401(K) ACCOUNT BALANCES PLUS SOCIAL SECURITY MAY BE ADEQUATE

According to a newly released study by the non-partisan Employee Benefit Research Institute ("EBRI"), individuals with access to 401(k) plans for at least 30 years will probably have enough for a reasonably comfortable retirement. According to the study, more than four out of five American workers with at least 30 years of 401(k) participation, coupled with Social Security, are likely to have retirement income equal to 60% or more of their inflation adjusted income. What's more, about three out of four should be able to receive approximately 70% of pre-retirement income. The 70% replacement level is widely touted as a reasonable target for individuals wishing to be financially comfortable during their retirement years. EBRI statistics for employees participating in automatic enrollment plans with automatic contribution escalators were even higher. For example, approximately nine out of ten participants in these plans are likely to replace 60% of their pre-retirement income with income from Social Security and their 401(k) plan.

These statistics are encouraging, especially since many articles on the subject predict dismal financial conditions for workers who have no defined benefit pension plans. Of course, the above conclusions are valid only if Social Security benefits are not cut and only if eligible workers actually participate in their employer offered 401(k) plans. EBRI points out that less than 60% of American workers are eligible for a 401(k) plan and less than 75% of eligible employees choose to actually defer compensation. Dire predictions for inadequate retirement benefits are being partially offset by an increase in the average retirement age. After several decades of declining retirement ages, the trend has been reversed. According to Gallup, the average age of retirement among American workers has gone from 57 to 61 over the past twenty years.

UNDERSTANDING MID-YEAR PLAN DOCUMENT AMENDMENTS TO SAFE HARBOR 401(K) PLANS

For several years, the IRS has taken a position that 401(k) plans generally may not make plan amendments during a plan year designated as a safe harbor year. This position has provoked a good deal of controversy on the part of retirement plan professionals. As a result, the IRS has informally indicated that it will re-examine its position and provide more guidance. The final regulations give the IRS authority to establish exceptions to the rule. It remains to be seen what exceptions will be announced. While there has been no indication from the IRS that they intend to adopt a non-enforcement position on this matter, IRS enforcement to date has been rare or non-existent, according to a number of pension professionals.

<u>Changes that are Definitely Prohibited</u>

Based on IRS opinions to date, the mid-year amendment prohibition extends to amendments that change anything described in the annual safe harbor participant notice (whether directly or by reference to the SPD). Regulations require the following items be addressed in the annual notice, so presumably any mid-year change in these provisions is prohibited:

- The safe harbor matching or non-elective formula used for the plan year
- Other employer plan contributions and the conditions governing such contributions
- The type and amount of compensation that can be deferred
- The administrative requirements that apply to salary deferral elections and the procedure for making such deferrals

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- Periods available for making deferral elections
- The withdrawal and vesting provisions applicable to plan contributions

The IRS has informally indicated that the basis for allocating discretionary employer profit sharing contributions cannot be changed in the middle of a plan year even though arguably they are not related to employee deferrals.

Basis for Rule and Some Limited Exceptions

The heart of the problem lies in language found in the Regulations governing safe harbor 401(k) plans. The Regulations require the annual employee safe harbor notice to contain the information listed in the preceding paragraph and requires that these provisions remain in effect for the entire 12 month plan year to which the notice relates. The IRS has interpreted this to extend to most mid-year plan amendments. The IRS permitted two exceptions to the mid-year amendment rules several years ago. Both referred to amendments to take advantage of provisions offered by 2006 legislation. The first allowed a mid-year amendment permitting Roth deferrals, while the second allowed hardship withdrawals for hardships suffered by a participant's beneficiary. Informal IRS guidance provided at the 2012 American Society of Pension Professionals and Actuaries ("ASPPA") conference permits mid-year amendments to change: (1) the plan year, (2) available investment options, (3) the identity of the trustee, (4) plan coverage by expanding the eligible class, and (5) coverage or non-discrimination related provisions to correct a failure that occurred in the immediately previous plan year.

The 401(k) Regulations permit an employer to suspend or reduce Average Deferral Percentage ("ADP") safe harbor contributions mid-year, provided certain conditions are met. Participants must be advised at least 30 days in advance of the change and allowed to change their deferral elections before the change is effective. If a mid-year suspension or reduction occurs, the employer is required to conduct an ADP test for the plan year involved and all safe harbor contributions up to the effective date of the change must be deposited to the plan.

Employer Strategies to Avoid the Prohibition

Although there is little leeway permitted for employers with safe harbor plans wishing to change provisions mid-year, one strategy would be to use the "wait and see" approach. This approach involves an advance notice provided to participants that the employer may decide later in the year to adopt a non-elective contribution safe harbor. Mid-year amendments can be made before the employer decides whether to make safe harbor contributions.

A second strategy that is particularly useful if a mid-year amendment is urgently desired by the employer early in the year after a safe harbor notice has been issued involves suspending safe harbor contributions.

The suspension process is described above under the Limited Exceptions heading. This strategy stops the obligation for future employer contributions, but the plan must pass the non-discrimination ADP test for the plan year.

The Future is Uncertain

While both the private sector and IRS officials agree that more guidance in this area is advisable, most practitioners are urging caution for employers interested in making mid-year changes to safe harbor plans. Since the 2013 final regulations permit the IRS to publish additional exceptions to the general prohibition, it is likely they will do so. However, this will take time and the "exception approach" of necessity will involve many types of amendments not being approved simply because

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the possibility was not examined.

FEBRUARY 2014 REMINDERS

- **February 18 –** Forms 5500/8955-SSA are due for Plan Years ending 4/30/13 if they are on extension.

- **February 18 –** Retirement plan employer contributions are due for corporate tax returns due February 18, 2014 covering the fiscal period ending 11/30/13 and for the fiscal period ending 5/31/13 for returns on extension.

- **February 28 –** Form 5500/8955-SSA – Forms are due for Plan Years ending 7/31/13 unless an extension applies.

- **February 28 –** This is the deadline for sending Form 1099-R to the IRS concerning participants who received benefits in 2013.

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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