New IRS Rules Allow for Mid-Year Changes to 401(k) Safe Harbor Contributions - But, to qualify for this, employees must receive notice by December 2, 2013 that changes might be made in 2014

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Contact

Vincent P. Cacciottoli

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New final regulations released by the IRS on November 15, 2013, allow employers to reduce or suspend their safe harbor nonelective contributions to their 401(k) plans.*

Under the new rules, an employer can reduce or suspend safe harbor nonelective contributions at any time during the plan year upon 30 days' advance notice to employees provided either:

(1) The employer is operating at an "economic loss" (as defined in the new rules); or

(2) Employees were given notice before the beginning of the plan year that the safe harbor contributions might be reduced or suspended during the plan year.

In view of the new rules, we recommend that the safe harbor notices for the 2014 plan year, which need to be distributed to participants by December 2, 2013, include a statement that the employer can reduce or suspend the safe harbor contributions at any time during the plan year. This will give the employer the flexibility to reduce or suspend those contributions without needing to be operating at an economic loss. (If the notice has gone out already, you should consider sending out an updated notice.)

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* Making a safe harbor contribution allows an employer to avoid the special nondiscrimination test that applies to 401(k) plans. This test, called “ADP Test,” compares the voluntary 401(k) contributions made by the highly paid employees to those made by the lower paid. If the test is failed, the amount of the excess contributions has to be refunded to the highly paid employees, which often requires issuing amended W-2s. (None of which makes the executives happy.) However, if the employer makes a safe harbor contribution (either a matching contribution or a 3% of pay nonelective contribution), the highly paid employees can contribute up to the 401(k) maximum for the year (currently $17,500) without being limited by what the nonhighly paid employees are contributing. (A “nonelective contribution” means that the employees do not have the option of receiving the contribution in cash instead of having it deposited into their 401(k) accounts.)

If you have any questions, please contact:

Vince Cacciottoli vcacciottoli@gsblaw.com 503.553.3181