THE EMPLOYEE BENEFIT
Forum
current issues in retirement benefit planning

Suspending a Safe Harbor Match

SITUATION: We have been operating our 401(k) plan as a safe harbor plan for several years, making dollar-for-dollar safe harbor matching contributions on employee elective deferrals up to 3% of compensation and a 50 cent match on elective deferrals that exceed 3% of compensation but do not exceed 5% of compensation. We had planned to continue to operate as a safe harbor plan in 2009 and sent out the required safe harbor notice for the 2009 plan year to plan participants in late October 2008. Now, due to the economic downturn, our company is having difficulty making the matching contributions.

QUESTION: Can we amend our plan now, after the plan year has started, to suspend or eliminate matching contributions?

ANSWER: Yes, as long as you follow the procedures in Reg. Sec. 1.401(k)-3(g).

DISCUSSION: Many employers adopt a basic safe harbor plan design to allow them to avoid required annual nondiscrimination tests and the top-heavy rules. (A different safe harbor design is also available for plans with automatic enrollment.) A safe harbor design allows owners and other highly compensated employees to contribute the maximum amount allowed by law to their 401(k) plan accounts. Without a safe harbor design, if a plan fails one of the nondiscrimination tests, excess contributions by highly compensated employees have to be refunded to the employees or recharacterized as after-tax contributions, or additional employer contributions have to be made.

Before you reduce or suspend your safe harbor matching contributions, you need to provide all eligible employees with a written *supplemental notice* at least 30 days before the change goes into effect. The notice must explain: (1) how the suspension or reduction will affect matching contributions on future elective contributions and, if applicable, employee contributions; (2) procedures for changing employee elective deferrals; and (3) the date the amendment is effective. Employees must be given the opportunity to change their deferral election.

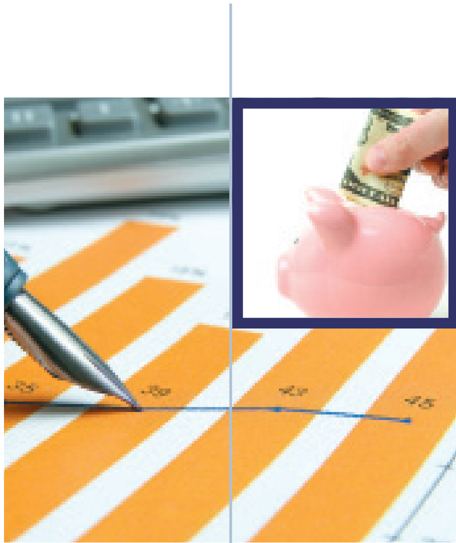
In addition, the plan must be amended to provide that the actual deferral percentage (ADP) nondiscrimination test will be satisfied for the entire plan year using the current year testing method. Very simply, the ADP test compares the average rate at which highly compensated employees defer salary with the average deferral rate for nonhighly compensated employees. The difference between highly paid and nonhighly paid employees must be within certain defined limits. If it isn't, you must correct the excess contributions made by the highly compensated employees.

2 Keep Them Contributing

2 Workers Unaware of Distribution Options

3 The Worker, Retiree, and Employer Recovery Act of 2008

4 Recent Developments In Benefit Plans



Keep Them Contributing

Have you noticed a decline in employee contributions to your 401(k) or 403(b) plan since year-end 2008 plan statements went out? To encourage stock-shy employees to keep contributing to your plan, you may want to share this information with them. According to the Employee Benefit Research Institute, plan participants with current account balances of more than $200,000, on average, have seen a 161% increase in their account balances since 2000. This is despite the fact that, in four out of these nine years, the stock market posted negative returns.

You may need to remind employees that their account balances include both investment returns *and* the contributions they make to your plan. Generally employees who made contributions throughout 2008 ended the year with higher account averages (and more accumulated shares) than those who stopped contributing when the market started declining. Employees who make regular plan contributions regardless of market conditions — and therefore, continuously invest in the market — may have a better chance of growing their accounts over time.

Workers Unaware of Distribution Options

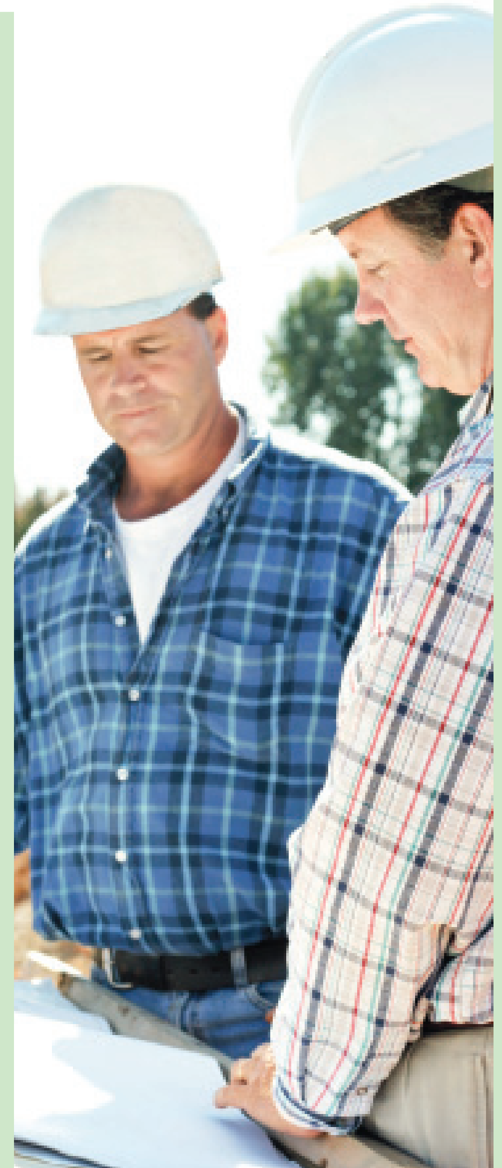
Research shows that many older workers (those aged 50 to 64) do not know much about their retirement plans' distribution options.* For example, when asked whether they could withdraw their account balances as a life annuity, rather than as a lump-sum distribution, fewer than half of the employees surveyed who participate in 401(k) or other defined contribution plans (46%) answered correctly.

401(k) plans can offer lump-sum, installment, and annuity distribution options, but few of the plans in the survey had a life annuity option. Of the employees who answered the above question incorrectly, the vast majority (roughly 88%) thought they could choose an annuity when, in reality, their plans did not offer this distribution option.

The research found that most employees don't think about how they will receive their retirement benefits until they retire, even though available distribution options can have an impact on retirement planning. It further suggested that this delay may indicate that many older employees have not prepared for the need to budget their money during retirement or thought about how they will manage their money, which could adversely affect their retirement security.

To help your employees prepare for retirement, it's important for you to communicate your plan's distribution options to plan participants as part of your regular retirement plan education program. For younger employees, knowing how they may want to receive their retirement benefits — lump sum versus installment payments or a life annuity — may help them better plan their retirement savings program. For older employees, knowing their options may help them set a realistic retirement date.

* *U.S. Survey of Older Employees' Attitudes Toward Lump Sum and Annuity Distributions from Retirement Plans*, May 2007, Watson Wyatt



The Worker, Retiree, and Employer Recovery Act of 2008

The Worker, Retiree, and Employer Recovery Act (the "Act"), which was signed into law in late 2008, includes short-term relief to help individuals and plan sponsors cope with the recent economic uncertainty. It also makes technical corrections to the Pension Protection Act of 2006 (PPA). Below we answer some questions you may have about the Act.

What relief does it provide to employers? Most notably, it provides relief to underfunded pension plans by adjusting the phase-in to PPA's new full funding targets. The Act also repeals the requirement that 401(k) plans calculate gap period income (the income from the last day of an employee's taxable year to the date an excess deferral distribution is made) and distribute it to employees along with excess deferrals.

What about employees and other plan participants? The Act waives "required minimum distributions" (RMDs) from tax-deferred retirement accounts — including 401(k)s, 403(b) tax-sheltered annuities, 457(b) governmental plans, individual retirement accounts (IRAs), and others — for calendar year 2009 only. Under the new law, participants who turn age 70½ in 2009 will not have to take their first RMD — technically, the RMD for 2009 — by April 1, 2010. Instead, the first RMD will be for 2010, and the deadline for taking it will be December 31, 2010. Participants who have already begun taking RMDs may skip their 2009 RMD. But, if they do take a withdrawal in 2009 that is not an RMD for 2008, they may be able to roll over the withdrawn amount into an IRA or other eligible retirement plan. Beneficiaries who are receiving distributions over a five-year period may waive the distribution for 2009, effectively extending the distribution period to six years.

The Act provides no relief to individuals who turned 70½ in 2008. These taxpayers are still generally required to take their 2008 RMDs by April 1, 2009. RMDs will resume for all for 2010, and they must be taken by December 31, 2010 (April 1, 2011, for individuals who reach age 70½ in 2010).

Are account rollovers affected by the Act? Yes. PPA allows plans to offer a nonspouse beneficiary the option to directly roll over an eligible rollover distribution to an IRA set up to receive the distribution on behalf of the beneficiary. The new law *requires* 401(k), 403(b), and 457(b) plan sponsors to offer this option for plan years beginning after December 31, 2009. Sponsors must provide nonspouse beneficiaries with a Section 402(f) notice explaining the tax options for distributions. The Act also clarifies that the income restriction on rollovers to a Roth IRA does not apply to rollovers from a designated Roth account under a 401(k) or 403(b) plan.

What about automatic contribution arrangements? Under PPA, automatic contributions to eligible automatic contribution arrangements (EACAs) had to be invested in a qualified default investment alternative (QDIA) as defined by U.S. Department of Labor regulations, unless otherwise directed by the participant. Participants in EACAs could make "permissible withdrawals" within 90 days of the date the first automatic contribution was made to the participant's account.

The Act repeals the QDIA requirement for EACAs. It also broadens the definition of applicable plan to include SIMPLE IRAs and Simplified Employee Pension plans that have a salary reduction arrangement (often referred to as SARSEPs) and makes permissible withdrawals available to participants in these plans.

When do the Act's PPA corrections go into effect? With the noted exceptions, the technical corrections to PPA are generally effective as though they were included in PPA.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

RECENT DEVELOPMENTS
In Benefit Plans

Written Plan Reprieve — More 403(b) Guidance To Come. In response to difficulties some 403(b) plans were having with putting a written plan document in place by January 1, 2009, as required by final regulations issued in 2007, the IRS has released a notice extending the written document deadline by a year to December 31, 2009 (Notice 2009-2, 2009-IRB, IR 2008-140). Other provisions of the final 403(b) regulations are now in effect. In granting the written plan extension, the IRS noted that, other than through a private letter ruling, there is no current program under which an employer can obtain assurance that the written form of its plan satisfies Section 403(b). The IRS plans to issue further guidance, including a prototype plan program and a determination letter program for individually designed 403(b) plans. These programs will include a means for plans to make remedial amendments to retroactively fix plan provisions. The IRS also plans to modify the EPCRS to include additional 403(b) issues.

Employees Miss Money-saving Opportunities. A recent survey by CareerBuilder.com reports that 23% of workers do not pay attention when employers offer new, potentially cost-saving benefits. More than half of the employers surveyed reported that missing out on open enrollment could cost workers $250 or more in out-of-pocket expenses. And 20% of employers reported it costs workers more than $1,000.

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