TROMBINO PENSION ADMINISTRATORS, INC.

Discontinuing Safe Harbor Contributions Mid- Plan Year

As the economy continues to be impacted by the coronavirus, we have been receiving questions from our safe harbor 401(k) plan sponsors about the ability to discontinue safe harbor contributions mid-plan year.

The short answer is “yes”, safe harbor contributions can be discontinued mid-plan year, but of course there can never be a short answer with retirement plan compliance. The issue is further complicated if the plan is top heavy, so please be certain to read that section below carefully.

Here are the details.

Prospective Elimination Only and Notice to the Participants

Safe harbor contributions can be discontinued prospectively only. The safe harbor must be funded through the date of the discontinuance, and the participants must be notified of the discontinuance no later than 30 days prior to the date of the discontinuance. So there is a timing element to discontinuing the safe harbor contributions. For example, if a decision was made to discontinue safe harbor contributions, and a notice was provided to the participants by April 1, 2020, the safe harbor contributions could be discontinued on May 1, 2020, with the contributions needing to be funded through May 1, 2020.

The timing rule applies to 3% nonelective safe harbor contributions as well as the safe harbor match.

For example, assume the 2020 3% safe harbor nonelective contribution is discontinued with a discontinuance date of May 1, 2020. The employer would need to fund the 3% safe harbor from January 1, 2020 to May 1, 2020.

Plan Amendment

The Plan must be amended to remove the safe harbor requirements and will then be subject to the ADP and ACP nondiscrimination test requirements. The effective date of the amendment must align with the notice requirement.

ADP/ACP Test Applicable for the entire plan year

One benefit of making safe harbor contributions is the ability to avoid having to pass the Actual Deferral Percentage (“ADP”) and the Actual Contribution Percentage (“ACP”) tests.

When safe harbor 401(k) contributions are discontinued mid-year, the plan is then subject to the ADP and ACP testing requirements for the entire plan year. In other words, even though the safe harbor contributions must be funded through the date of the discontinuance, all of the salary deferrals and matching contributions for the entire plan year must be included in the ADP and ACP tests.

Watch out for Top Heavy!

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You need to make sure the plan is not top heavy first before considering stopping safe harbor contributions. Many safe harbor 401(k) plans are top heavy, but get a "pass" on the minimum top heavy contribution requirement while they are a safe harbor plan. If the safe harbor provisions are eliminated, including eliminated mid-year, the plan becomes subject to the top heavy rules for the entire plan year.

In general, a plan is top heavy if the account balances of the Key Employees represent more than 60% of the total plan assets, as determined using the account balances as of the last day of the prior plan year.

A plan that is top heavy must make a minimum top heavy contribution to non-Key Employees. The minimum contribution is the lesser of the highest Key Employee allocation rate or 3%. Safe Harbor 401(k) plans are deemed to be not top heavy even if the top heavy ratio exceeds 60% if the only contributions made to the plan are salary deferrals and safe harbor 401(k) contributions.

For many safe harbor 401(k) plans, especially plans that make a safe harbor match rather than the 3% non-elective safe harbor, the top heavy minimum contribution may be more costly than the safe harbor contributions, making discontinuing the safe harbor contributions a more expensive strategy.

Please do not hesitate to contact our office if you are considering stopping your safe harbor contributions so that we can be certain that that the discontinuance is implemented correctly and does not put you in a worse position economically.

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