

“What keeps you up at night?”

Saul Ewing Labor,
Employment and
Employee Benefits
Practice Group:

Harriet E. Cooperman
Co-Chair

Robert L. Duston
Co-Chair

New IRS guidance allows plan sponsors with a “Substantial Business Hardship” to suspend or reduce 401(k) safe harbor contributions mid-year

By Joan M. Corcoran, Esq. and Denise E. Menna, QPA, QKA

On May 18, 2009, the IRS issued proposed regulations that allow an employer who is experiencing a “substantial business hardship” to reduce or suspend required safe harbor nonelective contributions to its 401(k) plan (“Safe Harbor Contributions”) during the plan year without causing the plan to lose its qualified status if certain requirements are met. In general, a 401(k) plan that provides Safe Harbor Contributions (contributions equal to at least 3% of pay) automatically passes the actual deferral percentage (“ADP”) nondiscrimination test of Section 401(k) if certain notice and other requirements are met, including the requirement that Safe Harbor Contributions be provided for the entire plan year.

Although the regulations are in proposed form, employers may rely on the proposed regulations for amendments made after May 18, 2009. If final regulations are more restrictive than the proposed regulations, the provisions of the final regulations will not be retroactive.

SUBSTANTIAL BUSINESS HARDSHIP

Safe Harbor Contributions during the plan year may only be reduced or eliminated under the new IRS guidance if the employer has a “substantial business hardship.” The factors taken into account in this regard include whether:

- The employer is operating at an economic loss;
- There is substantial unemployment or underemployment in the trade or business and in the industry concerned, and;
- The sales and profits of the industry concerned are depressed or declining.

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PRIOR NOTICE AND OTHER REQUIREMENTS

To take advantage of the IRS guidance, the following requirements must be satisfied:

- A notice must be provided to all eligible employees that explains: (i) the reduction or suspension of future Safe Harbor Contributions; (ii) the procedures for changing employee deferral elections; and (iii) the effective date of the amendment.
- The reduction or suspension cannot occur earlier than thirty (30) days after the notice is provided or before the plan amendment reducing or suspending contributions is adopted.
- Eligible employees must be given a reasonable amount of time to change their deferral elections prior to the reduction or suspension.
- The ADP test, using the current year testing method, must be satisfied for the entire plan year and the plan must be amended accordingly.
- The plan must satisfy the Safe Harbor Contribution requirement for compensation paid through the effective date of the amendment, and the annual plan year compensation limit under Section 401(a)(17) (\$245,000 for 2009) must be prorated in determining the partial year Safe Harbor Contribution.

The plan must satisfy the “top-heavy” minimum contribution requirements under Section 416 for the entire plan year. This change in the safe harbor rules may provide valuable financial

relief to businesses suffering from the current economic downturn, but to take advantage of it, the plan must be amended and proper notice must be provided. Please feel free to contact any of the following members of our Employee Benefits Group if you have questions about the new IRS guidance.

Dan S. Brandenburg dbrandenburg@saul.com 202.295.6644
Robert H. Louis rlouis@saul.com 215.972.7155
Joan M. Corcoran jcorcoran@saul.com 410.332.8691
Joanne G. Jacobson jjacobson@saul.com 202.295.6616
Denise E. Menna dmenna@saul.com 215.972.7766

This Alert was written by Joan M. Corcoran, and Denise E. Menna. Ms. Corcoran is a Partner in the Firm's Labor, Employment and Employee Benefits Practice Group and may be reached at 410.332.8691 or jcorcoran@saul.com. Ms. Menna is a Paralegal in the Firm's Philadelphia office and is not a licensed attorney. This publication has been prepared by the Labor, Employment and Employee Benefits Practice Group for information purposes only.

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