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## IRS Issues Two Pieces of Guidance to Relax Rules on Safe Harbor Plans

### Mid-Year Amendments to Safe Harbor Plans

#### Background

A safe harbor plan design allows the plan sponsor to get a “bye” on ADP nondiscrimination testing, if the sponsor is willing to make a certain level of a matching or nonelective contribution to all eligible employees. The contribution would need to be fully vested at the time it is allocated to the participants’ accounts and subject to limited withdrawal provisions. The ACP test will also be deemed to pass if certain additional requirements are satisfied. The safe harbor plan design allows the highly compensated employees to take full advantage of the 401(k) elective deferral limit each year without the worry of failing the ADP test and receiving a corrective distribution.

In order to take advantage of the safe harbor provision, the IRS generally requires that the plan design be adopted and in place as of the first day of the plan year and continue for an entire 12-month plan year. In addition, 30 to 90 days before the beginning of the plan year the eligible plan participants must receive a safe harbor notice which provides a summary of the plan’s safe harbor provisions. The IRS has had a long standing interpretation that whatever plan provisions were in place as of the first day of the plan year would need to remain the same for the entire plan year with limited exceptions to amend

during the plan year. This had been a source of frustration for plan sponsors of safe harbor plans that may have wanted to make plan changes during the plan year, but were required to wait until the end of the plan year.

#### New Rules

In Notice 2016-16 the IRS provides guidance that greatly relaxes the ability to amend a safe harbor plan mid-year. Instead of restricting amendments to a short list of what is available for mid-year amendments, the IRS now allows for any type of amendment other than a short list of what is prohibited. In general, the notice prohibits the following types of mid-year amendments:

- A change to the plan’s eligibility provisions that would reduce or narrow the group of employees eligible to receive the safe harbor contribution
- A change in the type of safe harbor plan, for example, a change from a traditional 401(k) safe harbor to a Qualified Automatic Contribution Arrangement (QACA) safe harbor
- A change 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 or to permit discretionary matching contributions

*continued...*

- A change to increase the number of years of service required for full vesting of a QACA contribution

Certain other existing regulations will still prohibit or restrict mid-year amendments. Some examples include:

- An amendment cannot reduce a participant's right to an accrued benefit
- If a sponsor amends the plan year, any resulting short plan years must be at least three months long and comply with other requirements
- Any reduction or suspension of safe harbor contributions must comply with existing rules

A revised safe harbor notice will be required for any mid-year amendment that changes a plan provision that is part of the safe harbor notice disclosure requirements. A revised notice must be provided to all eligible participants 30 to 90 days before the effective date of the amendment.

## **Application of Plan Forfeitures Toward ADP Safe Harbor Nonelective and Matching Contributions, as well as Other QNECs and QMACs**

### **Background**

The IRS Regulations define an ADP Safe Harbor Contribution as either a matching or nonelective contribution that satisfies a number of requirements, one of which is that the contribution be 100 percent vested *at the time contributed to the plan*. Due to this language, a safe harbor plan could not apply forfeitures toward any safe harbor contribution. A plan forfeiture account is made up of non-vested contributions that were originally contributed to a source of money that was subject to a vesting schedule; therefore, were not fully vested at the time contributed to the plan.

When pre-approved plans were updated to comply with the last restatement cycle (known as the PPA restatement), the IRS required that the document include language indicating that a safe harbor contribution be 100 percent

vested at the time contributed to the plan. As such, the American Trust pre-approved Volume Submitter base language includes language to this effect (see 3.07(A)(7)) of base plan document).

### **Proposed Regulations**

The IRS has issued proposed regulations which will update the definition of an ADP safe harbor matching or nonelective contribution to no longer require the 100 percent vesting at the time they are first contributed to the plan, but instead, be 100 percent vested at the time they are allocated to participants' accounts. This change of definition will apply to the ADP safe harbor contribution, as well as any other QNEC or QMAC source of money. The IRS has indicated that the proposed regulations can be relied upon immediately.

### **Impact and Next Steps**

With the proposed regulations, there is no longer a regulatory restriction on using plan forfeitures to offset ADP safe harbor matching or nonelective contributions or other QNEC/QMAC contributions. However, the base plan document contains language that restricts the use of forfeitures. American Trust, as sponsor of the Volume Submitter plan document, has amended the document on your behalf to allow plan forfeitures to be used to offset ADP safe harbor contributions, as well as any other QNEC or QMAC source contribution.

While this amendment removes the document restriction on how the plan forfeitures may be applied, you will need to review your plan's adoption agreement to determine the usage of plan forfeitures (see #33 in your adoption agreement). If you currently have selected that forfeitures may be used to reduce nonelective or match contributions, then plan forfeitures can be used to offset your safe harbor contribution. However, if you have not elected to use forfeitures to reduce nonelective or match contributions and you would like to use forfeitures to offset safe harbor contributions, please contact your American Trust Relationship Manager to initiate an amendment request.

***If you are not sure how these changes in the safe harbor rules affects your plan, or you have any additional questions, please contact your Relationship Manager at 800.548.2995.***