

# Reducing or Suspending a Safe Harbor Contribution Mid-Year

MassMutual's Regulatory Advisory Services



*On December 20, 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law. One of its provisions eliminated the annual safe harbor notice requirement for plans meeting the ADP Test Safe Harbor by making a nonelective contribution. The information contained in this white paper remains relevant for safe harbor plans that satisfy the safe harbor by making a matching contribution; however, until Treasury issues further guidance, it remains unclear what notice requirements, if any, will apply to a mid-year reduction or suspension of nonelective safe harbor contributions (or for the "wait and see" approach described later in this article).*

## Application

If you maintain an IRC §401(a) qualified plan with a salary deferral feature, you may utilize a safe harbor §401(k) plan design. The safe harbor design is also available to any deferred compensation program under IRC §403(b).

For simplification purposes, the concepts addressed in this white paper are explained in the context of a §401(a) qualified plan with a §401(k) feature. However, the rules regarding reduction or suspension of a safe harbor benefit (and "the wait and see approach" rules available in a non-safe harbor plan) also extend to §403(b) plans.

## Background

Generally, in order to be considered a §401(k) safe harbor plan, the contribution source used to satisfy the ADP test safe harbor must be both a required contribution and must be effective for the entire plan year. However, as is often the case with most things related to plan administration, there can be exceptions to the general rule. This paper focuses on when it is permissible to either suspend or reduce the safe harbor contribution during the plan year.

A plan will lose its safe harbor status when it fails to deliver on the promises made in the safe harbor notice. However, reduction or suspension of the safe harbor contribution does not necessarily disqualify a plan. Steps can be taken by the sponsor to ensure the plan retains its qualified status. Of important note: Reduction or suspension subjects the plan to

ADP/ACP nondiscrimination testing, when applicable, for the full plan year - even when safe harbor contributions are made for any portion of the year.<sup>1</sup> ADP/ACP testing must be performed using the current year testing method.

## Exceptions Allowing for Reduction or Suspension

There are two conditions which, if met, would allow for reduction or suspension of the safe harbor contribution during the plan year. These conditions offer an exception to the requirement that the safe harbor contribution must be effective for the full plan year. A plan must satisfy only one of the conditions to be eligible for an exception to the "full-year" requirement. These exceptions are available to plans that meet the safe harbor either with a matching contribution or with a nonelective contribution (including a qualified automatic contribution arrangement). The available exceptions are as follows:

**(1) The operating loss exception.** The employer may suspend or reduce the safe harbor contribution if it determines it is operating at an economic loss. The plan fiduciary should consider the following factors when relying on this exception:

- Economic loss is defined in §412(c)(2)(A) of the Internal Revenue Code. When referring to this citation, or to accompanying regulations, you will note the term is not expressly defined. Accordingly, you should work with your tax adviser or with qualified counsel to determine if this exception is available to you.
- The term "employer" in the context of a retirement plan means the employer that adopts the plan and any related employer. A safe approach when assessing economic loss is to consider the financial condition of all members of the employer's related group. You should consult your tax advisor or qualified counsel to assess how this exception applies to your plan.

**(2) The annual notification exception.** To use this exception, the safe harbor notice provided to participants 30 to 90 days before the start of the plan year must include a statement that says the employer may amend the plan during the plan year to suspend or reduce the safe harbor contribution, and that the reduction or suspension will not apply until at least 30 days after all eligible employees are provided notice of the reduction or suspension. Further considerations when using this exception:

- If relying on this exception, the employer does not need to meet the economic loss criteria.

<sup>1</sup> Cessation of safe harbor contributions when there is a plan termination caused by a substantial business hardship or business acquisition/disposition/merger generally will not subject the plan to ADP/ACP testing. Termination scenarios are beyond the scope of the information presented in this article.



- The annual notice that is issued 30 to 90 days before the start of the plan year must include specific language indicating that the employer reserves the right to suspend or reduce the safe harbor contribution mid-year. If the annual notice does not include this language, this exception is not available. MassMutual's sample safe harbor notice (i.e., the annual notice) does include language intended to satisfy this notification requirement.

## Plan Amendment and Supplemental Notice Always Required

Once a decision to suspend or reduce the safe harbor contribution has been made, there are additional requirements that must be followed. These requirements apply regardless of which exception is used.

- The plan must be amended to reduce or suspend the safe harbor contribution.
- A supplemental safe harbor notice must be provided to all eligible employees in advance of the plan suspending or reducing the safe harbor contribution. MassMutual can provide templates for the supplemental notice upon request.
- The supplemental safe harbor notice must explain the consequences of the amendment, the procedures by which an employee may change his or her deferral and/or after-tax election(s), and the effective date of the amendment.
- The effective date of the reduction or suspension cannot be earlier than the later of (a) the date the amendment is adopted, or (b) 30 days after the supplemental notice is provided to eligible employees. The employer remains responsible for funding the safe harbor contribution up until the effective date of the amendment suspending or reducing the safe harbor contribution.
- Eligible employees must have a reasonable opportunity after receipt of the notice and prior to the reduction or suspension of the safe harbor contribution to change their elective deferral elections.
- If not already addressed in the plan document, the amendment must provide that the ADP/ACP test, as applicable, will be satisfied for the entire plan year in which the reduction or suspension occurs, using the current year testing method.

## A Similar Sounding but Very Different Approach

Everything in this article up to this point applies to a plan that as of the first day of the plan year intends to be a safe harbor plan; and then at some point during the plan year the employer decides it wants to reduce or suspend the safe harbor contribution, taking the plan out of safe harbor status.



Did you know there is a plan design alternative specific to the nonelective contribution source that allows you to choose during the plan year to be a safe harbor plan? It is commonly referred to as "the wait and see approach." Unlike the reduction or suspension rules for a safe harbor plan, under the wait and see approach, a plan that incorporates this feature starts the year as a non-safe harbor plan and may be converted into a 401(k) safe harbor plan during the year.

Here's how it works...

1. The employer must provide a notice before the beginning of the plan year that says the plan **may** become a safe harbor plan for the coming year, but only if the employer decides to make a safe harbor nonelective contribution. The timing for when this notice must be distributed is the same timing requirement that applies to the safe harbor notice.
2. The plan must be amended if the employer decides during the course of the year to make a safe harbor nonelective contribution. The amendment must be effective no later than 30 days before the end of the plan year. *Note: If you are using MassMutual's pre-approved plan document, an amendment may not be required. There is existing wait and see language available within the document. If already elected, no amendment is required (however, the annual and supplemental notice requirements will still apply).*
3. A supplemental notice must be provided to eligible employees, no later than 30 days before the end of the plan year, letting them know of the employer's decision to make a safe harbor nonelective contribution.

Should the employer decide it does not want to make a safe harbor contribution, no supplemental notice is issued and the plan retains its non-safe harbor status for the entire year (and is therefore subject to nondiscrimination testing for that year). Also keep in mind that the wait and see approach is only available to plans that meet their safe harbor obligation by making a nonelective contribution. This approach cannot be used if a company is making a safe harbor matching contribution.

## In Summary

The reduction or suspension of a benefit in a safe harbor plan appear to share similar characteristics with the previously outlined wait and see approach. There actually are some very important distinctions, especially when it comes to the employer's obligation to fund a safe harbor contribution. In the table shown below we've highlighted some of the operational considerations. For purposes of illustration, assume the following:



- The safe harbor plan satisfies the safe harbor by making a nonelective contribution. At some point during the plan year the employer decides to suspend the safe harbor benefit.
- The plan taking the wait and see approach decides during the course of the year that it will not fund a safe harbor nonelective contribution.

	REDUCING OR SUSPENDING IN A SAFE HARBOR PLAN	WAIT AND SEE APPROACH
Is plan designated a \$401(k) safe harbor plan at start of plan year?	Yes. The plan starts the year as a safe harbor plan and only loses that designation when the safe harbor contribution is reduced or suspended.	No. The plan starts the year designed as an ADP tested plan. Since the employer will not be funding a safe harbor contribution during the plan year, it will remain a non-safe harbor plan for the entire year.
Plan amendment	An amendment is required to take the plan out of safe harbor status.	The plan is not making a safe harbor nonelective contribution. No amendment is required.
Annual notice	The plan must issue the annual safe harbor notice 30 to 90 days before the start of the plan year. The notice must include language indicating the employer has the right to reduce or suspend the safe harbor benefit at any time.	The plan must issue a notice before the start of the plan year (using the same timing standards that apply to the safe harbor notice) that says the plan may become a safe harbor plan, but only if the employer makes a safe harbor nonelective contribution.
Supplemental notice	Required. A supplemental notice is required whenever the employer reduces or suspends a safe harbor benefit.	Not required. The supplemental notice is required only if the employer decides during the year that it intends to make a safe harbor nonelective contribution.
Nondiscrimination testing (ADP/ACP)	Nondiscrimination testing is required. Upon reduction or suspension of benefit, the plan loses its safe harbor status. ADP/ACP testing, as applicable, must be performed using the current year testing method.	Nondiscrimination testing is required. The plan never converted to safe harbor status. The plan announced through its annual notice that it was taking a wait and see approach; therefore, testing must be performed using the current year testing method.
Funding obligation	Participants have earned a benefit in the safe harbor contribution up until the effective date of the amendment taking the plan out of safe harbor status. The employer must fund the nonelective contribution for the portion of the year that the plan was designated a safe harbor plan.	The employer did not issue a supplemental notice. Absent this notice, the plan does not convert to a safe harbor status. If there is no other language in the plan document requiring the employer to make a nonelective contribution, the employer is under no obligation to make a contribution.



## Next Steps

If you have questions about the information in this white paper, or are wondering what your 'next steps' might be with respect to reducing or suspending safe harbor contributions, please contact your MassMutual representative.

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