NATIONAL RETIREMENT SERVICES, INC.

IRS ANNOUNCES NEW RULES FOR DROPPING SAFE HARBOR EMPLOYER CONTRIBUTIONS MID-YEAR

In mid-November, the IRS announced changes to the rules that enable employers to reduce or suspend 401(k) plan safe harbor contributions in the middle of the year in which they were supposed to apply. Safe harbor employer contributions guarantee passage of the nondiscrimination rules without testing. They either take the form of (1) matching contributions equal to a percentage of employee deferrals up to specific percentages of compensation or (2) contributions unrelated to the amount of employee deferrals ("non-elective contributions") equal to a level percentage of compensation. Employers are required to notify eligible employees of their intent to make specified contributions before a plan year begins. Generally, safe harbor arrangements relate to a specific 12 month plan year and continue without change for the entire year.

Some New Rules Apply in 2014

Previous regulations permitted employers using the safe harbor matching contribution to stop mid-year without operating at a loss and without any notice before the Plan year began. These rules will continue to apply during plan years beginning in 2014, meaning that for safe harbor match plans, it's "business as usual" during 2014. However, a new rule requiring an employee notice concerning a possible future suspension (dubbed a "maybe not" notice by some practitioners) can apply for an employer using the non-elective safe harbor contributions as early as the 2014 plan year. Since the "maybe not" notice must be provided before the first day of the applicable plan year, calendar year plans need to notify plan participants within a reasonable period before January 1, 2014. An Addendum to the usual participant notice (which may have already been distributed) must be provided if the employer wants to preserve the right to reduce or suspend contributions during 2014. In addition, employers using the non-elective safe harbor contribution and operating at a loss in 2014 are allowed to reduce or suspend contributions without a "maybe not" notice.

New Uniform Rules for 2015 and Beyond

Starting for plan years that begin in 2015 or later, the following set of rules must be followed if an employer who committed to a safe harbor contribution wants to reduce or suspend these contributions mid-year. The rules do not distinguish between the two safe harbor employer contribution types and are contained in new final regulations. In order to be eligible for a mid-year reduction or suspension, the employer must either (a) *be operating at an economic loss during the year*, or (b) *have notified eligible employees of the possibility that employer contributions could be reduced or suspended before the Plan year began*.

Employers eligible to reduce or eliminate their safe harbor contributions mid-year must take the following steps to implement a mid-year change:

- Provide a participant notice at least 30 days before the change that provides –
    1. The effective date of the reduction or suspension.
    2. Explanation that there will be a plan amendment and the consequences of that amendment.
    3. Explanation of how eligible employees may change their cash or deferred elections before the change takes place.
- Amend the Plan document to reduce or stop employer matching contributions and provide for suitable ADP testing using the current year testing method.
- Perform necessary ADP testing at the end of the affected plan year.

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<u>Summary of Impact on Employers</u>

For plan years beginning in 2013, the rules before the new regulations apply: employers with employer matching safe harbors can reduce or suspend with a 30 day notice, while those with non-elective safe harbor contributions have more stringent requirements. Employers with safe harbor matching contributions may suspend them in mid-year 2014 using the same rules as 2013. Employers with non-elective safe harbor contributions may suspend in mid-year 2014 if they are operating at a loss or if they send a notice to participants before the 2014 year begins. Finally, for plan years starting in 2015, all employers with safe harbor contributions of either kind will be subject to the same rules: suspend safe harbor contributions mid-year if you are either operating at a loss or if you provided a "maybe not" notice to participants. A supplemental notice to participants describing an actual reduction or suspension must be provided at least 30 days before the reduction or suspension is effective. Also, a suitable plan amendment must be adopted no later than the effective date of the suspension.

REMINDERS FOR DECEMBER AND 2014

The following administrative items either need to be addressed prior to December 31, 2013 or the upcoming plan year:

1) **Timely Deposit of Participant Contributions and Loan Payments –** Federal regulations deem late deposits of monies withheld from an employee's paycheck for deposit into the employer's retirement plan to be prohibited transactions under ERISA. For this purpose, a deposit is late unless it is paid to the Plan by the earliest date on which the money can reasonably be segregated from the employer's general assets.

Retirement plans covering fewer than 100 participants at the beginning of the Plan year are given a 'Safe Harbor' equal to **seven business days** after the payroll date. For retirement plans with 100 or more participants (at the beginning of the Plan year), there is no such safe harbor. However, an example in U. S. Department of Labor regulations indicates that a 600 participant plan with multiple payroll centers can nevertheless deposit funds within 3 business days. Accordingly, prudent employers normally deposit participant loan repayments on the same day as the payroll, but no longer than two or three days after the payroll.

2) Required Minimum Distributions (RMD) – The Required Minimum Distributions for 2013 must be completed prior to December 31, 2013.

Participants who fit into any of the following categories are required to take minimum distributions each calendar year:

A. Terminated participants over age 70½ that have accrued benefits.
B. 5% owners of the company (regardless of employment status) over age 70½ who have accrued benefits. Please note that Required Minimum Distributions must continue in subsequent years even if the ownership falls below 5%.
C. Lineal ascendants/descendants and spouses of 5% owners of the company (regardless of employment status) who are over age 70½ and have accrued benefits.

Defined contribution plan distributions may begin in the calendar year in which the participant attains age 70½ and must begin no later than April 1 of the following year. Defined benefit plan distributions must begin no later than April 1 of the year following the calendar year in which the participant attains age 70½. Periodic distributions must continue no less frequently than annually and must be made during each subsequent year. There is a

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50% nondeductible excise tax on the portion of the RMD which has not been distributed. In addition, failure to make these payments is considered to be a failure to operate the Plan per its terms which can compromise the Plan's tax favored status.

3) **Participant Fee Disclosure (Code Section 404a-5) –** Plan Administrators are required to disclose certain plan and investment-related information, including fee and expense information, to eligible participants and beneficiaries in participant-directed individual account plans. This is a recurring annual requirement and is normally due on or before the anniversary date of the distribution of the last notice. However, for existing plans, the second annual notice can be delayed up to 18 months after the initial distribution date. In the meantime, please note that the annual notice must be distributed to new employees as they become eligible to enroll in the Plan.

4) **Maximum Compensation –** As a reminder, the maximum compensation that can be considered when determining contributions for plan years beginning in 2013 is $255,000. For plan year's beginning in 2014, the maximum compensation has been increased to $260,000. Be sure to take this compensation cap into consideration when determining the compensation for owners and other principal employees for plan years beginning in 2013 and 2014.

5) **Definition of Plan Compensation –** The definition of Compensation in the Plan Document should be carefully followed when administering a plan. Certain forms of compensation can be excluded for the purposes of calculating contributions. Excluded compensation must be clearly defined in the Plan document. Failure to use correct compensation for calculating contributions may result in an operational defect.

6) **Terminated Participants –** Former employees with vested benefits should be encouraged to receive distributions from the Plan which can be rolled over to an IRA or distributed as a direct payment. Plans approaching 100 participants may be subject to audit requirements which could be avoided if terminated participants receive distributions from the Plan. Note that in many cases terminated participants with vested benefits of less than $1,000 can receive mandatory distributions. A distribution form signed by the trustee is all that is required. Participants with vested benefits of $1,000 to $5,000 may also receive mandatory distributions in the form of a Safe Harbor Automatic Rollover IRA.

7) **Loan Defaults –** Most plans require terminated participants who have a participant loan at the time of termination of employment have their loans defaulted/distributed by the last day of the quarter following the quarter in which the last payment was made. The Plan Sponsor must make sure that the required tax reporting is accomplished in the event of a loan default in the case of participants who do not take a distribution from the Plan.

8) **Changes to Plan Provisions –** If you are considering making a change to the Plan for the current plan year and have not yet adopted a formal amendment to reflect the change, please contact NRS as soon as possible. Nearly all plan amendments must be adopted before the end of the Plan year in which they are effective. Plan changes that represent a reduction in future rights or benefits must be adopted on or before their effective date. If you are considering such an amendment for the upcoming plan year, you should contact NRS as soon as possible.

9) **Fidelity Bond Coverage –** All qualified retirement plans are required to carry a Fidelity Bond with the exception of plans that cover only the owner or owner and spouse or business partners

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and their spouses. The amount of the bond should be at least equal to 10% of the highest amount of the funds handled in the current year, with a minimum of $1,000 and a maximum of $500,000 ($1,000,000 for plans that hold employer securities). Due to special rules concerning exemption from ERISA required annual financial audits, small plan filers that have more than 5% of plan assets invested in “non-qualifying assets” (generally assets not at a regulated financial institution or participant loans) may need to expand the fidelity bond to cover at least 100% of the non-qualifying assets. Employers should review their current policy to ensure that the Plan carries sufficient coverage.

FOR MORE INFORMATION OR TO REQUEST A PROPOSAL, PLEASE VISIT OUR WEBSITE AT WWW.NRSERVICES.COM, OR FOR SALES SUPPORT, PLEASE CONTACT:

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