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Helpful Web Links

Department of Labor
www.dol.gov/

Taking the Mystery Out of
Retirement Planning
www.dol.gov/ebsa/publications/nearretirement.html

Internal Revenue Service
www.irs.gov/

Relief for Safe Harbor 3% Nonelective Contributions

QPN Highlights

Action Required: Employers with 401(k) and 401(m) safe harbor plans should be made aware of these proposed regulations.

- Safe Harbor 3% nonelective contributions may be reduced or suspended mid-year, by plan amendment, when the employer faces **substantial business hardship** (as described in IRC 412(c)). This option is intended to be an alternative to plan termination.
- The 3% nonelective contribution must be made through the effective date of the amendment.
- Eligible employees must be provided with advance notice and the opportunity to make changes to their elective deferrals or, if applicable, employee contributions.
- ADP/ACP and Top Heavy testing must be performed for the entire plan year in which the 3% nonelective contribution is reduced or suspended.
- This relief applies to 401(k) safe harbor plans, Qualified Automatic Contribution Arrangements, and certain 403(b) plans. (Similar relief already exists for plans that meet the safe harbor matching contribution option.)

- Effective date: for amendments effective after May 18, 2009. These proposed regulations may be relied upon until final regulations are released.

The Internal Revenue Service (IRS) has released proposed regulations that permit the reduction or suspension of the safe harbor 3% nonelective contribution, during the plan year, for employers facing substantial business hardship. In light of the current difficult economic environment, the proposed regulations are intended to provide an alternative to terminating the plan in such situations.

Background – The existing regulations permit an employer to eliminate the need for ADP/ACP testing by making a safe harbor employer contribution to the plan that is either a nonelective contribution that is equal to 3% of the compensation of all eligible employees or a matching contribution, as specified in the regulations (other requirements apply as well). Generally, the existing regulations require that the employer safe harbor contribution must be made for the entire 12 month plan year. Exceptions exist for the initial plan year, the final plan year and a change of plan year. In addition, the current regulations permit a plan that meets the safe harbor by making an employer



matching contribution (as specified in the regulations) to be amended during the plan year to reduce or suspend the safe harbor matching contribution if certain requirements are met. No such exception exists currently for the 3% nonelective safe harbor contribution.

Currently, any plan that includes the safe harbor 3% nonelective contribution provision prior to the start of the plan year may only eliminate the requirement to make that contribution during the plan year by terminating the plan.

Key Points of Proposed Regulations – These proposed regulations would amend the 401(k) and 401(m) regulations to permit a safe harbor plan to reduce or suspend an existing 3% nonelective safe harbor contribution in the middle of the plan year. The following requirements must be met (comparable to those for reducing or suspending the safe harbor match under current rules):

1. The employer must be facing a substantial business hardship as generally defined in IRC 412(c) (described below);
2. A supplemental notice is provided to all eligible employees announcing the reduction or suspension;
3. The effective date of the reduction or suspension is not earlier than the later of 30 days after the supplemental notice is provided to eligible employees and the date the amendment is adopted;
4. Eligible Employees have a reasonable opportunity to change their cash or deferred election and, if applicable their employee contribution election, before the reduction or suspension (including a reasonable period after receipt of the supplemental notice);
5. 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
6. The 3% nonelective contribution must be made through the effective date of the amendment.

Applicable Plans - The proposed regulations apply to the following plans:

1. A 401(k) or 401(m) plan that intends to comply with the safe harbor plan rules that eliminate the need for ADP/ACP nondiscrimination testing;
2. A Qualified Automatic Contribution Arrangement (QACA) that is intended to meet both the safe harbor ADP/ACP requirements and the automatic enrollment requirements; and
3. A 403(b) plan (other than a church plan) that has employer contributions and meets the ACP testing requirements in the same manner as a safe harbor plan,

Content of Supplemental Notice – The notice requirement is satisfied if each eligible employee is provided with a notice that explains:

1. The consequences of the reduction or suspension of future 3% nonelective contributions;
2. Procedures for changing the employees elective deferrals and, if applicable, employee contribution elections; and
3. The effective date of the amendment.

Same rules apply to the ACP safe harbor – The same rules described above also apply to ACP safe harbor plans, except that the plan must be amended to provide that the ACP test will be satisfied for the entire year.

Top heavy testing will apply – Under the top heavy rules of IRC 416, a plan that meets all the requirements of a safe harbor plan under IRC 401(k)(12) or a QACA under 401(k)(13) is not considered to be top heavy. However, since a plan that reduces or suspends the 3% nonelective safe harbor contribution fails to meet all the safe harbor requirements for the year, the top heavy rules will apply and **top heavy testing must be performed for the year** of the reduction or suspension.

Annual compensation limit is prorated – In the case of a reduction or suspension of the safe harbor 3% elective contribution (or the safe harbor matching contribution) the annual compensation limit under Internal Revenue Code (IRC) Section 401(a)(17) is prorated (i.e., annual compensation limit multiplied

by the number of months for which the safe harbor contribution must be made, over 12).

Substantial business hardship – IRC Section 412(c) describes the factors to be taken into account to determine if an employer that sponsors a defined benefit plan has a business hardship for the purpose of requesting a minimum funding waiver. These proposed regulations direct the use of these same factors to determine if an employer that sponsors a 401(k), 401(m) or 403(b) safe harbor plan is facing a substantial business hardship for the purposes of reducing or suspending the safe harbor 3% nonelective contribution. Under 412(c), determination of whether an employer is facing substantial hardship shall include (but is not limited to) the following factors:

1. The employer is operating at an economic loss;
2. There is substantial unemployment or under employment in the trade or business and in the industry concerned;
3. The sales and profits of the industry concerned are depressed or declining; and
4. It is reasonable to expect that the plan will be continued only if the waiver (i.e., the reduction or suspension of the 3% nonelective safe harbor contribution) is granted.

Proposed Effective Date – These regulations are proposed to be effective for amendments adopted after May 18, 2009. The proposed regulations may be relied upon until final regulations are released. If any provisions of the final regulations are more restrictive they will be applied without retroactive effect. The IRS is requesting comments by August 17, 2009 and a public hearing will be held on September 23, 2009.

IRS Circular 230 Disclosure

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