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At Last . . . My Safe Harbor Guidance Has Come Along

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By David S. Rosner

On January 29, 2016, the IRS issued Notice 2016-16 containing guidance on mid-year changes to safe harbor plans that are a huge relief to plan sponsors. The Notice applies both to qualified plans under Internal Revenue Code sections 401(a) and 403(b) and is effective for mid-year changes occurring on or after January 29, 2016.

At last . . . the Internal Revenue Service (IRS) finally provides mid-year safe harbor guidance. Etta James's legendary cover of that song is fitting considering the many years that employers have waited to receive this valuable relief.

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Background

Safe harbor plans are immensely popular because they eliminate the need for employers to undergo expensive and complicated actual deferral percentage (ADP) and actual contribution percentage (ACP) nondiscrimination testing. Also, they provide predictability for highly-compensated employees on the amount of deferrals they may contribute for a given plan year.

Prior to this guidance, there was a cloud of uncertainty and risk regarding whether it was safe to amend a safe harbor plan mid-year. This is because the IRS took the position that its regulation prohibited any amendment modifying the safe harbor plan unless specific guidance stated otherwise. Their concern is that a mid-year change may affect a participant's decision regarding how much to defer for a given plan year (or whether to increase/decrease deferrals prospectively) That decision is made based on the annual required safe harbor notice that is given to participants at least 30 days before the beginning of the plan year.

Previously, mid-year amendments to safe harbor plans were expressly permitted to:

- adopt a Roth contribution program;
- expand the plan's hardship withdrawal feature;
- conform amendments to the plan with the Supreme Court's *United States v. Windsor* decision relating to same-sex spouses;
- suspend a plan's safe-harbor contributions; and
- terminate the plan.

Currently, plan sponsors may rely on the Notice to determine whether a mid-year change is permitted and if so, what notice and election conditions need to be satisfied in order to avoid violating section 401(k) and 401(m) of the Code.

What Is a Mid-Year Amendment?

Under the Notice, a mid-year amendment can mean one of two things (assuming a calendar plan year):

- An amendment that is first effective during a plan year, as opposed to the beginning of the plan year; and
  Example: an amendment that is effective on March 1.
- An amendment that is effective as of the beginning of the plan year, but adopted after the beginning of the plan year.
  Example: an amendment that is effective on January 1 but is executed on March 1.

The IRS includes helpful examples in the Notice that illustrate the below rules.

Notice Conditions

The new notice must be given to participants at a reasonable period of time prior to the effective date of the change. A period of 30 to 90 days is deemed to meet this requirement, but the IRS gives sponsors at most 30 days after the change is adopted if it is not practicable to give notice before the effective date. For example, this outer limit would apply if there was a mid-year change to increase matching contributions retroactively back to the beginning of the plan year. If the change was already included in the original safe harbor notice or does not relate to information that is required to be included within the safe harbor notice, then a new notice is not required.

Election Conditions

Correspondingly, if a new safe harbor notice is required, then each eligible employee must be given a "reasonable opportunity"—at least 30 days before the effective date of the change—to modify their deferral election after receiving an updated notice. Once again, the IRS provides sponsors at most 30 days after the change is adopted if it is not practicable to give notice before the effective date.

Prohibited Mid-Year Changes

The IRS lists five types of mid-year changes to safe harbor plans that Notice 2016-16 prohibits.

1. Sponsors may not amend safe harbor plans mid-year to increase the completed number of years of service to vest in a Qualified Automatic Contribution Arrangement (QACA) safe harbor contribution. For example, this means that sponsors may not change the vesting schedule from one-year to two-year cliff vesting.
2. Sponsors may not amend safe harbor plans mid-year to decrease the group of employees eligible to receive safe harbor contributions. An employer may, however, change the entry date for those that are not already eligible to participate in the plan.
3. Sponsors may not amend plans mid-year to change the type of safe harbor plan. If a sponsor has a traditional safe harbor plan, the plan may not be changed mid-year to become a QACA safe harbor plan.
4. Sponsors may not amend safe harbor plans mid-year to permit discretionary matching contributions.
5. Sponsors may not amend safe harbor plans mid-year to modify (or add) a formula used to determine matching contributions (or the definition of compensation used to determine matching contributions) if the change increases the amount of matching contributions.

The fourth and fifth prohibited amendments in the above list are not absolute prohibitions. Sponsors may make those amendments mid-year provided the employer meets several criteria as follows:

- The amendment is executed prior to October 1.
- The notice and election conditions are met.
- The change is retroactive for the entire plan year back to January 1 (e.g., matching contributions for the payroll period are modified to matching contributions based on the entire plan year).

Open Questions

The IRS requests written comments by April 28, 2016, on mid-year changes relating to:

1. plans that have Eligible Automatic Contribution Arrangements (EACA); and
   a. The defining characteristic of EACAs is that they allow employees to withdraw default elective deferrals within 90 days after the first contribution is made.
2. mergers and acquisitions.

Practical Impact

By adequately protecting the interests of participants and beneficiaries through supplemental notices and elections, the IRS largely evens the playing field between non-safe harbor and safe harbor plans. At the same time, employers now have the flexibility to incorporate mid-year changes without losing sleep at night . . . at last.

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