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IS ENDING A SAFE HARBOR PLAN

Mid-year the best solution?

With the economic downturn due to the COVID-19 epidemic, many 401(k) plan sponsors are considering suspending their safe harbor arrangements mid-year. But, is this the best course of action? Here are some things to consider.

Is the plan top-heavy?

IRC Sec. 416 provides for certain requirements to be followed if a plan is "top heavy," or if more than 60 percent of the plan's assets are held in the accounts of "key" employees. A top-heavy plan requires a minimum contribution of at least 3 percent of compensation to be made on behalf of all non-key employees who are employed on the last day of the year.

Safe harbor plans are usually exempt from top-heavy requirements, however, if the safe harbor contribution is removed mid-year, the plan is subject to the top-heavy requirements for the year. This means that even though the safe harbor contribution is no longer required (following the effective date of the amendment), a top-heavy minimum contribution may be due—and it may cost more than the safe harbor contribution would have. Check with your plan service provider to find out if your plan is top heavy.

Is ADP and ACP testing required?

A safe harbor plan is also exempt from the ADP test for deferrals and, usually, the ACP test for employer matching contributions. A plan that curtailed its safe harbor mid-year will have to pass both the ADP and ACP nondiscrimination tests. Even the safe harbor matching contributions made for the portion of the year the plan was safe harbor are included in the ACP test. The result of a failed test means refunds of deferrals for owners and other highly compensated employees.

Does stopping the safe harbor mid-year estimate the full year's contribution?

The obligation to deposit the safe harbor contribution amount is enforceable under ERISA through the mid-year amendment date. For example, if a calendar year plan is amended to discontinue the safe harbor match as of June 30, 2020, it still must be deposited for the period January 1, 2020 through June 30, 2020. The amendment must be preceded by a 30-day participant notice.

Will employees be laid off, or working fewer hours?

If a plan sponsor is laying off a portion of their workforce, the safe harbor contribution obligation will naturally be decreased based on the reduced payroll and employee deferrals. It may not be much more expensive to keep the safe harbor intact for the remainder of the year.

What is the right decision?

In summary, when considering the decision to end safe harbor contributions mid-year, it is important to remember the following considerations.

- The safe harbor contribution must still be made for the portion of the year that has already elapsed, through the effective date of the amendment.
- Nondiscrimination testing requirements will kick-in for the full plan year and potentially reduce the plan's benefit for highly compensated employees, including owners.
- Top-heavy requirements may add required minimum contributions that could partially or completely negate the cost savings.
- Due to a reduced workforce, the safe harbor contribution cost for the remainder of the year may already be significantly reduced.

After all of this, if the decision is to amend the plan to remove the safe harbor keep in mind that participants must receive an advance 30-day notice before the amendment can be effective. Once the plan has amended out of safe harbor, the earliest the plan can be safe harbor again is the next plan year. Contact your Retirement Plan Consultant to request an amendment to your plan document.