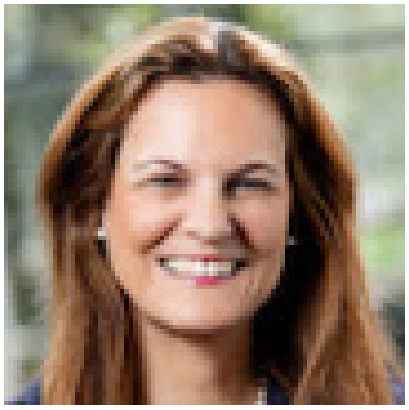
Can employers contribute less to their retirement plans?

By Wagner Law Group *Thu, Mar 26, 2020*

In the current stressed environment, "employers must take steps to remain in business, which means reducing expenses, including their contributions to their qualified retirement plans," say Wagner Law Group attorneys. (Photo: Marcia Wagner)



In reaction to the current volatility in the economy due to COVID-19, we have been receiving a large number of questions from retirement plan sponsors regarding whether it is permissible to suspend or reduce required safe-harbor contributions during the plan year.

Many companies have to reduce their expenses and improve cash flow. In recent years many of these companies adopted safe harbor designs for their defined contribution retirement plans in order to satisfy required nondiscrimination and top heavy testing, but these designs impose on the sponsoring company the cost of making required employer safe harbor nonelective contributions or safe harbor matching contributions.

An employer can reduce or suspend its safe harbor contributions during a plan year, but only if certain conditions are met:

- The employer must either: (a) have included in the required annual safe harbor notice a statement that the plan could be amended during the plan year to reduce or suspend safe harbor contributions, or (b) be operating at an economic loss as described in Section 412(c)(2)(A) of the Code, which generally requires that the employer and related employers in the same controlled group would likely need to show that its expenses exceed income for the year using generally accepted accounting principles.
- The plan sponsor must send a supplemental notice informing participants that the plan will be amended with an explanation of the reduction or suspension of the safe harbor contribution. The suspension or reduction cannot be effective until 30 days after the later of: (a) the date the supplemental notice is distributed to participants, or (b) the effective date of the plan amendment. Participants must have a reasonable opportunity prior to the suspension or reduction of the safe harbor contribution to change their deferral elections, and this opportunity also must be described in the supplemental notice.
- The plan document must be amended to reduce or suspend the safe harbor

contribution and to add the required nondiscrimination testing provisions for the plan year: the “actual deferral percentage” (“ADP”) test for 401(k) plans and the “actual contribution percentage” (“ACP”) test for plans with matching contributions, both of which must use the current-year testing method. The plan also cannot rely on the top-heavy exemption available to safe harbor plans for the plan year in which the safe harbor contributions are suspended or reduced, which means the employer may be required to make a top heavy minimum contribution at the end of the plan year that could potentially exceed the cost of the safe harbor contributions.
- An employer that suspends or reduces its safe harbor contribution mid-year must pay the safe harbor contribution amount from the beginning of the plan year until the effective date of the change. The annual compensation limit used to calculate the amount of the safe harbor contribution is prorated through the date of suspension.

A few additional considerations also should be kept in mind:

- If the employer wishes to reinstate the safe harbor provision, another plan amendment and an annual notice may be required before the start of the applicable plan year (see additional comment regarding the SECURE Act below).
- A plan could lose its tax-qualified status if safe harbor contributions are suspended during a plan year and the IRS determines that all requirements were not met. The employer may further be at risk of being found to have engaged in a prohibited transaction or fiduciary breach by not making its required contributions.
- Given the current circumstances, the Internal Revenue Service may issue further guidance in this regard.

Additional comment regarding SECURE Act changes to safe harbor nonelective contribution requirements.

The SECURE Act made changes to the safe harbor rules that allow an employer to amend a plan during the plan year or even after the end of a plan year to add safe harbor nonelective contributions without having to provide notice to plan participants before the start of that plan year. It is not clear how the new rules under the SECURE Act will affect an employer that suspends its safe harbor contributions during a plan year and wishes to amend its plan later that same plan year to resume making those contributions and make up the amount owed for the suspension period. The IRS will need to provide guidance to clarify the interplay of these rules.

The long-term prospects for the economy are uncertain, but the immediate short-term impact of the current degradation in economic growth has been significant. Employers must take steps to remain in business, which means reducing expenses, including their contributions to their qualified retirement plans.

The Wagner Law Group can provide whatever assistance is needed to review and revise plan documents, draft amendments and prepare employee communications for employers wishing to suspend or reduce their safe harbor contributions, or to amend their non-safe harbor plans to make mandatory employer contributions discretionary.