IRS provides mid-year amendments to 401(k) and 403(b) safe harbor plans

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Section 401(k) and Section 403(b) retirement plans are subject to very specific non-discrimination testing, which can make it difficult for highly paid employees to defer and/or to receive a full match on their deferrals. The Internal Revenue Code permits employers to take advantage of what it designates as safe harbor 401(k) and 403(b) plans. These safe harbor plans require employers to include certain types of plan features, which then allows the employer to avoid this intricate discrimination testing they would otherwise be subjected to. The Code also requires any employer which uses this type of safe harbor plan to provide a notice describing the plan's features, which must be given to employees prior to the beginning of each plan year. Due to this notification requirement, historically the IRS has been adamant that changes to these plans could not be made throughout the plan year. Only changes made before the plan year began could be made, so those changes could be reflected in the notice. This limited ability for employers to make changes to their safe harbor plans during the plan year has been consistently problematic.

However, in a much-welcomed change, the IRS recently issued its Notice 2016-16, which provides for mid-year amendments to 401(k) and 403(b) safe harbor plans. The scope of this guidance covers traditional safe harbor plans as well as Qualified Automatic Contribution Arrangements (QACAs). The guidance allows for almost any type of amendment, with a few exceptions discussed in further detail below, to a safe harbor plan during the plan year. The guidance allows for both prospective and retrospective amendments to these plans, at any time throughout the plan year.

The guidance addresses the issue of the notice provided to employees by providing that if an amendment affects information contained in a safe harbor notice, the employer can provide participants with an updated notice describing the amendment, its effective date, and give participants a reasonable opportunity to change their deferral elections based on that notice. If practical, the notice must give participants a reasonable time before going into effect, which is further defined as 30 – 90 days before the effective date. However, for changes such as retroactive amendments, where this prior notice is not possible, the notice must simply be provided as soon as practical, while still giving a reasonable amount of time after receipt of the notice to make a deferral election change.

This guidance differs from typical IRS action in that it provides most changes are allowed, with the exception of a few prohibited changes. Those prohibited changes include:

- A switch between a traditional safe harbor plan and a QACA (although the addition of an automatic enrollment feature to a safe harbor plan is permitted);
- A change to a longer vesting schedule for QACA safe harbor contributions;
- A change which reduces the number of employees eligible to receive safe harbor contributions (unless only changing the eligibility requirements to those employees who are not yet eligible to receive safe harbor contributions).

Anyone considering taking advantage of the new leeway provided by the IRS under this guidance should keep in mind that there are several specific types of amendments, which have separate requirements. Specifically, the IRS prohibits amending a 401(k) or 403(b) plan to a safe harbor plan mid-year. In addition there are specific rules for terminating safe harbor provisions mid-year.