

Timing of Amendments to 401(k) Plans

We often receive questions whether a certain plan feature can be added or removed from a plan at any time during the plan year. This article will provide general guidance as to the timing rule for plan amendments and review some of the more common plan amendment issues.

Before a plan feature is administratively acted upon, a plan amendment authorizing the feature must be in place. For example, if a plan currently does not permit plan loans, but the sponsor now wants to permit plan loans, the plan must be amended to permit plan loans prior to any participant taking a plan loan. Otherwise, the plan will not be operated in compliance with the plan document and correction will need to be made through the VCP program (not self correction, since the correction involves a plan amendment). Also, elective deferrals must not commence until the plan is amended or created to permit elective deferrals. The elective deferral portion of the plan may have a separate effective date than the rest of the plan.

Before a plan feature is removed, you must determine if the feature is protected under Internal Revenue Code Section 411(d)(6). If it is, then the feature may need to be preserved, or at least preserved through a certain date. If the plan feature is not a 411(d)(6) protected feature, you must determine if any participant has accrued a right to that feature during the plan year. While there are differing opinions as to the timing of a plan amendment that modifies a plan's allocation formula, a safe approach would be to modify the allocation formula prior to any participant accruing a right under that particular formula. For example, if the plan formula is an integrated formula and the plan sponsor wishes to amend the formula to a cross-tested formula and the only allocation requirement is 1,000 hours of service, you must determine whether any participants met the allocation requirement and if so, then those participants' allocations under the cross-tested formula must equal or exceed the allocations provided by the integrated formula.

Required statutory or regulatory plan amendments may be prepared and applied retroactively per the Internal Revenue Service rules. Examples of these include the Cash-out amendments, Required Minimum Distribution amendments and restatements.

Optional statutory or regulatory plan amendments must be in place in order to apply those optional provisions to the plan. For example, adding Roth 401(k) features and expanding the definition of hardship for hardship distributions must be done in the plan year for which they apply.

A 401(k) safe harbor feature can be added to a profit sharing at any time during the plan year, as long as it is in place for at least three months. For example, for a calendar plan year, a 401(k) safe harbor can be added to a profit sharing plan as long as it is in place by October 1. However, a 401(k) safe harbor feature cannot be added to an existing 401(k) plan during a plan year. The safe harbor feature can only be added at the beginning of the plan year.

A 401(k) safe harbor feature can be removed from the plan during the year as long as the participants are given 30 days prior notice of the change and the opportunity to change their deferral election. Any safe harbor contribution accrued prior to the change must be made to the plan. If the safe harbor is removed during the plan year it cannot be reactivated that same year and the elective deferrals and matches will need to be tested using the ADP and ACP tests. A safe harbor may be re-elected for the following plan year.

Finally, with any plan amendment, you should ensure that the plan amendment, in operation, is not discriminatory. For example, if the plan sponsor amends the plan to permit loans and then six months or a year later, amends the plan to remove the plan loan feature prospectively and the only participant who took a plan loan was a HCE, there may be a discrimination issue as to the “availability of a plan feature.”

Thus, the preparation and the timing of plan amendments require careful consideration as to the type of amendment (e.g., required or optional), whether 411(d)(6) is applicable, whether participants have accrued a right in the feature to be amended and whether there are any potential discrimination issues.