IRS Delivers Temporary Midyear Relief to 401(K) & 403(B) Safe Harbor Plans

August 13, 2020

Plan sponsors that have already or are considering reducing or suspending contributions to their safe harbor 401(k) or 403(b) plans as a result of the coronavirus pandemic now have helpful relief thanks to new guidance from the Internal Revenue Service (IRS).

In Notice 2020-52, the IRS recognized that many employers are facing unprecedented financial challenges as a result of the coronavirus pandemic and that employers may need to reduce or suspend contributions to satisfy payroll and other operating costs. This new guidance allows plan sponsors to make midyear contribution changes without having to satisfy certain rules, including notifying participants in advance. It is important to note that plan sponsors that take advantage of this relief must amend their plan documents to reflect contribution changes by August 31, 2020.

Background on Safe Harbor Rules

Safe harbor plans waive certain nondiscrimination testing requirements as long as plan sponsors make a 3% qualified non-elective contribution (QNEC) or comply with a formula for matching employee contributions. Under normal rules, plan sponsors can make midyear contribution changes if they satisfy one of two requirements: 1) they are operating at an economic loss; or 2) they give warning to participants in the annual safe harbor notice that contributions may be reduced or suspended after giving 30 days' notice.

Relief is Immediate

Notice 2020-52 recognizes that plan sponsors could not have foreseen the coronavirus pandemic and therefore most likely did not include their right to reduce or suspend contributions when they sent their annual safe harbor notices to participants before the start of the 2020 plan year. In addition, plan sponsors may not know at this point whether they are operating at an economic loss for the year.

Consequently, Notice 2020-52 allows plan sponsors to reduce or suspend contributions regardless of whether they are operating at a loss or warned participants of potential reduced/suspended contributions in annual safe harbor notice. To qualify for this relief, plan sponsors must amend the plan document to include contribution changes by August 31, 2020; the amendment is effective on the date the adjustment became operational. As long as participants are notified by August 31, 2020, the notice also temporarily relieves plan sponsors who contribute a QNEC from the 30-day advance notice to participants regarding the change in contributions (but employers who use the matching contribution safe harbor formula must still give affected participants a revised safe harbor notice).

Tax exempt and governmental employers should note that Notice 2020-52 applies to 403(b) plans that use the Section 401(m) safe harbor rules for nondiscrimination testing relief.

The notice clarified that contributions made to highly compensated employees (HCEs) are not included in the definition of safe harbor contributions. Nevertheless, a midyear change that only reduces contributions made on to HCEs may be a change to the plan's required safe harbor notice. Plan sponsors who change the contributions for HCEs (but do not change the contributions for other employees) would need to give HCEs (but not other employees) an updated safe harbor notice and a reasonable time to revise their salary deferral elections.

Insight: Don't Overlook the August 31 Amendment Deadline

The IRS has given plan sponsors operating safe harbor 401(k) and 403(b) plans valuable flexibility in adjusting contributions during the coronavirus pandemic. But plan sponsors must amend their plan documents and notify participants by August 31, 2020 to reflect any contribution changes. Failure to do so could jeopardize the plan's tax-qualified status and trigger expensive penalties and tax consequences. This is a very short deadline, which differs from most tax-qualified retirement plan amendment deadlines (which are often not due until years after the effective date of the change).

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