

The IRS Provides Relief for Mid-Year Reductions in Employer Contributions to Safe Harbor Plans

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On June 29, the Internal Revenue Service (“IRS”) issued Notice 2020-52, which provides guidance and temporary relief for employers who may choose to reduce contributions during 2020 to their safe harbor 401(k) or 403(b) plan. Specifically, Notice 2020-52:

- Clarifies that an employer can amend a safe harbor plan to reduce contributions made only on behalf of highly compensated employees (“HCEs”) without losing safe harbor plan status; and
- Allows an employer to make a mid-year amendment to a safe harbor plan to reduce or suspend safe harbor contributions to non-highly compensated employees (“NHCEs”) regardless of whether the employer is suffering an economic loss or has provided a notice that that the employer may suspend or reduce the safe harbor contribution during the year. This temporary relief applies to amendments adopted between March 13, 2020 and August 31, 2020.

Background

Generally, employee deferrals and employer contributions provided under a tax-qualified retirement plan must be non-discriminatory – i.e., not favor HCEs. This means employee deferrals must satisfy the annual deferral percentage (“ADP”) test, and employer matching contributions must satisfy the annual contribution percentage (“ACP”) test. In lieu of satisfying the ADP and ACP tests, however, a plan may satisfy certain “safe harbor” provisions of the Code and corresponding Treasury Regulations such that it automatically satisfies these tests.

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Under these safe harbor provisions, a plan will satisfy ADP and ACP testing if it provides for certain minimum matching or nonelective contributions to NHCEs. A plan will generally fail to satisfy these safe harbor requirements unless its provisions satisfy the safe harbor prior to the first day of the plan year and remain in effect for an entire twelve-month plan year. However, existing regulations do provide some leniency, noting that a safe harbor plan may be amended during the plan year to reduce or suspend future safe harbor contributions so long as certain conditions are met. To be eligible to reduce or suspend safe harbor contributions, the employer must either:

- Be operating at an economic loss for the plan year; or
- Have included in the plan's safe harbor notice a statement that the plan may be amended during the plan year to reduce or suspend safe harbor contributions and that the reduction or suspension will not apply earlier than thirty days after all eligible employees are provided notice of the reduction or suspension (often referred to as a supplemental notice).

If a permitted suspension is implemented, the plan amendment must also reflect that the plan will be subject to the ADP and ACP tests (using the current year testing method) for the entire plan year.

IRS Notice 2016-16 provides additional guidance related to mid-year changes – specifically, that certain changes made to a safe harbor plan or to a plan's required safe harbor notice content does not fail to satisfy the Code's safe harbor requirements merely because the change is a mid-year change, provided certain notice and election opportunity conditions are satisfied, and the mid-year change is not a prohibited mid-year change.

Relief Under the Notice

Due to the ongoing and unprecedented challenges caused by the COVID-19 pandemic, including the unexpected financial challenges caused to employers, Notice 2020-52 provides special relief from some of the existing safe harbor rules for employers who may take action to reduce or suspend employer contributions this year.

Notice 2020-52 provides two forms of relief: one related to the reduction or suspension of contributions made on behalf of HCEs; and the other related more generally (but only temporarily) to the reduction or suspension of safe harbor contributions.

Suspension of HCE Contributions – First, Notice 2020-52 provides that contributions made on behalf of HCEs are not included in the definition of safe harbor contributions, and, therefore, a mid-year change that reduces only contributions made on behalf of HCEs is not a reduction or suspension of safe harbor contributions and will not cause the plan to lose its safe harbor status. However, although contributions made on behalf of HCEs are not included in the definition of safe harbor contributions, an updated safe harbor notice and an election opportunity must be provided to HCEs to whom the mid-year change applies, determined as of the date of issuance of the updated safe harbor notice.

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Suspension of Safe Harbor Contributions – Second, Notice 2020-52 provides temporary relief related to the mid-year reduction or suspension of safe harbor contributions (either matching or nonelective) and the supplemental notice requirements for mid-year changes in safe harbor contributions (only applicable to nonelective contributions).

- **Reduction or Suspension of Safe Harbor Contributions.** Notice 2020-52 provides that a plan amendment may be adopted between March 13, 2020, and August 31, 2020 that reduces or suspends safe harbor contributions during the plan year regardless of whether the employer is operating at an economic loss, or has included the required “suspension language” in the plan’s safe harbor notice for the plan year (see above).
- **Supplemental Notice Requirements – Nonelective Contributions.** If a plan amendment that reduces or suspends safe harbor nonelective contributions during a plan year is adopted between March 13, 2020, and August 31, 2020, then the supplemental notice described in Notice 2016-16 must be provided to eligible employees no later than August 31, 2020 (instead of thirty days prior to the reduction or suspension). Also, the plan amendment that reduces or suspends safe harbor nonelective contributions must be adopted no later than the effective date of the reduction or suspension of safe harbor nonelective contributions (i.e., it cannot be retroactive).
- **Supplemental Notice Requirements – Matching Contributions.** Notice 2020-52 does not provide relief with respect to the timing of supplemental notices for a mid-year reduction or suspension of safe harbor matching contributions, as the IRS takes the position that matching contribution levels communicated to employees directly affect employee decisions regarding elective contributions. This means that the supplemental notice must be provided at least 30 days before the reduction in the matching contributions begins.

This special relief regarding the suspension or reduction of safe harbor contributions does not eliminate the requirement that the plan will become subject to ADP/ACP testing for the entire plan year.

Next Steps

Plan sponsors of safe harbor 401(k) and 403(b) plans now have a clear road map from the IRS on how to reduce or suspend employer contributions to their plan during 2020.

If a plan sponsor has already reduced or suspended contributions, it should review whether it has provided the required notice to participants. Other plan sponsors may wish to consider whether to take advantage of this relief in light of current economic circumstances. If a plan sponsor has a significant number of HCEs, one option would be to reduce or suspend contributions to those employees, as Notice 2020-52 provides that a reduction or suspension in contributions to HCEs would not be considered a reduction or suspension of safe harbor contributions. If a broader reduction or suspension is desired (i.e., it would impact both HCEs and NHCEs), plan sponsors should review the

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types of safe harbor contributions made under their plans. Nonelective contributions qualify for relief from the thirty-day notice requirement, making those contributions easier to reduce or suspend.

Unfortunately, safe harbor matching contributions are not eligible for this temporary notice relief so plan sponsors should act quickly if they want to suspend safe harbor matching contributions, as any amendment will not be effective until thirty days following the date of the supplemental notice. With an August 31st expiration date on the relief, plan sponsors of safe harbor plans should add this review to their to-do list!

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