IRS Revisits Mid-Plan Year Changes to Safe Harbor 401(k) Plans

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In September of 2014, we here at Legacy Retirement Solutions, LLC (“Legacy”) published an article in our monthly newsletter that both summarized and humbly questioned the restrictive position taken by the Internal Revenue Service (“IRS”) with regard to the permissibility of mid-plan year amendments to “safe harbor” 401(k) plans. Then, on January 29, 2016, the IRS released Notice 2016-16 which, with limited exception, eliminated this restriction. Coincidence?

As much as the dedicated and loyal readers of our newsletter have suggested otherwise (Thanks Mom!), we are confident that Legacy’s article on this issue had absolutely nothing to do with the decision of the IRS to change the rules. Notwithstanding our complete and utter lack of influence on the IRS in relation to this matter; we can, nonetheless, provide you with the following thorough and informative summary of the new rule.

Background

Prior to the release of IRS Notice 2016-16, the IRS took that the position that, with the exception of a handful of specifically enumerated situations, safe harbor 401(k) plans were not allowed to be amended mid-plan year. In general, the documented exceptions to the restriction on mid-year amendments included: 1) reducing or eliminating the safe harbor feature in its entirety if certain other conditions also were satisfied; 2) allowing hardship distributions on account of medical expenses, college expenses and funeral expenses of a plan beneficiary; 3) adding a Roth 401(k) feature; 4) adding “in-plan Roth rollovers” and “in-plan Roth transfers” but each was only available during a brief, since expired, timeframe; and 5) revising the definition of spouse in order to conform plan provisions to the requirements of the 2014 DOMA “same sex” ruling.

Many industry practitioners questioned the need to restrict mid-plan year safe harbor 401(k) amendments. This challenge seemed particularly appropriate in the context of plan provisions that were completely unrelated to the safe harbor feature of the plan at issue and its operation. For example, why should a plan sponsor of a plan with a safe harbor 401(k) feature be precluded from amending its plan mid-year to provide for loans or in-service distributions upon the attainment of age 59-1/2? How would granting participants the ability to receive loans or in-service distributions negatively impact the operation of a safe harbor 401(k) plan? Presumably, these types of situations were the ones that ultimately convinced the IRS that it should relent … along with the September 2014 Legacy newsletter article, of course … or not.

New Guidance

As indicated above, the prior position of the IRS was that mid-plan year changes to safe harbor 401(k) plans were prohibited except in the case of a few limited and specifically enumerated exceptions. However, the new guidance provided within IRS Notice 2016-16 implements literally the opposite approach. Under the new guidance, in general, any amendment that is permitted to be made mid-plan year to a non-safe harbor 401(k) plan can also be made to a safe harbor 401(k) plan with the exception of a defined list consisting of a few specifically prohibited situations. In addition, no special procedures are required to effectuate the amendment unless it would impact the safe harbor 401(k) plan provisions or the required content of the safe harbor 401(k) notice.

Impact on Safe Harbor Notices

Safe harbor 401(k) plans have an annual notice requirement. Therefore, logically, the new IRS guidance indicates that if the information that is required to be disclosed on the safe harbor notice changes as a result of a plan amendment, plan participants must receive an updated notice. In that situation, plan participants must also be provided with a reasonable opportunity to alter their deferral elections before the effective date of the change. In this regard, the IRS has indicated that a 30 day advance notice would satisfy this requirement. However, if a 30 day advance notice time period is not practical (for example, a mid-year change that permissibly applies retroactively for the entire plan year), the notice is considered timely if it is provided as soon as practicable but not later than 30 days after the change is adopted.

It is important to recognize that the dissemination of an updated safe harbor notice does not impact a plan sponsor's independent obligation under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), to supply participants with a "summary of material modifications" ("SMM") or updated "summary plan description" ("SPD") that communicates the impact of the plan amendment. Thus, be aware that the new IRS guidance supplements existing IRS safe harbor notification requirements but does not supersede the SMM and SPD requirements of ERISA.

Specific Prohibitions

As mentioned above, the new IRS guidance does specifically prohibit certain mid-plan year amendments to safe harbor 401(k) plans. The specifically enumerated mid-plan year prohibitions dictate that:

- No amendment may increase the years of service necessary to vest in a "qualified automatic contribution arrangement" ("QACA") safe harbor contribution. (Although most safe harbor contributions must be 100% fully vested when made, up to a two-year cliff vesting schedule may apply to QACA safe harbor contributions.)
- No amendment may narrow the group of employees eligible to receive the safe harbor unless the excluded group is not yet eligible to participate in the plan.
- No amendment may change the plan from one "type" of safe harbor plan to another. For example, a plan could not change from a traditional safe harbor plan to a QACA.

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- No amendment may add or increase a matching contribution feature unless the change is made at least three months prior to the end of the plan year and is retroactively effective to the beginning of the plan year.

The guidance granted by the IRS within Notice 2016-16 will allow plan sponsors to exercise greater plan design flexibility without negatively affecting plan participants. Thus, it is welcome relief from the prior regulatory structure in connection with this issue.

As much as we hope this article helped you to better understand this topic, it is not to be construed as financial, tax or legal advice. Therefore, if you believe that it may apply to your (or your client's) company, be sure to further discuss it with a qualified retirement plan professional. For more information about this topic, please contact our marketing department at 484-483-1044 or your administrator at Legacy.