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Retirement Plan Cost Savers

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In the face of COVID-19, as the economy falters, both employers and employees may need to save and access cash. Retirement plans are potential cash-drains on employers, and cash-sources for employees. In this article, we discuss ways for employers to reduce contribution/funding obligations. We will send a second alert covering employee access to retirement plan monies in the next day or so (there may be a number of provisions for employee access to retirement funds in the stimulus package.)

QUALIFIED RETIREMENT PLANS -- EMPLOYER COST-SAVERS:

Suspending or ending employer contributions to tax-qualified retirement plan

DEFINED CONTRIBUTION PLANS:

Some defined contribution plans require specific employer contributions. These may take the form of non-safe harbor matching, profit sharing, or money purchase pension plan contributions.* These can be suspended for at least part of the year in several circumstances:

*Safe-harbor contributions and safe-harbor match in 401(k) plans are subject to special rules, discussed separately below.

Profit-sharing plans with a stated employer contribution: The employer can amend the plan to eliminate contributions for all of 2020 if the plan requires a year of service (typically 1,000 hours of service) to earn the right to the contribution and if no participant has yet reached the 1,000 hours of service. Other plans may make the contribution available only to participants who are employed on the last day of the plan year. Again, for those who have not reached that benchmark, the contribution may be shut-off for all of 2020.

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Even if a plan lacks the year of service or “last day” requirements, the employer could amend the plan to suspend contributions to the plan after the date of the amendment.

Money purchase pension plan contributions: Money purchase pension plans are defined contribution pension plans that promise a stated contribution amount. Similar to the “fixed-contribution” profit-sharing plan, above, an employer can suspend money purchase plan contributions for the whole year if the plan requires a year of service in order to earn the right to the contribution for 2020, and participants have not earned the requisite service. (The same would be true of a “last day of employment” requirement.) However, any participant who had met the “year of service” (or “last day”) requirement by the effective date of an amendment voiding the contribution obligation would have “accrued” the right to a contribution based on at least pay through the effective date of the amendment.

Even if those benchmarks had been met, the employer can suspend money purchase plan contributions based on pay earned after the effective date of an amendment suspending contributions.

204(h) Notice. However, any money purchase plan amendment that reduces or suspends contributions is effective only after special advance notice to participants and others. This is called a “204(h) notice,” after the section of ERISA that requires advance notice of “significant reduction in benefit accruals.” Some notice rules –

- Plans with 100 or more participants must give notice at least 45 days before the effective date of the amendment reducing/eliminating contributions. (Hence, at this time of year, in a typical calendar year plan, many participants may work 1,000 hours of service by the time notice and amendment could be effective. That would mean that contributions would be required on at least pay earned to the effective date of the notice/amendment. But the amendment could cut-off contributions on subsequent pay.)
- Smaller plans (with fewer than 100 participants expected to have a plan benefit on the amendment-effective date) need to give only 15 days advance notice.
- The notice must provide sufficient information so that the recipients will understand the effect of the contribution-reduction/elimination amendment. It must be understandable and apprise the reader of the significance of the notice.
- The notice must include sufficient information for each recipient to determine the approximate magnitude of the expected reduction for her or him. In a money purchase plan, the description is usually straightforward. (In defined benefit pension plans, also subject to the 204(h) rules, the illustrations can be complex.) Illustrative examples are helpful and near-required.
- Rules are prescribed for how to deliver the notice, etc.
- Failure to give proper notice can void the contribution reduction, and lead to the imposition of excise taxes.

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Defined Contribution Plans With Discretionary Contributions: If the plan provides for discretionary profit sharing or discretionary matching contributions, an employer is not required to make those contributions. To avoid contribution obligations, all that is required is for the employer to take no action to declare a contribution.

Defined benefit plans: Defined benefit plan funding requirements will be substantially increased by current conditions, absent funding relief from Congress. The value of plan investments is falling, and the interest rates used to project funding requirements have also dropped (an unusual combination of events). An employer that has a defined benefit plan must make the minimum required contributions on time. The only relief would be if the employer amended the plan to stop (freeze) future benefit accruals. This would reduce future costs, but the obligation to fund current benefits would remain.

In any case, to stop increasing obligations, defined benefit plans can be amended to reduce or eliminate the rate of future benefit accruals, similar to the process for money purchase plans described above. It is possible to cut off all of the current year's benefit accruals by adopting a "freeze amendment" before a year of service is attained, if the plan has a year of service requirement. ("Last day" requirements don't work for DB plans.) Lacking a 1,000-hour requirement, a pay-based benefit accrual can be eliminated with respect to pay earned after the effective date of a freeze amendment.

The 204(h) notice rules, outlined above, would apply. Note that the illustration of benefit reductions in a DB plan is more complex than in a defined contribution plan.

Minimum Funding Waiver: It is also possible to get an IRS waiver of minimum funding requirements for a DB plan. But the process for getting a waiver is expensive and very time consuming, and such waivers are not granted to employers who are likely to go bankrupt or who, on the other hand, could manage to make the contributions even if it imposes a cash flow or other financial hardship. Security must be posted for waived funding amounts. The process is complex and akin to threading a needle. That said, it can defer cash obligations for employers in the right circumstances.

Other DB Funding Relief: In view of the current extreme circumstances, Congress may provide some form of funding relief.

Note that any plan contributions or benefits required by a union contract would require union consent to change or eliminate.

Defined Contribution Plans: eliminating matching contributions, including safe harbor match or safe harbor non-elective contributions:

Many profit-sharing plans provide an "employer match" to employee 401(k)** contributions. Example: 50% of the first 4% contributed by a participant. (Maximum match would be 2% of pay.)

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**The same may be true in 403(b) plans.

Discretionary match: In some plans, the match may be at the employer's discretion. As noted above, in these cases, the employer can simply take no action to provide the contribution. In some plans, there may be a 1,000 hour or last day requirement. As above, these could be cut-off for the whole year, or at least prospectively.

Safe harbor match: Many 401(k) plans provide a safe-harbor match.

- Basic match - 100% match on the first 3% of deferred compensation plus a 50% match on deferrals between 3% and 5% (4% total).
- Enhanced match - a match at least as good as the above.
- Safe harbor non-elective contribution - this is an automatic 3% contribution to all participants, whether they contribute or not.

A safe harbor match (or the safe-harbor non-elective contribution) is immediately vested, and is subject to withdrawal restrictions. By using a safe harbor match (or safe harbor non-elective), 401(k) Actual Deferral Percentage (ADP) nondiscrimination testing is not required. In other words, with a safe harbor match or safe harbor non-elective feature, Highly Compensated Employees ("HCE's) can make 401(k) salary reduction contributions out of their own pay, up to an annual maximum (\$19,500 in 2020) without regard to the amounts deferred by non-Highly Compensated Employees. In a safe harbor plan, HCE's can also receive match without testing the Actual Contribution Percentage (which tests the "match" under Internal Revenue Code Section 401(m)) provided to HCE's versus non-HCE's.

HOWEVER, once a plan year begins, and a safe harbor match or non-elective is in force, there are limits on an employer's ability to cut-off the match or non-elective.

Non-elective employer safe harbor contributions or a safe-harbor match may be reduced or suspended mid-year, provided *either* that (1) the plan sponsor shows that it is operating at an economic loss, *or* (2) the plan's safe-harbor notice for the year in which the reduction or suspension occurs states:

- The Plan may be amended mid-year to reduce or suspend the safe-harbor contribution,
- A supplemental notice will be provided if reduction or suspension occurs, and
- No reduction or suspension will take effect until at least 30 days after the supplemental notice is provided.

The SECURE Act deleted the notice requirement for a safe harbor non-elective plan for years after 12/31/19, but many calendar year plans had already given out a notice for 2020. It's not clear at this time how the lack of a notice that the safe harbor contribution could be amended might affect an employer's ability to modify safe harbor contributions mid-year.

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The safe harbor match or non-elective contribution can only be shut off prospectively, that is, as applied to pay earned after the amendment and 30-day notice. Note that shutting off the safe harbor match or non-elective contribution will subject the plan to testing the deferrals and match of HCE's versus non-HCE's. Other ramifications apply.

Plan Termination. Other options exist, such as fully terminating a retirement plan. However, the rights to benefits accrued to the date of termination are generally absolute, and would be handled similarly to what's described above relative to various kinds of plans. And of course, when a defined benefit plan is terminated, absent bankruptcy, all benefits promised by the plan must be funded (which would, in fact, accelerate the cash drain on an employer, unless the DB plan were fully-funded an unlikely situation right now.)

Partial Terminations. Also be aware that even in an ongoing retirement plan, a "partial termination" can call for full vesting of all participants. A partial termination may occur when there is a reduction in workforce due to a significant corporate event such as a closing of a plant or a division, or as a result of general employee turnover due to adverse economic conditions or other reasons that are not within the employer's control. The law requires all "affected employees" to be fully vested in their account balance as of the date of a full or partial plan termination. They must become 100% vested in all employer contributions (including matching contributions) regardless of the plan's vesting schedule. Employee salary deferrals are always 100% vested, as are safe-harbor matches or safe-harbor non-elective contributions.

An affected employee in a partial termination is generally anyone who left employment for any reason during the plan year in which the partial termination occurred and who still has an account balance under the plan.

Determining the existence of a partial termination requires a complex melding of law and facts.

These retirement plan cost-saving techniques above can help conserve cash for employers. This summary touches only the high-points of the options. The right course for each employer involves melding legal requirements, the terms of a specific retirement plan, and the employer's financial and business needs. Butzel's experienced team of employee benefits lawyers have been through many previous economic downturns, and have applied all available techniques to help employers and their retirement plans weather the storms. Please contact us to see what can be done in your situation, should saving cash be a current consideration.

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