Need to Change Safe Harbor Contributions in Your Safe Harbor 401(k) Plan During 2020? Timing is Everything

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As employers look for ways to reduce expenses or address cash flow issues, many are considering a reduction or suspension of their required contributions under their safe harbor 401(k) plan. Safe harbor 401(k) plans allow employers to avoid required ADP/ACP testing that may otherwise limit the employee elective deferrals and matching contributions available to highly compensated employees (HCEs). To avoid this ADP/ACP testing, the employer must agree to contribute a specified safe harbor employer nonelective contribution or safe harbor matching contribution for the entire plan year and comply with certain notice requirements, among other things. As a result, an employer generally may not reduce or suspend the required safe harbor contributions during the plan year unless certain conditions are satisfied. In the current economic climate, many employers need to reduce or suspend their required safe harbor contributions now and cannot wait until January 1, 2021, to preserve the economic viability of the company.

Recognizing the financial distress many companies face, the IRS has provided some relief, but it will not last long and employers seeking this relief must act by August 31, 2020. IRS Notice 2020-52 (Notice) clarifies some existing guidance and provides additional temporary flexibility that enables an employer to reduce or suspend safe harbor nonelective employer contributions and safe harbor matching contributions during 2020. First, the Notice clarifies that contributions on behalf of Highly-Compensated Employees (HCEs) are not considered safe harbor contributions. Thus, a mid-year change which only prospectively reduces or suspends nonelective employer or matching contributions to HCEs is permitted. Since the ability to reduce or suspend safe harbor matching contributions to HCEs may not have been specified in the safe harbor notice previously provided, an updated safe harbor notice must be given

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and a 30-day period provided for HCEs to change their deferral elections before the reduction or suspension of matching contributions to HCEs becomes effective. This updated safe harbor notice is not required if nonelective employer contributions to HCEs are reduced or suspended.

The Notice also provides temporary relief that allows an employer to prospectively reduce or suspend safe harbor matching contributions or safe harbor nonelective employer contributions to all participants in a 401(k) plan. To qualify for this relief, a 401(k) plan which provides for safe harbor matching contributions must be amended to reduce or suspend the safe harbor matching contributions no later than August 31, 2020. A supplemental safe harbor notice must also be provided to participants at least 30 days before the reduction or suspension becomes effective so that participants may modify their deferral elections if they choose. A 401(k) plan that includes safe harbor nonelective employer contributions must likewise adopt the required amendment by August 31, 2020 and provide a supplemental notice by August 31, 2020; however, it is not subject to the advance notice requirement that gives participants an opportunity to change deferral elections before the change is effective.

If an amendment is not adopted by August 31, 2020, an employer must rely on prior guidance with respect to a mid-year change in safe harbor contributions. Prior guidance requires that either (i) the employer be operating at an economic loss for the plan year, or (ii) the prior annual safe harbor notice specify that the 401(k) plan could be amended during the plan year to reduce or suspend safe harbor contributions and that any reduction or suspension would not be effective until at least 30 days after participants receive notice of the reduction or suspension. In order to suspend safe harbor contributions under the prior guidance, the 401(k) plan must (i) be amended, (ii) provide 30 days advance written notice to participants, (iii) provide a reasonable opportunity to participants to change deferral elections, and (iv) the reduction or suspension cannot be effective until at least 30 days after the participants receive notice.

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Employers considering reducing or suspending safe harbor nonelective employer contributions or safe harbor matching contributions in 2020 should act quickly to take advantage of the temporary relief provided by the IRS. It is important to note that if safe harbor contributions are reduced or suspended during the plan year, the 401(k) plan must satisfy the ADP/ACP test for the entire plan year.

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