% of elective salary deferrals up to 3% of compensation and then 50% of salary deferrals on the next 2% of compensation, or
- Non-Elective Formula - Alternatively, an employer may make a nonelective contribution of at least 3% of each eligible employee’s compensation.

A safe harbor plan must follow additional requirements:

- Plan document must include safe harbor plan language.
- Eligible participants must receive written notice 30 days prior to the beginning of the plan year that the plan is intended to be a safe harbor plan for the coming plan year. This notice must be provided for each year the plan will be a safe harbor plan.
- An allocation requirement such as 1,000 hours of service or employment on the last day of the plan year may not be imposed on safe harbor contributions.
- Safe harbor contributions are always 100% vested.
- Safe harbor contributions may not be eligible for in-service withdrawals prior to age 59 ½.
- An ongoing 401(k) plan may only be amended to a safe harbor plan for the beginning of the next plan year.
- Special rules permit termination of a safe harbor plan during the plan year.

No part of this document is intended to provide tax or legal advice. Any questions involving tax or legal matters should be referred to your plan’s legal counsel or tax advisor.

Proposed Regulatory Changes

Recognizing that the current economic environment has prompted some plan sponsors to decide to reduce or suspend contributions to their retirement plans, the proposed regulations would allow a plan sponsor that incurs a substantial business hardship to reduce or suspend safe harbor nonelective contributions during a plan year. This modification would assist employers who choose to maintain their retirement plan, rather than electing to terminate the plan.

The proposed regulations provide that a plan that reduces or suspends nonelective contributions or safe harbor matching contributions if:

- all eligible employees are provided a supplemental notice of the reduction or suspension;
- the reduction or suspension of safe harbor nonelective contributions is effective no earlier than the later of 30 days after eligible employees are provided the supplemental notice and the date the amendment is adopted;
- eligible employees are given a reasonable opportunity to make changes to their contribution elections;
- the plan is amended to provide that the ADP and/or ACP test will be satisfied for the entire plan year in which the reduction or suspension occurs, using the current year testing method; and
- the plan satisfies the safe harbor nonelective contribution requirement with respect to safe harbor compensation paid through the effective date of the amendment.

Following is an example included in the Spring Edition of *Retirement News for Employers* referenced above:

I received notice before 2009 that my employer's safe harbor 401(k) plan would match dollar-for-dollar up to the first 3% of my contribution to the plan and 50 cents on the dollar of my contribution above 3% and up to 5%. However, I was recently notified that my company will not make any matching contributions this year. Can they do this?

Yes. Due to the economic crisis, many employers are facing a tough choice to either terminate their 401(k) retirement plans or, alternatively, reduce or suspend matching contributions. An employer may reduce or suspend matching contributions after amending its plan. The employer must send a notice to all eligible employees of:

- the plan's amendment to reduce or suspend matching contributions, and
- their right, within a reasonable amount of time, to change their salary deferral election (the amount they contribute to the plan).

The employer must also make the matching contributions at the plan's previously stated rate for at least 30 days after it gives notice to employees. As an employee, you can generally elect, for 2009, to contribute the lesser of 100% of your salary or \$16,500 (\$22,000 if age 50 or older).

IRS Publishes Spring Edition of *Retirement News for Employers*

The Spring 2009 Edition of *Retirement News for Employers*, http://www.irs.gov/pub/irs-tege/rne_spr09.pdf which is published by the IRS to provide tax information for sponsors of retirement plans, includes articles on the following topics:

- Proposed regulations on the suspension or reduction of safe harbor nonelective contributions, as discussed in the article above.
- Information on an Employee Plans Compliance Resolution System (EPCRS) phone forum scheduled for July 27, 2009.
- An article explaining automatic enrollment.

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Department of Labor

Department of Labor Releases Semiannual Regulatory Agenda

On May 11, 2009, the Department of Labor, Employee Benefits Security Administration, released plans to issue regulatory guidance by the end of 2009. <http://www.regulations.gov/fdmspublic/component/main?main=UnifiedAgenda> The following projects were included in the regulatory agenda:

- *Amendment of Final Regulation Relating to the Definition of Plan Assets Relating to Participant Contributions* – The objective will be to define when participant funds paid to or withheld by an employer to an employee benefit plan constitutes “plan assets” under ERISA. A safe harbor period of a specified number of business days will be established under the final regulation, which is expected to be issued by the end of September 2009.
- *Time and Order of Issuance of Domestic Relations Orders* – By end of 2009, final regulations are expected to be issued clarifying certain issues relating to the timing and order of domestic relations orders under ERISA.
- *Proposed Amendment to Rules Relating to Use of Electronic Communication* – A notice of proposed rule making is anticipated to be issued by the end of November, 2009 to update the electronic disclosure safe harbor to reflect advances in technology, recently enacted IRS regulations as well as recent changes to the ERISA disclosure requirements.
- *Proposed Rules on Periodic Benefit Statements* – By the end of 2009, a proposed rule providing a model benefit statement for individual account plans may be released.

Department of Labor Extends Effective Date of Investment Advice Rules Again

The Department of Labor’s Employee Benefits Security Administration (EBSA) published a notice in the May 22, 2009 edition of the Federal Register extending to November 18, 2009, the applicability and effective dates of the final rule on investment advice under the Pension Protection Act (PPA). <http://edocket.access.gpo.gov/2009/pdf/E9-12065.pdf>

The PPA amended ERISA by adding a new prohibited transaction exemption that allows greater flexibility for participants of 401(k) plans and individual retirement accounts to obtain investment advice. The DOL published the final rule on January 21, 2009. The DOL decided to postpone for 60 days until May 22, 2009 the effective and applicability dates of the final rule to give it time to review legal and policy issues raised by many of the 27 public comment letters received. The DOL believes that the complexity and significance of the issues involved justify the additional delay of the effective and applicability dates of the final rule to November 19, 2009 to provide the DOL time for further review. <http://www.dol.gov/opa/media/press/ebsa/EBSA20090567.htm>

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