

SUSPENDING SAFE HARBOR CONTRIBUTIONS MID-PLAN YEAR

Given the current uncertainty in the world economy due to the coronavirus pandemic, employers who sponsor 401(k) plans want to know if they can stop their safe harbor contributions mid-year. The simple answer is yes, but there are amendments and notice requirements along with the implications of removing the safe harbor contribution.

Removing the Safe Harbor Contribution

First, the plan document must be amended to remove the safe harbor provision, whether the plan uses the safe harbor 3% non-elective or matching contribution. In addition, all employees who are eligible for the plan must be given a notice 30 days ahead of the change and the opportunity to change their deferral elections at that time. We can assist you by preparing the amendment and required notice.

Implications

If you are considering removing the safe harbor provisions, there are a few very important stipulations we must pass on.

Funding Year-to-Date Contributions

Under current law, the plan sponsor is still required to fund the safe harbor for the period from the start of the year through the date the safe harbor removal becomes effective, e.g. 30 days after participant notice is given. For example, if you provide a notice on April 1, 2020 indicating the safe harbor will cease on May 1, 2020, the safe harbor contribution will be calculated on eligible compensation and deferrals from January 1 through April 30, 2020.

However, you will be able to minimize the immediate impact of this requirement by postponing the actual deposit. In order to take a tax deduction for the contribution, you must make the deposit by the due date (with extensions) of the company tax return for the year. If your company is on a calendar tax year and you extend the 2020 return, that could be as late as September or October of 2021. If you are not concerned about the tax deduction, then you have until December 31, 2021 to deposit the 2020 safe harbor contribution. There is one additional note of caution with regards to deposit timing. Check the plan document for the timing of the deposits as an amendment may be necessary.

Loss of Top-Heavy Exemption

If the plan is currently top-heavy, stopping the safe harbor contributions means the plan loses its exemption from the top-heavy rules. Therefore, all eligible participants who are employed as of the last day of the plan year must receive an employer contribution equal to the lesser of 3% of compensation or the highest percentage received by key employee (basically an owner or officer). If no key-employees have made 401(k) contributions or received an employer contribution during the year, the minimum top-heavy contribution is zero. However, if key employees have been contributing during the year, this could result in a required contribution equal to 3% of wages for all eligible participants. It is important to review the plan's top-heavy status and the year-to-date contributions when making this decision.

ADP/ACP Testing

With the removal of safe harbor contribution, the plan will also become subject to ADP/ACP Non-Discrimination Test. This test limits the amount that highly compensated employees (HCEs) can defer based on the average deferral rate for non-HCEs. In the event the plan fails the ADP/ACP tests, you may have to make corrective distributions.

This information is based on the rules currently in place, but it is possible that relief may be issued in the upcoming weeks. When other options become available, we will pass along that information as soon as possible. We want to make sure you are well-informed of the options and requirements.

NH Hicks is always available to help with your specific plan and situation.