CHAPTER 2 Summary of Plan Requirements Under Notice 98-52 (ADP/ACP Safe Harbors), As Modified by Notice 2000-3

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EMPLOYEE PLANS
TECHNICAL

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I. INTRODUCTION.

This section summarizes the plan provision requirements under Notice 98-52, 1998-46 I.R.B. 16, and Notice 2000-3, 2000-4 I.R.B. 413. These two notices provide guidance on the design-based alternative or "safe harbor" methods under sections 401(k)(12) and 401(m)(11) of the Internal Revenue Code for satisfying the actual deferral percentage ("ADP") and the actual contribution percentage ("ACP") tests under sections 401(k) and 401(m). The safe harbor methods are effective for plan years beginning after 12/31/98.

Notice 98-52 contains 11 sections, which are summarized as follows:

- Sections I-III provide for the purpose, background and the effect on regulations.

- Section IV incorporates definitions from other published guidance and provides certain definitions.

- Sections V and VI describe the ADP and ACP test safe harbors.

- Section VII provides for the timing of plan contributions, which generally requires contributions be made no later than 12 months after the close of the plan year.

- Section VIII provides for the interaction of the safe harbors with other rules, such as other nondiscrimination rules. For example, although the safe harbor provisions satisfy the ADP/ACP tests, the plan still has to satisfy coverage under section 410(b).

- Section IX provides for:

satisfying the safe harbor contribution requirement under another defined contribution plan and

the aggregation and disaggregation rules in situations such as multiple cash or deferred arrangements ("CODAs") in one plan or where two plans are permissively aggregated.

- Section X provides that a plan with less than a 12-month plan year will fail to satisfy the ADP and ACP test safe harbors unless the plan is in its first year and certain conditions are satisfied.

- Section XI.A. provides that the plan must include the safe harbor provisions if the sponsor intends to use them as an alternative to the ADP/ACP tests. In addition, the plan containing the CODA must specify the name of the other plan if the safe harbor contributions are made to another plan and, if there are disaggregated plans, must specify which of them is using the safe harbor method. Section XI.B. provides for a special remedial amendment period.

Notice 2000-3 provides guidance, in the form of 11 questions and answers, on the safe harbor methods. These Q&As are in section III of the notice, and they either modify Notice 98-52 or provide additional guidance on the safe harbors. Sections I and II of the notice explain the purpose of the notice, summarize the contents of the notice and provide background information.

II. WHEN A PLAN MUST BE AMENDED FOR SAFE HARBOR PROVISIONS

Section XI of Notice 98-52 provides that, generally, a plan sponsor that intends to use the safe harbor provisions for a plan year must adopt those provisions before the first day of that plan year.

However, for the remedial amendment period, under Section 4 of Rev. Proc. 2000-27, 2000-26 I.R.B. 1272, a section 401(k) plan intending to take advantage of the safe harbor methods for the 1999, 2000 or 2001 plan year must generally be amended no later than the end of the 2001 plan year, retroactive to the first day of the 1999, 2000 or 20001 plan year, to reflect the first use of the safe harbor methods.

Pursuant to Q&A-1 of Notice 2000-3, a section 401(k) plan can be amended as late as 30 days prior to the end of a plan year to provide for the use of the safe harbor nonelective contribution method for that plan year, provided that a regular safe harbor notice (with modified content) is given to eligible employees before the beginning of the plan year and a supplemental notice is given no later than 30 days before the end of the plan year.

Pursuant to Q&A-11 of Notice 2000-3, a profit-sharing plan that does not contain a CODA generally can be amended as late as 3 months prior to the end of a plan year to provide for the use of the ADP/ACP safe harbor methods for that plan year.

III. DEFINITIONS AFFECTING ADP/ACP SAFE HARBOR PROVISIONS - SECTION IV OF NOTICE 98-52

A. Definition of compensation - section IV.B

Except as provided in section V.B.1.c.iii. of Notice 98-52, compensation means compensation as defined in section 1.401(k)-1(g)(2) of the regulations (which incorporates by reference the compensation definitions in sections 414(s) and 1.414(s)-1). Thus, a uniform definition of compensation satisfying section 1.414(s)-1 must be used for the ADP and ACP safe harbors for purposes of:

- the basic matching formula and the enhanced matching formula under section V.B.1.a.,
- the nonelective contribution requirement under section V.B.2., and
- the matching contribution limitations under section VI.B.

For example, a plan could use a definition of compensation that includes all compensation within the meaning of section 415(c)(3) and excludes all other compensation. (This is a section 414(s) safe harbor definition of compensation. See section 1.414(s)-1(c)(2).)

With respect to elective contributions under a plan using the ADP safe harbor matching formula, each eligible nonhighly compensated employee ("NHCE") may make elective contributions under a "reasonable definition" of compensation as defined under section 1.414(s)-1(d)(2). Such definition is not required to satisfy the nondiscrimination requirement of section 1.414(s)-1(d)(3).

However, the plan must permit each eligible NHCE to make elective contributions in an amount that is at least sufficient to receive the maximum amount of matching contributions under the plan for the plan

year and the employee must be permitted to elect any lesser amount of elective contributions.

Compensation may not be limited to a specific dollar amount for NHCEs for purposes of the ADP and ACP safe harbors. (The last sentence in section 1.414(s)-1(d)(2)(iii) of the regulations does not apply.) Note that the annual compensation limit under section 401(a)(17) still applies.

A plan can limit an employee's compensation to the portion of the plan year in which the employee was an eligible employee under the plan, provided that this limit is applied uniformly to all eligible employees.

EXAMPLE 1: Illustrating compensation

An employer's section 401(k) plan defines compensation as "all salary, wages, bonuses, and other remuneration not exceeding $75,000." The plan does not satisfy the ADP/ACP test safe harbors because the definition of compensation excludes compensation over $75,000.

EXAMPLE 2: Illustrating compensation

An employer's section 401(k) plan allows employees to make elective contributions only from basic compensation, defined as salary, regular time wages, bonuses and commissions, and excluding overtime pay. This is a reasonable definition of compensation within the meaning of section 1.414(s)-1(d)(2) of the regulations, but is not necessarily nondiscriminatory.

The plan provides for a required matching contribution equal to 100 percent of each eligible employee's elective contributions, up to 4 percent of compensation. For purposes of the matching formula, compensation is defined as compensation under section 415(c)(3) of the Code. Under the plan, each NHCE who is an eligible employee is permitted to make elective contributions equal to at least 4 percent of the employee's compensation under section 415(c)(3) (that is the amount of elective contributions sufficient to receive the maximum amount of matching contributions available under the plan). This plan's definitions of compensation satisfy the safe harbor rules.

B. Requirements for safe harbor matching and safe harbor nonelective contributions

The plan must specify that the safe harbor matching and nonelective contributions are:

- nonforfeitable within the meaning of section 1.401(k)-1(c), and
- subject to the withdrawal restrictions of section 401(k)(2)(B) and section 1.401(k)-1(d) (that is, such contributions and earnings cannot be distributed earlier than separation from service, death, disability, an event described in section 401(k)(10), or age 59 1/2 for a profit-sharing or stock bonus plan).

IV. ADP TEST SAFE HARBOR-SECTION V OF NOTICE 98-52

A. Overview of ADP test safe harbor requirements

Under section V.A. of Notice 98-52, a CODA is treated as satisfying the ADP test under section 401(k)(3)(A)(ii) of the Code and section 1.401(k)-1(b)(2) of the regulations if the arrangement satisfies:

1. the safe harbor contribution requirement of V.B., and
2. the notice requirement of V.C.

B. Safe harbor contribution requirement-section V.B. of Notice 98-52

The safe harbor contribution requirement under section V.B. is satisfied for a plan year if the plan satisfies either:

1. the matching contribution requirement of section V.B.1. or
2. the nonelective contribution requirement of section V.B.2.

The safe harbor contribution requirement must be satisfied without regard to the integration provisions of section 401(l).

1. MATCHING CONTRIBUTION REQUIREMENT - SECTION V.B.1. OF NOTICE 98-52

The plan may satisfy the matching contribution requirement by providing for either:

- the basic matching formula, or
- an enhanced matching formula.

A. BASIC MATCHING FORMULA

The basic matching formula provides matching contributions on behalf of each eligible NHCE in an amount equal to:

A. 100 percent of the employee's elective contributions up to 3 percent of the employee's compensation, and

B. 50 percent of the employee's elective contributions that exceed 3 percent of the employee's compensation but do not exceed 5 percent of the employee's compensation.

B. ENHANCED MATCHING FORMULA

An enhanced matching formula provides matching contributions for each eligible NHCE under a formula that:

- provides an aggregate amount of matching contributions at least equal to the aggregate amount that would have been provided under the basic matching formula at any elective contribution rate, and
- the rate of matching contributions may not increase as an employee's rate of elective contributions increases.

EXAMPLE 3:

A plan provides that matching contributions will be made at the following rates:

100 percent of an employee's elective contributions that do not exceed 2 percent of compensation and

75 percent of the employee's elective contributions that exceed 2 percent but do not exceed 5 percent of compensation.

This formula **does not** satisfy the enhanced matching formula since the aggregate amount that is provided by this formula is not at least equal to the amount that would have been provided under the basic matching formula at all rates of elective contributions.

Under the basic matching formula, matching contributions of 100 percent would be made on the amount of the employee's elective contributions that do not exceed 3 percent of compensation.

Under the plan's formula, the amount of matching contributions at 3 percent is less than 100 percent. For additional examples, see the examples in section V.B.3. of Notice 98-52.

Note that a plan that contains a formula that satisfies the ADP test safe harbor under section V.B. will not fail the ADP test safe harbor because the plan also provides for discretionary matches.

See below or section VI.B.4 of Notice 98-52 for the limitations on the amount of discretionary matches under the ACP test safe harbor.

C. OTHER REQUIREMENTS FOR MATCHING CONTRIBUTIONS

(i) Matching rate cannot be higher for highly compensated employees ("HCEs") - Under section V.B.1.b. of Notice 98-52, a matching formula does not satisfy the safe harbor if, at any rate of elective contributions, the rate of matching contributions for an eligible HCE is greater than the rate of matching contributions for an eligible NHCE at the same rate of elective contributions.

EXAMPLE 4:

A plan covers Divisions A and B, both of which have NHCEs and HCEs. If

the plan provides for a basic matching formula for Division A and an enhanced matching formula for Division B, (such as 100 percent match of each employee's elective contributions up to 4 percent of a Division B employee's section 415(c)(3) compensation),

the rate of match for a **Division B HCE** at a rate of elective contributions of 4 percent is greater than the rate of match **for a Division A NHCE** at the same rate of elective contributions; therefore, the plan would not satisfy the ADP test safe harbor (see example 5 under section V.B.3 of Notice 98-52).

(ii) Restrictions on elective contributions

Generally, the matching contribution requirement of section V.B.1. of Notice 98-52 is not satisfied if elective contributions by NHCEs are restricted. However, under section V.B.1.c. of Notice 98-52 and Q&As -3 and -4 of Notice 2000-3, the following restrictions on elective contributions are permitted:

- certain reasonable limits on the periods during which employees can make or change their deferral elections;
- certain limits on the amount of elective contributions that can be made, for example, an employer can require that elective contributions be made in whole percentages of pay or in whole dollar amounts;
- certain limits on the types of compensation that may be deferred; and
- limits on elective contributions to satisfy section 402(g) or 415 or on account of suspensions due to hardship distributions or withdrawals of employee contributions.

With all of these restrictions, there are certain conditions that must be satisfied. For example, as discussed earlier, under V.B.1.c.ii. of Notice 98-52, although a plan sponsor may limit the amount of elective contributions, the employer must permit each eligible NHCE to make sufficient elective contributions to receive the maximum amount of matching contributions available under the plan.

For an explanation of restrictions on types of compensation that may be deferred, see the definition of compensation above or section V.B.1.c.iii.

(iii) Suspension of safe harbor matching contributions –

Under Q&A-6 of Notice 2000-3, a safe harbor plan using matching contributions to satisfy the safe harbor contribution requirement can be amended during a plan year to prospectively reduce or eliminate matching contributions and instead use the current year testing method, provided certain notice and election requirements are satisfied.

2. NONELECTIVE CONTRIBUTION REQUIREMENT - SECTION V.B.2. OF NOTICE 98-52

An alternative to the matching contribution requirement, that can also satisfy the safe harbor contribution requirement, is the nonelective contribution requirement.

The nonelective contribution requirement is satisfied if, under the terms of the plan, the employer is required to make a safe harbor nonelective contribution on behalf of each eligible NHCE in an amount equal to at least 3 percent of the employee's compensation.

C. Notice requirement

The second requirement necessary to satisfy the ADP test safe harbor is the notice requirement, which is satisfied if:

each eligible employee for the plan year is given written notice of the employee's rights and obligations under the plan and

the notice satisfies

the content requirement of section V.C.1. of Notice 98-52 and

the timing requirement of section V.C.2. of Notice 98-52, both sections as modified by Notice 2000-3.

The content requirement requires that the notice must describe the safe harbor method in use, making elections, any other plans involved, etc. (with 1999 transition relief).

> See Q&As -7 and -8 of Notice 2000-3 for information on satisfying the content requirement using electronic media and referencing the plan's summary plan description.

The timing requirement requires that the plan sponsor must provide notice within a reasonable period.

> This requirement is deemed to be satisfied if the notice is given to each eligible employee at least 30 days and not more than 90 days before the beginning of each plan year (with special rules for employees who become eligible after such 90th day). Transition relief for 1999 and 2000 is provided.

Under Q&A-1 of Notice 2000-3, the content requirement is modified for a section 401(k) plan that wants to reserve the option of using the safe harbor nonelective contribution method to satisfy the ADP/ACP test for a plan year. Under Q&As -1 and -6 of Notice 2000-3, a supplemental notice (with special content requirements) may have to be given during the plan year.

D. Examples

Unless otherwise noted, assume that the definition of compensation satisfies section 415(c)(3) of the Code.

Each plan limits elective contributions for purposes of section 402(g) and section 415 and provides that all contributions are fully vested and are subject to the withdrawal restrictions of section 401(k)(2)(B).

Each employee may change a cash or deferred election at any time.

Each plan does not provide for any other contributions and provides that an eligible employee does not have to be employed on the last day of the plan year to receive an allocation (i.e., no last day rule).

Each employer does not maintain any other plans.

Finally, assume the notice requirements of section V.C. are satisfied.

EXAMPLE 5: Illustrating basic matching formula

Beginning January 1, 1999, an employer's plan permits elective contributions up to 8 percent of compensation and provides for matching contributions of 100 percent of the amount of each employee's elective contributions that do not exceed 3 percent of the employee's compensation.

On all elective contributions in excess of 3 percent of compensation, the employer will match 50 percent of the amount of each employee's elective contributions that do not exceed 5 percent of compensation.

This formula is a basic matching formula and satisfies the ADP test safe harbor requirements.

EXAMPLE 6: Illustrating basic matching formula

The plan (in Example 4) defines compensation as all basic compensation, excluding bonuses, overtime and commissions. Assume that the definition of compensation is discriminatory.

The plan does not have a different definition of compensation for purposes of the basic matching formula that would meet section 1.401(k)-1(g)(2) (which requires a nondiscriminatory definition of compensation under section 414(s) of the Code and section 1.414(s)-1 of the regulations). Thus, the formula does not satisfy the ADP test safe harbor requirements.

Whether the plan satisfies the ADP/ACP tests or the nondiscrimination tests under section 401(a)(4) of the Code depends on the plan's particular facts and circumstances. In applying such tests, a nondiscriminatory definition of compensation that satisfies section 414(s) and section 1.414(s)-1 of the regulations must be used. In addition, if the employer shows that the compensation definition is nondiscriminatory (i.e., Demonstration 9 of Schedule Q, Form 5300), the formula would satisfy the ADP test safe harbor.

EXAMPLE 7: Illustrating enhanced matching formula

A plan permits elective contributions up to 12 percent of compensation, with matching contributions of 100 percent on all elective contributions. This is an enhanced matching formula that satisfies the ADP test safe harbor requirements because the aggregate amount of matching contributions is at least equal to the aggregate amount of matching contributions that would have been provided under the basic matching formula at any rate of elective contributions.

EXAMPLE 8: Illustrating enhanced matching formula with different compensation definition

A plan permits elective contributions up to the section 402(g)/415 limits. The employer allows employees to defer compensation only from basic compensation, excluding overtime, bonuses and commissions.

The plan also provides for matching contributions of 100 percent on elective contributions that do not exceed 4 percent of total compensation, which is defined as section 415(c)(3) compensation.

Although the definition used for elective contributions does not satisfy the nondiscrimination requirements of section 1.414(s)-1(d), the plan still meets the ADP test safe harbor because

the plan provides for matching contributions based on 4 percent of compensation as defined in section 415(c)(3) and

each eligible NHCE may make elective contributions equal to at least 4 percent of the employee's section 415(c)(3) compensation.

EXAMPLE 9: Illustrating enhanced matching formula

The facts are the same as in Example 8, except that the plan limits elective contributions to 4 percent of basic compensation (which excludes overtime, bonuses and commissions) and this definition does not satisfy section 414(s).

This does not satisfy the ADP test safe harbor because the plan limits compensation with respect to elective contributions in such a way that the employees are not able to defer enough to get the full 4-percent match (determined using a section 414(s) definition of compensation in the matching formula).

EXAMPLE 10: Illustrating enhanced matching formula

Same facts as Example 9. If an employee's basic compensation is $10,000, but, under any definition of compensation that would satisfy section 414(s), his compensation is $15,000 (counting overtime, etc.), the most he could defer under the terms of the plan is $400 ($10,000 x 4%).

To satisfy the ADP test safe harbor, the plan must permit the employee to defer at least $600, so he can get the maximum match of $600 ($15,000 x 4%), determined using a section 414(s) definition of compensation in the formula.

EXAMPLE 11: Illustrating "all eligible NHCEs"

The facts are the same as in Example 5, except that the plan also provides for a last day rule (that is, only employees employed on the last day of the plan year will receive a safe harbor matching contribution).

Even if the plan satisfies section 410(b)(1) taking into account the last day rule, the plan does not satisfy the safe harbor requirement of section V.B. because the safe harbor matching contributions are not made on behalf of all eligible employees who make elective contributions.

EXAMPLE 12: Illustrating nonelective contributions

An employer sponsors a section 401(k) plan that permits elective contributions up to 8 percent of an employee's section 415(c)(3) compensation. The plan also provides for a nonelective contribution of 3 percent of section 415(c)(3) compensation. This formula satisfies the ADP test safe harbor.

V. ACP TEST SAFE HARBOR - SECTION VI OF NOTICE 98-52

A. Overview of ACP test safe harbor - two requirements

Under section VI of Notice 98-52, a plan satisfies the ACP test safe harbor if:

(i) each NHCE eligible to receive a matching contribution is also an eligible employee under a CODA that satisfies the ADP test safe harbor under section V, and

(ii) the plan satisfies the matching contribution limitations of section VI.B.

B. Matching contribution limitations under section VI.B

There are three ways to satisfy the matching contribution limitations.

1. Safe harbor under basic matching formula

A plan satisfies the ACP test safe harbor if:

the plan satisfies the ADP test safe harbor using the basic matching formula of section V.B.1. of Notice 98-52 and

no other matching contributions are provided under the plan.

2. Safe harbor under an enhanced matching formula

A plan satisfies the ACP test safe harbor if:

the plan satisfies the ADP test safe harbor using an enhanced matching formula under which **matching contributions are only made with respect to elective contributions that do not exceed 6 percent of the employee's compensatio**n and

no other matching contributions are provided under the plan.

3. Other matching contributions

In the case of any other plan, the matching contribution limitations satisfy the ACP test safe harbor if, under the plan:

- matching contributions are not made with respect to elective contributions or employee contributions that in the aggregate exceed 6 percent of the employee's compensation,

- the rate of matching contributions does not increase as the rate of employee contributions or elective contributions increases, and

- for employees at the same rate of elective contributions or employee contributions, the rate of matching contributions for an HCE does not exceed the rate of matching contributions for an NHCE.

Note that the elective contributions or employee contributions that are used for determining the matching contributions may be restricted only as permitted by section V.B.1.c. of Notice 98-52.

A plan that provides for discretionary matches (in addition to nondiscretionary matches needed to satisfy the ADP test safe harbor) can satisfy the ACP test safe harbor if the discretionary matches in the aggregate do not exceed a dollar amount equal to 4 percent of the employee's compensation. This limitation on matching contributions made at the employer's discretion does not apply to plan years beginning before 1/1/2000.

EXAMPLE 13: **Illustrating ADP test and ACP test safe harbor provisions**

Beginning in January 1, 2000, an employer maintains a plan which contains a CODA that satisfies the ADP test safe harbor using a 3 percent safe harbor nonelective contribution.

The plan also provides matching contributions equal to 50 percent of each eligible employee's elective contributions that do not exceed 6 percent of compensation.

Finally, the plan provides for a discretionary match equal to 50 percent of each eligible employee's elective contributions that do not exceed 6 percent of compensation.

Elective contributions are limited to 10 percent of compensation (which satisfies

section 414(s)) and are limited in accordance with sections 402(g) and 415. Employees may change their deferral elections at any time. Matching contributions are fully vested after 3 years of service. The plan is maintained on a calendar-year basis and all contributions for a plan year are made within 12 months after the end of the plan year.

The plan satisfies the ADP test safe harbor with the 3-percent nonelective contribution provision. The plan also satisfies the matching contribution limitations of section VI.B.3. since:

1. the matching contributions are not based on elective contributions that exceed 6 percent of the employee's compensation,

2. the rate of matching contributions does not increase as the rate of elective contributions increases, and

3. the rate of matching contributions for any eligible HCE does not exceed the rate of matching contributions for any eligible NHCE at the same rate of elective contributions.

Finally, the plan does not fail to satisfy the ACP test safe harbor on account of discretionary matching contributions because, under the plan, the dollar amount of discretionary matching contributions cannot exceed 4 percent of an employee's compensation.

EXAMPLE 14: Illustrating "in the aggregate exceed 6 percent of compensation"

The facts are the same as in the previous example, except that the plan **also** provides matching contributions equal to 50 percent of each eligible employee's after-tax employee contributions that do not exceed 6 percent of compensation.

The plan does not satisfy the limitations of section VI.B. because matching contributions can be made with respect to elective contributions and employee contributions that, in the aggregate, equal 12 percent of compensation (and thus exceed 6 percent of compensation).

This differs from the discretionary match requirement which limits the discretionary matches to a dollar amount.

C. Continued application of ACP test

The ACP test (not the safe harbor) still applies to a plan with respect to employee contributions and matching contributions that fail to satisfy the ACP test safe harbor. See section VIII.F. of Notice 98-52.

VI. INTERACTION WITH OTHER RULES AND TESTING METHODS - SECTION VIII OF NOTICE 98-52

A. A CODA using the ADP/ACP test safe harbor must satisfy the other qualification requirements - section VIII.A

1. A CODA satisfying the ADP/ACP test safe harbor must also satisfy the following qualification requirements of section 401(k):

   - under section 401(k)(3)(A)(i), the group of eligible employees under the CODA must satisfy the requirements of section 410(b);

   - under section 401(k)(4)(A), benefits (other than matching contributions) must not be contingent on an election to defer; and

   - elective contributions must satisfy the allocation and timing rules of section 1.401(k)-1(b)(4).

   - In addition, such a CODA must satisfy the other qualification requirements of the Code, such as the nondiscriminatory availability of benefits, rights and features under section 401(a)(4), and the limitations under section 401(a)(17), section 401(a)(30) and section 415.

2. With respect to a determination letter application, although a CODA may satisfy the ADP/ACP test safe harbor, the plan sponsor must demonstrate that the CODA satisfies the coverage requirements under section 410(b) and the benefits, rights and features requirement under section 401(a)(4).

3. Safe harbor nonelective contributions may be counted under section 416 toward the minimum contribution requirement for top-heavy plans. Thus, if a

plan allocates to all eligible employees a 3-percent safe harbor nonelective contribution, the plan generally would also satisfy the top-heavy minimum contribution requirement. However, safe harbor matching contributions may not be counted towards satisfying the top-heavy minimum contribution requirement.

4. Safe harbor matching and nonelective contributions, to the extent used to satisfy the safe harbor contribution requirement under section V.B. of Notice 98-52, may not be used as qualified matching contributions and qualified nonelective contributions.

5. A plan that uses the safe harbor methods to satisfy the ADP or ACP test is treated as using the current year testing method for that year. See Notice 98-1, 1998-3 I.R.B. 42.

VII. MULTIPLE CODAS OR MULTIPLE PLANS

A. In general - section IX.A.1. of Notice 98-52

Safe harbor matching contributions or nonelective contributions may be made to the plan that contains the CODA or to another defined contribution plan that satisfies section 401(a) or section 403(a). If safe harbor contributions are made to another defined contribution plan, the safe harbor contribution requirement of section V.B. must be satisfied in the same manner as if the contributions were made to the plan that contains the CODA.

Consequently, each employee eligible under the plan containing the CODA must be eligible under the same conditions under the other defined contribution plan (that is, both plans must have identical eligibility/participation requirements).

B. Certain requirements under section IX.A.2. - 4. of Notice 98-52

In order for safe harbor contributions to be made to another defined contribution plan, that plan must have the same plan year as the plan containing the CODA.

However, there is an exception for plans containing CODAs in the case of plan

years beginning before 1/1/2000 if:

the safe harbor contribution is allocated as of a date within the plan year of the plan containing the CODA, and

the contribution is made no later than 12 months after the close of that plan year.

The plan receiving the safe harbor contributions does not have to be capable of being aggregated with the plan containing the CODA for purposes of section 410(b).

In addition, safe harbor matching or nonelective contributions cannot be used to satisfy the safe harbor contribution requirements of section V.B. with respect to more than one plan. Thus, these contributions can be used only once to satisfy the safe harbor requirement.

C. Aggregation and disaggregation rules

The rules for aggregating and disaggregating CODAs and plans also apply for purposes of the ADP/ACP test safe harbor requirements. Thus, all CODAs included in a plan are treated as a single CODA that must satisfy the safe harbor contribution requirement of section V.B. and the notice requirement of section V.C.

Two plans (within the meaning of section 1.410(b)-7(b)) that are treated as a single plan under permissive aggregation are treated as a single plan for purposes of the safe harbor methods. Conversely, a plan (within the meaning of section 414(l)) that includes a CODA covering both collectively bargained employees and noncollectively bargained employees is treated as two separate plans for purposes of section 401(k), and the ADP test safe harbor need not be satisfied with respect to both plans in order for one of the plans to take advantage of the ADP test safe harbor.

D. Highly compensated employees under section IX.B.2. of Notice 98-52

If an HCE is simultaneously an eligible employee under two plans maintained by an employer for a plan year, only one of which is intended to satisfy the

ADP/ACP test using the safe harbor methods, and the matching contribution formula of the plan that is not using the safe harbor methods provides greater matching contributions than the formula under the plan that is intended to satisfy the ADP/ACP test using the safe harbor methods, the rules in V.B.1.b. and VI.B.3. (prohibiting an HCE from receiving a greater rate of matching contributions than an NHCE) could be violated.

VIII. SUMMARY

If an employer intends to adopt the ADP/ACP test safe harbor provisions for a plan year, the plan must generally be amended for the ADP/ACP test safe harbor provisions before the first day of that plan year. However, Rev. Proc. 2000-27 provides an exception for the remedial amendment period.

There are definitions provided in Notice 98-52, including two for compensation. For elective contributions, any reasonable definition of compensation can be used, whether or not the definition is nondiscriminatory. However, for purposes of the ADP/ACP test safe harbor formulas, the definition of compensation must be nondiscriminatory. (See section III and section IV.B. of Notice 98-52.)

ADP test safe harbor has two requirements:

safe harbor contribution requirement, and

notice requirement.

The safe harbor contribution requirement can be satisfied by either a matching contribution (under a basic or enhanced formula) or a nonelective contribution.

Generally, elective contributions for NHCEs cannot be restricted. However, certain restrictions are permitted.

The notice requirement is satisfied by giving employees timely notice that contains certain required information.

The ACP test safe harbor is satisfied by a basic matching formula or an enhanced matching formula, but only if the ADP test safe harbor is already satisfied. Matching contributions cannot be made with respect to elective or employee contributions that exceed 6 percent of compensation. Finally,

discretionary matches, used to satisfy the ACP test safe harbor, can be made as long as these matches don't exceed a certain dollar amount (4 percent of compensation).

The CODA with an ADP/ACP test safe harbor must also satisfy other qualification requirements, including other section 401(k) requirements as well as section 401(a) requirements. Safe harbor nonelective contributions may be counted toward the top-heavy minimum contribution requirement under section 416. (See section VII, section VIII of Notice 98-52.)

PUBLISHED GUIDANCE

Part III. Administrative, Procedural, and Miscellaneous

Cash or Deferred Arrangements; Nondiscrimination

Notice 98-52

I. PURPOSE

This notice provides guidance on the design-based alternative or "safe harbor" methods in § 401(k)(12) and § 401(m)(11) of the Internal Revenue Code for satisfying the § 401(k) and § 401(m) nondiscrimination tests.

Specifically, under this notice:

1. A section 401(k) plan generally satisfies the actual deferral percentage ("ADP") test:

If a prescribed level of safe harbor matching or nonelective contributions are made on behalf of all eligible nonhighly compensated employees ("NHCEs") and

if employees are provided a timely notice describing their rights and obligations under the plan. See section V.

2. Employee notices for the 1999 plan year are not required to be provided before March 1, 1999. See the transition rule in section V.C.2.

3. A plan that satisfies the ADP test safe harbor by providing a basic level of safe harbor matching contributions automatically satisfies the actual contribution percentage ("ACP") test with respect to matching contributions.

Plans that provide additional matching contributions satisfy the ACP test if matching contributions do not exceed specified limitations. See section VI.

4. A special rule allows § 403(b) plans to take advantage of the ACP test safe harbor. See section VI.C.

5. Plan amendments needed to implement the safe harbor methods generally may be deferred until the date other SBJPA plan amendments are required (for calendar year plans, December 31, 1999). See section XI.

Among other matters, this notice also addresses the timing of safe harbor contributions (section VII), the interaction of the safe harbor methods with other qualification rules and testing methods (section VIII), and how the safe harbor methods work where an employer maintains multiple CODAs or plans (section IX).

II. BACKGROUND

Section 1433(a) of the Small Business Job Protection Act of 1996 ("SBJPA"), Pub. L. 104-188, added new § 401(k)(12) and 401(m)(11) to the Code, effective for plan years beginning after December 31, 1998, which provide design-based safe harbor methods for satisfying the ADP test contained in § 401(k)(3)(A)(ii) and the ACP test contained in § 401(m)(2).

Section 401(k)(12) provides that a cash or deferred arrangement ("CODA") is treated as satisfying the ADP test if the CODA meets certain contribution and notice requirements.

Section 401(m)(11) provides that a defined contribution plan is treated as satisfying the ACP test with respect to matching contributions if the plan meets the contribution and notice requirements contained in § 401(k)(12) and, in addition, meets certain limitations on the amount and rate of matching contributions available under the plan.

Previous guidance on other SBJPA amendments to § 401(k) and 401(m) was provided in Notice 97-2, 1997-1 C.B. 348, and Notice 98-1, 1998-3 I.R.B. 42.

III. EFFECT ON REGULATIONS

Because of the amendments made to §§ 401(k) and 401(m) by SBJPA, as well

as by other recent legislation, certain portions of § 1.401(k)-1, 1.401(m)-1 and 1.401(m)-2 of the Income Tax Regulations no longer reflect current law.

However, these regulations continue to apply to the extent they are not inconsistent with the Code, Notices 97-2 and 98-1, this notice, and any subsequent guidance.

IV. DEFINITIONS

A. IN GENERAL

Except as provided in this section IV, any term used in this notice that is defined in Notice 98-1 or the regulations under § 401(k) and 401(m) has the same meaning as in Notice 98-1 or those regulations. For example, the definition of "plan" in § 1.401(k)-1(g)(11) applies for purposes of this notice.

B. COMPENSATION

Except as provided in section V.B.1.c.iii, "compensation" for purposes of this notice means compensation as defined in § 1.401(k)-1(g)(2) (which incorporates by reference the definition of compensation in § 414(s) and § 1.414(s)-1); provided, however, that the rule in the last sentence of § 1.414(s)-1(d)(2)(iii) (which generally permits a definition of compensation to exclude all compensation in excess of a specified dollar amount) does not apply in determining the compensation of NHCEs. The annual compensation limit under § 401(a)(17) applies for purposes of the safe harbor methods.

Thus, a uniform definition of compensation described in this section IV.B must be used for purposes of the basic matching formula or an enhanced matching formula under section V.B.1.a, the nonelective contribution requirement under section V.B.2, and the matching contribution limitations under section VI.B.

As provided under § 1.401(k)-1(g)(2), an employer may limit the period used to determine compensation for a plan year to that portion of the plan year in which the employee is an eligible employee, provided that this limit is applied uniformly to all eligible employees under the plan for the plan year.

C. BASIC MATCHING FORMULA

For purposes of this notice, the "basic matching formula" is the formula described in section V.B.1.a.i.

D. ENHANCED MATCHING FORMULA

For purposes of this notice, an "enhanced matching formula" is a formula described section V.B.1.a.ii.

E. RATE OF ELECTIVE CONTRIBUTIONS

For purposes of this notice, an employee's "rate of elective contributions" means the ratio of an employee's elective contributions under the plan for a plan year to the employee's compensation for that plan year.

F. RATE OF EMPLOYEE CONTRIBUTIONS

For purposes of this notice, an employee's "rate of employee contributions" means the ratio of an employee's employee contributions under the plan for a plan year to the employee's compensation for that plan year.

G. RATE OF MATCHING CONTRIBUTIONS

For purposes of the ADP test safe harbor under section V, a "rate of matching contributions" means the ratio of matching contributions on behalf of an employee under the plan for a plan year to the employee's elective contributions for that plan year.

For purposes of the ACP test safe harbor under section VI, a "rate of matching contributions" means the ratio of matching contributions on behalf of an employee under the plan for a plan year to the employee's respective employee contributions or elective contributions for that plan year.

H. SAFE HARBOR MATCHING CONTRIBUTIONS AND SAFE HARBOR NONELECTIVE CONTRIBUTIONS

For purposes of this notice, safe harbor matching contributions and safe harbor nonelective contributions are matching and nonelective contributions, respectively, that

(1) are nonforfeitable within the meaning of § 1.401(k)-1(c),

(2) are subject to the withdrawal restrictions of § 401(k)(2)(B) and § 1.401(k)-1(d), and

(3) are used to satisfy the safe harbor contribution requirement of section V.B.

Accordingly, pursuant to § 401(k)(2)(B) and § 1.401(k)-1(d), such contributions (and earnings thereon) must not be distributable earlier than:

- separation from service,
- death,
- disability,
- an event described in § 401(k)(10), or,
- in the case of a profit-sharing or stock bonus plan, the attainment of age 59 ½.

Pursuant to § 401(k)(2)(B) and § 1.401(k)-1(d)(2)(ii), hardship is not a distributable event for contributions other than elective contributions.

V. ADP TEST SAFE HARBOR

A. GENERAL RULE

A CODA is treated as satisfying the ADP test under § 401(k)(3)(A)(ii) and § 1.401(k)-1(b)(2) for a plan year if, for the entire plan year, the arrangement

satisfies

the safe harbor contribution requirement of subsection B of this section V and

the notice requirement of subsection C of this section V.

B. SAFE HARBOR CONTRIBUTION REQUIREMENT

The safe harbor contribution requirement of this section V.B is satisfied for a plan year if the plan satisfies either

(1) the matching contribution requirement of paragraph 1 of this section V.B or

(2) the nonelective contribution requirement of paragraph 2 of this section V.B.

Pursuant to § 401(k)(12)(E)(ii), the safe harbor contribution requirement of this section V.B must be satisfied without regard to § 401(l).

1. MATCHING CONTRIBUTION REQUIREMENT

a. In General

The matching contribution requirement of this section V.B.1 is satisfied if, under the terms of the plan, safe harbor matching contributions under either the basic matching formula or an enhanced matching formula described below are required to be made on behalf of each NHCE who is an eligible employee.

i. Basic Matching Formula

The basic matching formula provides matching contributions on behalf of each NHCE who is an eligible employee in an amount equal to

(A) 100 percent of the amount of the employee's elective contributions that do not exceed 3 percent of the employee's compensation and

(B) 50 percent of the amount of the employee's elective

contributions that exceed 3 percent of the employee's compensation but that do not exceed 5 percent of the employee's compensation.

ii. Enhanced Matching Formula

An enhanced matching formula provides matching contributions on behalf of each NHCE who is an eligible employee under a formula that, at any rate of elective contributions, provides an aggregate amount of matching contributions at least equal to the aggregate amount of matching contributions that would have been provided under the basic matching formula.

In addition, under an enhanced matching formula, the rate of matching contributions may not increase as an employee's rate of elective contributions increases.

b. Limitation on Matching Contributions for HCEs

The matching contribution requirement of this section V.B.1 is not satisfied if, at any rate of elective contributions

the rate of matching contributions that would apply with respect to any highly compensated employee ("HCE") who is an eligible employee is greater than the rate of matching contributions that would apply with respect to any NHCE who is an eligible employee and who has the same rate of elective contributions.

c. Permissible Restrictions on Elective Contributions by NHCEs

The matching contribution requirement of this section V.B.1 is not satisfied if elective contributions by NHCEs are restricted, unless the restrictions are permitted as described below.

i. Restrictions on Election Periods

A plan sponsor may limit the frequency and duration of periods in which eligible employees may make or change cash or deferred elections under a plan, provided that, after receipt of the notice described in subsection C of this section V, an employee has a reasonable opportunity (including a reasonable period) to make or change a cash or deferred election for the

plan year.

For purposes of the preceding sentence, a 30-day period is deemed to be a reasonable period.

ii. Restrictions on Amount of Elective Contributions

A plan sponsor may limit the amount of elective contributions that may be made by an eligible employee under a plan, provided that each NHCE who is an eligible employee is permitted (unless the employee is restricted under paragraph 1.c.iv of this section V.B) to make elective contributions in an amount that is at least sufficient to receive the maximum amount of matching contributions available under the plan for the plan year, and the employee is permitted to elect any lesser amount of elective contributions.

iii. Restrictions on Types of Compensation That May be Deferred

A plan sponsor may limit the types of compensation that may be deferred by an eligible employee under a plan, provided that each NHCE who is an eligible employee is permitted to make elective contributions under a definition of compensation that would be a reasonable definition of compensation within the meaning of § 1.414(s)-1(d)(2). (Thus, the definition is not required to satisfy the nondiscrimination requirement of § 1.414(s)-1(d)(3).)

However, see section IV.B regarding the definition of compensation for purposes of

the basic matching formula or an enhanced matching formula under paragraph 1.a of this section V.B,

the nonelective contribution requirement under paragraph 2 of this section V.B, and

the matching contribution limitations under section VI.B.

iv. Restrictions Due to Limitations under the Code

A plan sponsor may limit the amount of elective contributions made by an eligible employee under a plan

(A) because of the limitations under § 402(g) or § 415 or

(B) because, on account of a hardship distribution, an employee's ability to make elective contributions has been suspended for 12 months in accordance with § 1.401(k)-1(d)(2)(iv)(B)(4) or limited in accordance with § 1.401(k)-1(d)(2)(iv)(B)(3).

2. NONELECTIVE CONTRIBUTION REQUIREMENT

The nonelective contribution requirement of this section V.B.2 is satisfied if, under the terms of the plan, the employer is required to make a safe harbor nonelective contribution on behalf of each NHCE who is an eligible employee equal to at least 3 percent of the employee's compensation.

3. EXAMPLES

The safe harbor contribution requirement of this section V.B is illustrated by the following examples:

EXAMPLE 1:

(a) Beginning January 1, 1999, Employer A maintains Plan L covering employees (including HCEs and NHCEs) in Divisions D and E. Plan L contains a CODA and provides a required matching contribution equal to 100 percent of each eligible employee's elective contributions up to 4 percent of compensation.

For purposes of the matching contribution formula, compensation is defined as all compensation within the meaning of § 415(c)(3) (a definition that satisfies § 414(s)). Also, each employee is permitted to make elective contributions from all compensation within the meaning of § 415(c)(3) and may change a cash or deferred election at any time.

Plan L limits the amount of an employee's elective contributions for purposes of § 402(g) and § 415, and, in the case of a hardship distribution, suspends an employee's ability to make elective contributions for 12 months in accordance with § 1.401(k)-1(d)(2)(iv)(B)(4) and limits an employee's elective contributions in accordance with § 1.401(k)-1(d)(2)(iv)(B)(3). All contributions under Plan L are nonforfeitable and are subject to

the withdrawal restrictions of § 401(k)(2)(B). Plan L provides for no other contributions and Employer A maintains no other plans. Plan L is maintained on a calendar-year basis and all contributions for a plan year are made within 12 months after the end of the plan year.

(b) Based on these facts, matching contributions under Plan L are safe harbor matching contributions because they are nonforfeitable, are subject to the withdrawal restrictions of § 401(k)(2)(B), and are used to satisfy the safe harbor contribution requirement of section V.B.

(c) Plan L's formula is an enhanced matching formula because each NHCE who is an eligible employee receives matching contributions at a rate that, at any rate of elective contributions, provides an aggregate amount of matching contributions at least equal to the aggregate amount of matching contributions that would have been received under the basic matching formula, and the rate of matching contributions does not increase as the rate of an employee's elective contributions increases.

(d) Plan L satisfies the safe harbor contribution requirement of this section V.B because safe harbor matching contributions under an enhanced matching formula are required to be made on behalf of each NHCE who is an eligible employee.

(e) Plan L would satisfy the ADP test safe harbor if Plan L also satisfied the notice requirement of subsection C of this section V. (Plan L then would also satisfy the ACP test safe harbor. See section VI.)

EXAMPLE 2:

(a) The facts are the same as in Example 1, except that instead of providing a required matching contribution equal to 100 percent of each eligible employee's elective contributions up to 4 percent of compensation, Plan L provides a matching contribution equal to 150 percent of each eligible employee's elective contributions up to 3 percent of compensation.

(b) Plan L's formula is an enhanced matching formula and Plan L satisfies the safe harbor contribution requirement of this section V.B.

(c) Plan L would satisfy the ADP test safe harbor if Plan L also satisfied the notice requirement of subsection C of this section V. (Plan L then would

also satisfy the ACP test safe harbor. See section VI.)

EXAMPLE 3:

(a) The facts are the same as in Example 1, except that instead of permitting each employee to make elective contributions from compensation within the meaning of § 415(c)(3), each employee's elective contributions under Plan L are limited to 15 percent of the employee's "basic compensation." Basic compensation is defined under Plan L as compensation within the meaning of § 415(c)(3), but excluding overtime pay.

(b) The definition of basic compensation under Plan L is a reasonable definition of compensation within the meaning of § 1.414(s)-1(d)(2).

(c) Plan L will not fail to satisfy the safe harbor contribution requirement of this section V.B merely because Plan L limits the amount of elective contributions and the types of compensation that may be deferred by eligible employees, provided that each NHCE who is an eligible employee may make elective contributions equal to at least 4 percent of the employee's compensation under § 415(c)(3) (that is, the amount of elective contributions that is sufficient to receive the maximum amount of matching contributions available under the plan).

EXAMPLE 4:

(a) The facts are the same as in Example 1, except that Plan L provides that only employees employed on the last day of the plan year will receive a safe harbor matching contribution.

(b) Even if the section 401(m) plan satisfies the minimum coverage requirements of § 410(b)(1) taking into account this last-day requirement, Plan L would not satisfy the safe harbor contribution requirement of this section V.B because safe harbor matching contributions are not made on behalf of all NHCEs who are eligible employees and who make elective contributions.

(c) The result would be the same if, instead of providing safe harbor matching contributions under an enhanced formula, Plan L provides for a 3-percent safe harbor nonelective contribution that is restricted to eligible employees under the CODA who are employed on the last day of the plan year.

EXAMPLE 5:

(a) The facts are the same as in Example 1, except that instead of providing safe harbor matching contributions under the enhanced matching formula to employees in both Divisions D and E, employees in Division E are provided safe harbor matching contributions under the basic matching formula, while matching contributions continue to be provided to employees in Division D under the enhanced matching formula.

(b) Even if Plan L satisfies § 1.401(a)(4)-4 with respect to each rate of matching contributions available to employees under the plan, the plan would fail to satisfy the safe harbor contribution requirement of this section V.B because the rate of matching contributions with respect to HCEs in Division D at a rate of elective contributions between 3 and 5 percent would be greater than that with respect to NHCEs in Division E at the same rate of elective contributions. For example, an HCE in Division D who would have a 4-percent rate of elective contributions would have a rate of matching contributions of 100 percent while an NHCE in Division E who would have the same rate of elective contributions would have a lower rate of matching contributions.

C. NOTICE REQUIREMENT

The notice requirement of this section V.C is satisfied if:

each eligible employee for the plan year is given **written** notice of the employee's rights and obligations under the plan and

the notice satisfies

the content requirement of paragraph 1 of this section V.C and

the timing requirement of paragraph 2 of this section V.C.

1. CONTENT REQUIREMENT

a. General Rule

The content requirement of this section V.C.1 is satisfied if the notice

(1) is sufficiently accurate and comprehensive to inform the employee of

the employee's rights and obligations under the plan and

(2) is written in a manner calculated to be understood by the average employee eligible to participate in the plan.

For purposes of the preceding sentence, a notice is not considered sufficiently accurate and comprehensive unless the notice accurately describes

(i) the safe harbor matching or nonelective contribution formula used under the plan (including a description of the levels of matching contributions, if any, available under the plan);

(ii) any other contributions under the plan (including the potential for discretionary matching contributions) and the conditions under which such contributions are made;

(iii) the plan to which safe harbor contributions will be made (if different than the plan containing the CODA);

(iv) the type and amount of compensation that may be deferred under the plan;

(v) how to make cash or deferred elections, including any administrative requirements that apply to such elections;

(vi) the periods available under the plan for making cash or deferred elections; and

(vii) withdrawal and vesting provisions applicable to contributions under the plan.

b. 1999 Transition Relief for Content Requirement

For a plan adopting the safe harbor provisions for a plan year that begins before January 1, 2000, a notice will not fail to satisfy the content requirement for that plan year merely because the notice does not include all of the items listed in paragraph 1.a of this section V.C, provided that the notice satisfies a reasonable good faith interpretation of the notice requirements under § 401(k)(12) and 401(m)(11).

2. TIMING REQUIREMENT

a. General rule

The timing requirement of this section V.C.2 is satisfied if the notice is provided within a reasonable period before the beginning of the plan year (or, in the year an employee becomes eligible, within a reasonable period before the employee becomes eligible). The determination of whether a notice satisfies the timing requirement of this section V.C.2 is based on all of the relevant facts and circumstances.

b. Deemed Satisfaction of Timing Requirement

The timing requirement of this section V.C.2 is deemed to be satisfied if at least 30 days (and no more than 90 days) before the beginning of each plan year, the notice is given to each eligible employee for the plan year.

In the case of an employee who does not receive the notice within the period described in the previous sentence because the employee becomes eligible after the 90th day before the beginning of the plan year, the timing requirement is deemed to be satisfied if the notice is provided no more than 90 days before the employee becomes eligible (and no later than the date the employee becomes eligible).

Thus, for example, the preceding sentence would apply in the case of any employee eligible for the first plan year under a newly established section 401(k) plan, or would apply in the case of the first plan year in which an employee becomes eligible under an existing section 401(k) plan.

c. 1999 Transition Relief for Timing Requirement

For a plan year that begins on or before April 1, 1999, the notice described in this section V.C satisfies the timing requirement for that plan year (with respect to an existing section 401(k) plan or a newly established one) if the notice is given on or before March 1, 1999.

However, in order to satisfy the ADP or ACP test safe harbor for the plan year, a plan that is using the transition relief provided under this section V.C.2.c still must satisfy the otherwise applicable requirements of this Notice 98-52 with respect to the entire plan year.

VI. ACP TEST SAFE HARBOR

A. GENERAL RULE

A defined contribution plan is treated as satisfying the ACP test under § 401(m)(2) and § 1.401(m)-1(b) with respect to matching contributions for a plan year if, for the entire plan year,

(i) each NHCE eligible to receive an allocation of matching contributions under the plan is also an eligible employee under a CODA that satisfies the ADP test safe harbor of section V and

(ii) the plan satisfies the matching contribution limitations of subsection B of this section VI.

See section VIII.F.1 regarding the continued application of the ACP test to employee contributions.

B. MATCHING CONTRIBUTION LIMITATIONS

1. Safe Harbor Matching Contributions Under Basic Matching Formula

A plan satisfies the matching contribution limitations of this section VI.B if

(i) the plan satisfies the matching contribution requirement of section V.B.1 using the basic matching formula and

(ii) no other matching contributions are provided under the plan.

2. Safe Harbor Matching Contributions Under an Enhanced Matching Formula

A plan satisfies the matching contribution limitations of this section VI.B if

(i) the plan satisfies the matching contribution requirement of section V.B.1 using an enhanced matching formula under which matching contributions are only made with respect to elective contributions that do not exceed 6 percent of the employee's compensation and

(ii) no other matching contributions are provided under the plan.

3. Other Matching Contributions

In the case of any other plan, the matching contribution limitations of this section VI.B are satisfied if, under the plan,

(i) matching contributions are not made with respect to employee contributions or elective contributions that in the aggregate exceed 6 percent of the employee's compensation,

(ii) the rate of matching contributions does not increase as the rate of employee contributions or elective contributions increases, and

(iii) at any rate of employee contributions or elective contributions, the rate of matching contributions that would apply with respect to any HCE who is an eligible employee is no greater than the rate of matching contributions that would apply with respect to an NHCE who is an eligible employee and who has the same rate of employee contributions or elective contributions.

If a plan provides matching contributions with respect to employee contributions or elective contributions, those employee contributions or elective contributions may be restricted only to the extent permitted under section V.B.1.c.

4. Matching Contributions Generally Must be Required Under Plan Terms

a. ADP Test Safe Harbor

As provided under section V.B.1.a, a matching contribution may be taken into account in determining whether the matching contribution requirement of the ADP test safe harbor is satisfied only if the contribution is required to made under the terms of a plan. Even though matching contributions made at the employer's discretion may not be taken into account in determining whether the matching contribution requirement of section V.B.1 is satisfied, a plan that satisfies the safe harbor contribution requirement of section V.B will not fail to satisfy the ADP test safe harbor merely because additional matching contributions are made at the employer's discretion.

b. ACP Test Safe Harbor

A plan fails to satisfy the ACP test safe harbor for a plan year if the plan provides for matching contributions made at the employer's discretion on behalf of any employee that, in the aggregate, could exceed a dollar amount equal to 4 percent of the employee's compensation.

This limitation on matching contributions made at the employer's discretion does not apply to plan years beginning before January 1, 2000.

C. SPECIAL RULE FOR MATCHING CONTRIBUTIONS UNDER A § 403(B) PLAN

For purposes of § 403(b)(12)(A)(i), a § 403(b) plan is treated as satisfying the requirements of § 401(m) with respect to matching contributions if the plan satisfies the safe harbor contribution requirement of section V.B, the notice requirement of section V.C, and the matching contribution limitations of subsection B of this section VI. For purposes of applying the requirements of section V and this section VI, salary reduction contributions under a § 403(b) plan are treated as elective contributions under a CODA.

D. EXAMPLES

The following examples illustrate the requirements of the ACP test safe harbor described in this section VI:

EXAMPLE 1:

(a) An employer's only plan, Plan M, contains a CODA that satisfies the ADP test safe harbor using safe harbor matching contributions under the basic matching formula. No contributions, other than elective contributions and contributions under the basic matching formula, are made to Plan M.

(b) Because the CODA under Plan M satisfies the ADP test safe harbor using the basic matching formula and Plan M provides for no other matching contributions, Plan M automatically satisfies the ACP test safe harbor.

EXAMPLE 2:

(a) Beginning January 1, 2000, Employer B maintains Plan N, the only plan

maintained by Employer B. Plan N contains a CODA that satisfies the ADP test safe harbor using a 3-percent safe harbor nonelective contribution. Plan N also provides matching contributions equal to 50 percent of each eligible employee's elective contributions up to 6 percent of compensation.

Under Plan N, elective contributions are limited to 10 percent of an employee's compensation and are limited in accordance with § 402(g) and § 415. Under Plan N, an employee may change a cash or deferred election at any time. Plan N provides a definition of compensation that satisfies § 414(s) and that same definition is used for all purposes under Plan N. Matching contributions under Plan N are fully vested after 3 years of service. No other matching contributions are provided for under Plan N. The plan is maintained on a calendar-year basis and all contributions for a plan year are made within 12 months after the end of the plan year.

(b) Based on these facts, Plan N satisfies the ACP test safe harbor with respect to matching contributions because each NHCE eligible to receive an allocation of matching contributions under Plan N is also an eligible employee under a CODA that satisfies the ADP test safe harbor of section V and because the matching contribution limitations of subsection B of this section VI are satisfied.

EXAMPLE 3:

(a) The facts are the same as in Example 2, except that Plan N also provides matching contributions equal to 50 percent of each eligible employee's employee contributions up to 6 percent of compensation.

(b) Plan N does not satisfy the matching contribution limitations of subsection B of this section VI because matching contributions can be made with respect to elective contributions and employee contributions that, in the aggregate, equal 12 percent of compensation (and thus exceed 6 percent of compensation).

EXAMPLE 4:

(a) The facts are the same as in Example 2, except that Plan N also provides that Employer B, in its discretion, may make additional matching

contributions up to 50 percent of each eligible employee's elective contributions that do not exceed 6 percent of compensation.

(b) Plan N does not fail to satisfy the ACP test safe harbor on account of discretionary matching contributions, because, under Plan N, the amount of discretionary matching contributions cannot exceed 4 percent of an employee's compensation.

VII. TIMING OF PLAN CONTRIBUTIONS

A. IN GENERAL

As provided in subsections B and C of this section VII, matching and nonelective contributions under a plan using the safe harbor methods must be made to the plan within the same time period that would apply if these contributions were made to a plan using the current year testing method for ADP or ACP testing purposes (that is, no later than 12 months after the close of the plan year).

Matching and nonelective contributions also may be made from time to time during the plan year, instead of at one time after the close of the plan year. Regardless of the timing of employer contributions, however, the total amount of matching or nonelective contributions for the plan year still must satisfy the requirements of sections V and VI, taking into account the total amount of compensation for the plan year, in order for a CODA to satisfy the ADP test safe harbor.

B. CONTRIBUTIONS UNDER THE ADP TEST SAFE HARBOR

A CODA will not satisfy the ADP test safe harbor for a plan year unless safe harbor matching and nonelective contributions needed to satisfy the safe harbor contribution requirement of section V.B are made in accordance with the allocation and timing rules of § 1.401(k)-1(b)(4).

C. MATCHING CONTRIBUTIONS UNDER THE ACP TEST SAFE HARBOR

Matching contributions are taken into account for a plan year under the ACP test

safe harbor of section VI in accordance with the allocation and timing rules of § 1.401(m)-1(b)(4)(ii)(A).

VIII. INTERACTION WITH OTHER RULES AND TESTING METHODS

A. IN GENERAL

A CODA that is treated as satisfying the ADP test under § 401(k)(3)(A)(ii) and § 1.401(k)-1(b)(2) will not be treated as a qualified CODA unless the arrangement satisfies the other requirements of § 401(k). For example,

> under § 401(k)(3)(A)(i), the group of eligible employees under the section 401(k) plan must satisfy the requirements of § 410(b),
> under § 401(k)(4)(A), benefits (other than matching contributions) must not be contingent on an election to defer, and
>
> elective contributions must satisfy the allocation and timing rules of § 1.401(k)-1(b)(4).

A plan that satisfies the ADP or ACP test safe harbor must satisfy all other qualification requirements of the Code that are applicable to the plan, such as the nondiscriminatory availability of benefits, rights, and features under § 401(a)(4) and the limitations of § 401(a)(17), 401(a)(30) and 415.

USE OF SAFE HARBOR NONELECTIVE CONTRIBUTIONS TO SATISFY OTHER NONDISCRIMINATION TESTS

A safe harbor nonelective contribution used to satisfy the nonelective contribution requirement under section V.B.2 may also be taken into account for purposes of determining whether a plan satisfies § 401(a)(4). Thus, these contributions are not subject to the limitations on qualified nonelective contributions under § 1.401(k)-1(b)(5)(ii), but are subject to the rules generally applicable to nonelective employer contributions under § 401(a)(4). See § 1.401(a)(4)-1(b)(2)(ii).

However, pursuant to § 401(k)(12)(E)(ii), to the extent they are needed to satisfy the safe harbor contribution requirement of section V.B, safe harbor nonelective contributions may not be

taken into account under any plan for purposes of § 401(l) (including the imputation of permitted disparity under § 1.401(a)(4)-7).

C. TOP-HEAVY RULES

1. Safe Harbor Nonelective Contributions

Safe harbor nonelective contributions may be counted under § 416 toward the minimum contribution requirement for top-heavy plans.

Thus, if a plan allocates to all eligible employees a 3-percent safe harbor nonelective contribution, the plan generally would also satisfy the top-heavy minimum contribution requirement. See § 1.416-1, M-18 for a similar rule applicable to qualified nonelective contributions.

2. Safe Harbor Matching Contributions

If a plan uses contributions allocated to employees on the basis of elective contributions or employee contributions to satisfy the top-heavy minimum contribution requirement under § 416, these contributions are not treated as matching contributions for purposes of §§ 401(k) and 401(m). Therefore, safe harbor matching contributions may not be counted toward the minimum contribution requirement for top-heavy plans under § 416. See § 1.416-1, M-19.

D. QUALIFIED MATCHING CONTRIBUTIONS AND QUALIFIED NONELECTIVE CONTRIBUTIONS

To the extent they are needed to satisfy the safe harbor contribution requirement of section V.B, safe harbor matching and nonelective contributions may not be used as qualified matching contributions and qualified nonelective contributions, respectively, under any plan for any plan year.

For example, if a plan satisfies the safe harbor contribution requirement using a safe harbor nonelective contribution by allocating a 7-percent safe harbor nonelective contribution to all eligible employees, contributions in an amount equal to the first 3 percent of each employee's compensation may not be used as

a qualified nonelective contribution under the ACP test. However, safe harbor nonelective contributions in an amount equal to the remaining 4 percent of each employee's compensation may be used to satisfy the ACP test (subject to the requirements of § 1.401(m)-1(b)(5)).

E. TESTING METHODS UNDER NOTICE 98-1

For purposes of Notice 98-1, a plan that uses the safe harbor methods to satisfy the ADP or ACP test for a plan year is treated as using the current year testing method for that year and, thus, is subject to the rules contained in section VII of Notice 98-1 (relating to changes from current year to prior year testing).

In addition, in the case of a plan that is not maintained on a calendar plan year basis, the anti-abuse provision of section VIII of Notice 98-1 applies in a similar manner to changes between the safe harbor methods and the current or prior year testing method.

F. CONTINUED APPLICATION OF THE ACP TEST TO CERTAIN CONTRIBUTIONS

1. Employee Contributions

Even if a defined contribution plan satisfies the ACP test safe harbor of section VI with respect to matching contributions, the plan still must satisfy the ACP test in the manner described in paragraph 3 of this section VIII.F with respect to employee contributions made under the plan.

2. Matching Contributions that Fail to Satisfy the ACP Test Safe Harbor

If a plan satisfies the ADP test safe harbor of section V.A, but fails to satisfy the ACP test safe harbor with respect to matching contributions under the plan, then the plan must satisfy the ACP test in the manner described in paragraph 3 of this section VIII.F.

3. Special Rules for ACP Test

If paragraph 1 or 2 of this section VIII.F applies, then the plan must satisfy the ACP test under § 401(m)(2), and under § 1.401(m)-1(b), as modified by Notices 97-2 and 98-1, using the current year testing method. However, in applying the ACP test, an employer may elect to disregard with respect to all eligible

employees (i.e., all HCEs and NHCEs)

- all matching contributions, if the ACP test safe harbor of section VI is satisfied or
- matching contributions that do not exceed 4 percent of each employee's compensation, if the matching contribution requirement of section V.B.1 is satisfied.

Except as otherwise provided in section VIII.D, qualified nonelective contributions may be treated as matching contributions to the extent permitted under § 1.401(m)-1(b)(5).

Finally, in applying the ACP test

(i) matching contributions may not be treated as elective contributions under § 401(k)(3)(D) to a CODA that satisfies the ADP test safe harbor (and thus excluded from the ACP test under § 401(m)(3)) and

(ii) elective contributions under a CODA that satisfies the ADP test safe harbor may not be treated as matching contributions under § 401(m)(3).

G. MULTIPLE USE TEST

The restrictions on multiple use under § 1.401(m)-2 do not apply to a CODA that satisfies the ADP test safe harbor. In addition, the restrictions on multiple use under § 1.401(m)-2 do not apply to a defined contribution plan that satisfies the ACP test safe harbor, if the plan does not permit employee contributions. In determining whether multiple use of the alternative limitation under § 401(k)(3)(A)(ii)(II) or § 401(m)(2)(A)(ii) occurs with respect to another plan of an employer,

(1) a CODA that satisfies the ADP test safe harbor and

(2) a defined contribution plan that satisfies the ACP test safe harbor and does not permit employee contributions, are disregarded for purposes of § 1.401(m)-2(b).

In the case of a defined contribution plan to which subsection F.1 or F.2 of this section VIII applies (that is, a defined contribution plan that satisfies the ACP test safe harbor but permits employee contributions, or a defined contribution plan that fails to satisfy the ACP test safe harbor), the special rules of subsection F.3 of this section VIII (relating to ACP testing) also apply for purposes of § 1.401(m)-2(b) in determining whether the multiple use of the alternative limitation occurs.

H. EARLY PARTICIPATION RULES

Sections 401(k)(3)(F) and 401(m)(5)(C), which provide alternative nondiscrimination rules for certain plans that provide for early participation, do not apply for purposes of the safe harbor methods. However, see section IX.B.1 for application of the § 410(b)(4)(B) rule permitting the separate testing of employees who satisfy age and service conditions under the plan that are lower than the greatest age and service conditions permitted under § 410(a).

IX. MULTIPLE CODAS OR MULTIPLE PLANS

SATISFYING SAFE HARBOR CONTRIBUTION REQUIREMENT UNDER ANOTHER DEFINED CONTRIBUTION PLAN

1. In General

Safe harbor matching or nonelective contributions may be made to the plan that contains the CODA or to another defined contribution plan that satisfies § 401(a) or § 403(a). If safe harbor contributions are made to another defined contribution plan, the safe harbor contribution requirement of section V.B must be satisfied in the same manner as if the contributions were made to the plan that contains the CODA. Consequently, each employee eligible under the plan containing the CODA must be eligible under the same conditions under the other defined contribution plan.

2. Plan Year Requirement

In order for safe harbor contributions to be made to another defined contribution plan, that plan must have the same plan year as the plan containing the CODA. However, for plan years of plans containing CODAs beginning before January 1,

2000, contributions used to satisfy the safe harbor contribution requirement of section V.B for a CODA also may be made to another defined contribution plan that does not have the same plan year as the plan containing the CODA, provided that the safe harbor contribution is allocated as of a date within the plan year of the plan containing the CODA and is made no later than 12 months after the close of that plan year.

3. Section 410(b) Aggregation Not Required

In order for safe harbor contributions to be made to another defined contribution plan, it is not necessary that the other plan be capable of being aggregated with the plan containing the CODA for purposes of § 410(b). Therefore, notwithstanding § 1.410(b)-7(c)(2) and 54.4975-11(e), a contribution to an ESOP may be used to satisfy the safe harbor contribution requirement of section V.B for a CODA that is not part of the ESOP.

4. Contributions Used Only Once

Safe harbor matching or nonelective contributions cannot be used to satisfy the safe harbor contribution requirement of section V.B with respect to more than one plan.

B. AGGREGATION AND DISAGGREGATION RULES

1. Plans

The rules that apply for purposes of aggregating and disaggregating CODAs and plans under § 401(k) and 401(m) also apply for purposes of § 401(k)(12) and 401(m)(11), respectively. See § 1.401(k)-1(b)(3) and 1.401(m)-1(b)(3).

Accordingly, all CODAs included in a plan are treated as a single CODA that must satisfy the safe harbor contribution requirement of section V.B and the notice requirement of section V.C. Moreover, two plans (within the meaning of § 1.410(b)-7(b)) that are treated as a single plan pursuant to the permissive aggregation rules of § 1.410(b)-7(d) are treated as a single plan for purposes of the safe harbor methods.

Conversely, a plan (within the meaning of § 414(l)) that includes a CODA covering both collectively bargained employees and noncollectively bargained employees is treated as two separate plans for purposes of § 401(k), and the

ADP test safe harbor need not be satisfied with respect to both plans in order for one of the plans to take advantage of the ADP test safe harbor. Similarly, if, pursuant to § 410(b)(4)(B), an employer applies § 410(b) separately to the portion of a plan (within the meaning of § 414(l)) that benefits only employees who satisfy age and service conditions under the plan that are lower than the greatest minimum age and service conditions permitted under § 410(a), the plan is treated as two separate plans for purposes of § 401(k), and the ADP test safe harbor need not be satisfied with respect to both plans in order for one of the plans to take advantage of the ADP test safe harbor.

2. Highly Compensated Employees

In accordance with § 401(k)(3) and 401(m)(2), elective or matching contributions under a plan made on behalf of an HCE who is eligible to participate in more than one plan of the same employer providing such contributions must generally be aggregated and treated as made under each of the plans, even if one or more of the plans is intended to satisfy the ADP or ACP test safe harbor.

Thus, for example, if an HCE is simultaneously an eligible employee under two plans maintained by an employer for a plan year, only one of which one is intended to satisfy the ADP and ACP tests using the safe harbor methods, and the matching contribution formula of the plan that is not using the safe harbor methods provides greater matching contributions than the formula under the plan that is intended to satisfy the ADP and ACP tests using the safe harbor methods, the rules in sections V.B.1.b and VI.B.3 (prohibiting an HCE from receiving a greater rate of matching contributions than an NHCE) could be violated. These issues could also arise, for example, when an HCE is transferred from a plan maintained for one group of employees to a plan maintained for another group of employees.

X. PLAN YEARS OF FEWER THAN 12 MONTHS

A plan will fail to satisfy the ADP test safe harbor or the ACP test safe harbor for a plan year unless

(i) the plan year is 12 months long or

(ii) in the case of the first plan year of a newly established plan (other than a successor plan), the plan year is at least 3 months long (or, any shorter period in the case of a newly established employer that

establishes the plan as soon as administratively feasible after the employer comes into existence).

XI. PLAN PROVISIONS RELATING TO SAFE HARBORS

A. GENERAL RULES

1. Plan Must Include Safe Harbor Provisions

Sections 1.401(k)-1(b)(2)(iii) and 1.401(m)-1(b)(2) require that a plan to which § 401(k) or § 401(m) applies provide that the ADP or ACP test will be met. Because, effective for plan years beginning after December 31, 1998, a plan may use the SIMPLE 401(k) plan formula or safe harbor provisions as alternatives to the ADP and ACP tests, a plan must specify which of these alternatives it is using. Generally, a plan sponsor that intends to use the safe harbor provisions for a plan year must adopt those provisions before the first day of that plan year. However, see section XI.B for the remedial amendment period applicable to plan changes incorporating the safe harbor provisions.

2. Safe Harbor Contributions Made to Another Plan

If, pursuant to section IX.A, safe harbor matching or nonelective contributions will be made to another plan, the name of the other plan must be specified in the plan containing the CODA. Moreover, if safe harbor matching or nonelective contributions will be made to another plan for a plan year, the other plan must also adopt, before the first day of that plan year, provisions specifying that the safe harbor contributions will be made and providing for the withdrawal and vesting restrictions required by § 401(k)(12)(E)(i). However, see section XI.B for the remedial amendment period applicable to plan changes incorporating the safe harbor provisions.

3. Disaggregated Plans

If a plan, within the meaning of § 414(l), is composed of disaggregated plans under § 1.410(b)-7(c), the plan provisions must specify which disaggregated plans are subject to the safe harbor provisions.

B. REMEDIAL AMENDMENT PERIOD

Section 1.401(b)-1T(b)(3) authorizes the Commissioner to designate a plan provision as a disqualifying provision that either

(1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements or

(2) is integral to a qualification requirement that has been changed.

Section 1.401(b)-1T(c)(3) authorizes the Commissioner, in the case of a disqualifying provision designated as described in the preceding sentence, to impose limits and provide additional rules regarding the amendments that may be made with respect to that disqualifying provision.

Pursuant to § 1.401(b)-1T(b)(3) and (c)(3), a plan provision is hereby designated as a disqualifying provision if the plan provision is integral to a qualification requirement changed by a provision of SBJPA that becomes effective on the first day of the first plan year beginning after December 31, 1998, provided that the following conditions are satisfied.

First, the plan provision must be amended to reflect the change made by SBJPA by no later than the last day of the first plan year beginning after December 31, 1998. (If an employer or plan administrator files a request for a determination letter on the qualified status of a plan by the last day of the first plan year beginning after December 31, 1998, then the date by which the plan provision must be amended shall be extended through the 91st day following the applicable date under § 1.401(b)-1(e)(3)(i) or (ii).)

Second, the plan provision as amended must be effective as of the first day of the first plan year beginning after December 31, 1998. Thus, if a plan uses the safe harbor methods for the plan year beginning in 1999, the plan generally must be amended no later than the end of that plan year, retroactive to the first day of that year, to reflect the safe harbor methods. This remedial amendment period also applies to a plan amendment reflecting the use of the early participation rules under § 401(k)(3)(F) and 401(m)(5)(C).

The preceding paragraph does not permit a CODA to be adopted retroactively. See § 1.401(k)-1(a)(3)(ii).

A plan amendment described in this section XI.B shall not be treated as violating the requirements of § 411(d)(6) merely because the plan amendment imposes the withdrawal restrictions required by § 401(k)(12)(E)(i), provided that those withdrawal restrictions do not apply with respect to contributions allocated as of a date before the first day of the first plan year beginning after December 31, 1998.

REQUEST FOR COMMENTS

The Service and Treasury invite comments and suggestions concerning the guidance provided in this notice. Comments are specifically requested as to whether there are circumstances (in addition to the first plan year of a newly established plan) in which the use of the safe harbor methods would be appropriately allowed for a plan year of less than 12 months (e.g., certain corporate merger or acquisition transactions involving a plan sponsor maintaining a plan using the safe harbor methods, if appropriate conditions are satisfied).

Comments can be addressed to CC:DOM:CORP:R (Notice 98-52), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 98-52), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may transmit comments electronically via the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1624.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this notice is in section V.C, "Notice Requirement," and section XI, "Plan Provisions Relating to Safe Harbors." The collection of information is required to obtain a benefit. The likely respondents are businesses or other for-profit institutions, and not-for-profit institutions.

The estimated total annual reporting/recordkeeping burden is 80,000 hours.

The estimated annual burden per respondent/recordkeeper is 1 hour and 20 minutes. The estimated number of respondents/recordkeepers is 60,000.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Drafting Information

The principal author of this notice is Roger Kuehnle of the Employee Plans Division. For further information regarding this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers), between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday

Notice 2000-3

I. PURPOSE

This notice provides additional guidance regarding 401(k) plans that are intended to satisfy the 401(k) safe harbors. This guidance responds to comments and suggestions regarding ways to make it easier for employers both to adopt and to administer 401(k) safe harbor plans. The notice:

- Encourages adoption of 401(k) safe harbor plans by giving sponsors of existing 401(k) plans the flexibility to wait as late as December 1 of a calendar year to decide to adopt the 401(k) safe harbor 3-percent employer nonelective contribution method for that calendar year;
- Permits 401(k) safe harbor plans to match elective or employee contributions on the basis of compensation for a payroll period, month, or quarter;
- Provides an extended period of time -- until May 1, 2000 -- for 401(k) plan sponsors adopting the 401(k) safe harbor methods for the first time in 2000 to provide the required safe harbor notice to employees;

- Provides explicitly that 401(k) safe harbor plans are permitted to require salary reduction elections to be made using whole percentages of pay or whole dollar amounts;

- Permits plan sponsors to provide the 401(k) safe harbor notice electronically and otherwise simplifies the notice requirement;

- Permits 401(k) safe harbor plans to provide matching contributions on an employee's aggregate employee and elective contributions;

- Makes clear that 401(k) safe harbor plans are permitted to apply to employee after-tax contributions a suspension similar to the 12-month suspension that may be applied to employee elective contributions after an in-service withdrawal of those contributions;

- Permits plan sponsors using the 401(k) safe harbor matching contribution method to exit the safe harbor prospectively during a plan year (and switch to ADP and ACP nondiscrimination testing) if employees are notified beforehand;

- Clarifies the interaction between the 401(k) safe harbors and the election to separately test otherwise excludable employees for purposes of the § 410(b) minimum coverage requirements; and

- Makes clear how the 401(k) safe harbor rules apply in the case of a profit sharing plan to which a 401(k) feature is added for the first time during a plan year.

In addition to modifying the guidance provided in Notice 98-52, 1998-46 I.R.B. 16, relating to 401(k) safe harbor plans, this notice requests comments regarding two significant areas that relate to 401(k) plans in general. The two areas are

(1) potential approaches for simplifying the multiple use test applicable to § 401(k) plans, and

(2) potential approaches for applying the highly compensated employee definition under § 414(q), the nondiscrimination requirements under § 401(k) and 401(m), and possibly other applicable qualification requirements, when a plan sponsor is involved in a merger, acquisition, disposition, or similar transaction.

II. BACKGROUND

A. SBJPA AMENDMENTS TO §§ 401(k), 401(m), AND 414(q)

Under § 401(k)(3) and § 401(m)(2) of the Code, the actual deferral percentage ("ADP") and the actual contribution percentage ("ACP") of highly compensated employees ("HCEs") are compared with those of nonhighly compensated employees ("NHCEs").

Section 414(q) defines a highly compensated employee for purposes of § 401(k) and 401(m), and for other purposes under the Code.

Section 1433(a) and (b) of the Small Business Job Protection Act of 1996 ("SBJPA") added new §§ 401(k)(12) and 401(m)(11) to the Code, effective for plan years beginning after December 31, 1998, to provide design-based safe harbor methods for satisfying the ADP test contained in § 401(k)(3)(A)(ii) and the ACP test contained in § 401(m)(2).

Section 401(k)(12) provides that a cash or deferred arrangement ("CODA") is treated as satisfying the ADP test if the CODA meets certain contribution and notice requirements. Section 401(m)(11) provides that a defined contribution plan is treated as satisfying the ACP test with respect to matching contributions if the plan meets the contribution and notice requirements contained in § 401(k)(12) and in addition meets certain limitations on the amount and rate of matching contributions available under the plan.

Section 1433(c) of SBJPA amended § 401(k)(3)(A) and § 401(m)(2)(A), effective for plan years beginning after December 31, 1996, to provide for the use of prior year data in determining the ADP and ACP of NHCEs, while current year data is used for HCEs. Alternatively, an employer may elect to use current year data for determining the ADP and ACP for both HCEs and NHCEs, but this election may be changed only as provided by the Secretary.

Prior to the effective date of these amendments, plans were required to use current year data in determining the ADP and ACP for both HCEs and NHCEs. Section 1433(d) of SBJPA amended § 401(k)(3) and § 401(m)(3) to provide a special rule for determining the ADP and ACP for

NHCEs for the first plan year of a plan (other than a successor plan) where the prior year testing method is used.

Section 1433(e) of SBJPA amended § 401(k)(8)(C) and § 401(m)(6)(C), effective for plan years beginning after December 31, 1996, to provide that the distribution of excess contributions and excess aggregate contributions will be made on the basis of the amount of contributions by, or on behalf of, each HCE.

Prior to the effective date of these amendments, plans were required to distribute excess contributions and excess aggregate contributions using a method based on the actual deferral ratio or actual contribution ratio of each HCE.

Section 1431 of SBJPA amended § 414(q)(1) to provide that the term "highly compensated employee" means any employee who

(1) was a 5-percent owner at any time during the year or the preceding year, or

(2) for the preceding year had compensation from the employer in excess of $80,000 (as adjusted) and, if the employer so elects, was in the top-paid group for the preceding year.

The amendments made by § 1431 generally apply to years beginning after December 31, 1996.

B. PREVIOUS GUIDANCE ON THE SBJPA AMENDMENTS TO §§ 401(k), 401(m), AND 414(q)

Notice 97-2, 1997-1 C.B. 348, provides guidance on determining the individuals who are taken into account in computing the ADP or ACP for NHCEs for the prior year under the prior year testing method. The notice also prescribes rules for distributions of excess contributions and excess aggregate contributions.

Notice 97-45, 1997-2 C.B. 296, provides guidance relating to the definition of highly compensated employee under § 414(q), as amended by § 1431 of SBJPA.

Notice 98-1, 1998-3 I.R.B. 42, provides guidance relating to the current and prior year ADP and ACP testing methods.

Notice 98-52 provides guidance on the safe harbor methods under § 401(k)(12) for satisfying the ADP test contained in § 401(k)(3)(A)(ii) and safe harbor methods under § 401(m)(11) for satisfying the ACP test contained in § 401(m)(2).

C. DEFINITIONS

Any term used in this notice that is defined in Notice 97-45, 98-1, or 98-52, or in the regulations under § 401(k), 401(m), or 414(q) has the same meaning as in those notices and regulations. For example, the term "employee contribution" means any mandatory or voluntary contribution to the plan that is treated at the time of contribution as an after-tax employee contribution (e.g., by reporting the contribution as taxable income subject to applicable withholding requirements) and is allocated to a separate account to which the attributable earnings and losses are allocated.

In addition, for purposes of this notice,

(1) a "401(k) safe harbor plan" means a CODA that is intended to satisfy the ADP test safe harbor under section V of Notice 98-52, and, if applicable, a defined contribution plan (including a § 403(b) plan) that is intended to satisfy the ACP test safe harbor under section VI of Notice 98-52,

(2) the "401(k) safe harbor nonelective contribution method" means the alternative for satisfying the safe harbor contribution requirement of the ADP test safe harbor under section V.B. of Notice 98-52 that includes satisfying the nonelective contribution requirement under section V.B.2. of Notice 98-52,

(3) the "401(k) safe harbor matching contribution method" means the alternative for satisfying the safe harbor contribution requirement of the ADP test safe harbor under section V.B. of Notice 98-52 that includes satisfying the matching contribution requirement under section V.B.1. of Notice 98-52, and

(4) a "401(k) safe harbor method" means the 401(k) safe harbor nonelective contribution method or the 401(k) safe harbor matching contribution method.

D. EFFECT ON REGULATIONS

Because of the amendments made to §§ 401(k), 401(m), and 414(q) by SBJPA, as well as by other recent legislation, certain portions of §§ 1.401(k)-1, 1.401(m)-1, 1.401(m)-2, and 1.414(q)-1T of the Income Tax Regulations no longer reflect current law. However, these regulations continue to apply to the extent they are not inconsistent with the Code, Notices 97-2, 97-45, 98-1, and 98-52, this notice, and any subsequent guidance.

III. Questions and Answers Relating to the 401(k) and (m) Safe Harbor Methods

Flexibility in Adoption of 401(k) Safe Harbor Nonelective Contribution Method

Q-1. BY WHAT DATE MUST THE SPONSOR OF A 401(K) PLAN ADOPT THE 401(K) SAFE HARBOR NONELECTIVE CONTRIBUTION METHOD FOR A PLAN YEAR?

A-1. Generally, a plan that is intended to satisfy the 401(k) safe harbor requirements for a plan year must, prior to the beginning of the plan year, contain language to that effect and must specify the 401(k) safe harbor method that will be used. (However, see section XI.B. of Notice 98-52 and Rev. Proc. 99-23, 1999-16 I.R.B. 5, for the remedial amendment period applicable to plan changes incorporating the 401(k) safe harbor provisions.)

Notwithstanding section XI.A. of Notice 98-52, a plan that provides that it will satisfy the current year ADP (and, if applicable, ACP) testing method for a plan year may be amended not later than 30 days before the last day of the plan year to specify that the 401(k) safe harbor nonelective contribution method will be used for the plan year (including that the safe harbor nonelective contribution will be made), provided that the plan otherwise satisfies the ADP (and, if applicable, ACP) test safe harbor for the plan year (including the notice requirement under section V.C. of Notice 98-52, as modified by this notice).

For purposes of the preceding sentence, in applying the content requirement of section V.C.1 of Notice 98-52:

(1) Instead of stating the amount of the safe harbor nonelective contribution to be made under the plan, the notice given to eligible employees before the beginning of the plan year must provide that

(a) the plan may be amended during the plan year to provide that the employer will make a safe harbor nonelective contribution of at least 3 percent to the plan for the plan year, and

(b) if the plan is so amended, a supplemental notice will be given to eligible employees 30 days prior to the last day of the plan year informing them of such an amendment, and

(2) A supplemental notice must be provided to all eligible employees no later than 30 days prior to the last day of the plan year stating that a 3 percent safe harbor nonelective contribution will be made for the plan year. For administrative convenience, the supplemental notice may be provided separately or as part of the safe harbor notice for the following plan year.

Similar rules apply if, pursuant to section IX.A.1. of Notice 98-52, the safe harbor nonelective contribution is made to another plan of the employer.

Thus, for example, a plan sponsor that maintains a calendar-year 401(k) plan using the current year ADP testing method and that wishes to have the flexibility to decide toward the end of a plan year whether or not to adopt the 401(k) safe harbor nonelective contribution method with respect to its 401(k) plan could achieve that flexibility by providing the initial notice described in section V.C. of Notice 98-52 (as modified by this Q&A-1, and Q&A-7 and Q&A-8 of this notice) before the beginning of the plan year, as provided under section V.C.2. of Notice 98-52 (as modified by Q&A-9 of this notice).

If the plan sponsor then decides to adopt the 401(k) safe harbor nonelective contribution method for the plan year, the plan sponsor must, by December 1 of the plan year,

(1) amend the 401(k) plan accordingly and

(2) provide a supplemental notice to all eligible employees stating that a 3-percent safe harbor nonelective contribution will be made for the plan year.

A plan sponsor that takes advantage of the flexibility provided under this Q&A-1 is not required to continue using the 401(k) safe harbor nonelective contribution method for the following plan year and is not limited in the number of years that it takes advantage of this flexibility. In order to further facilitate the adoption of the 401(k) safe harbor nonelective contribution method under this Q&A-1, the Service intends to provide a simplified, pre-approved means of adopting the 401(k) safe harbor nonelective contribution method under the Service's master and prototype plan program.

Safe Harbor Matching Contribution Requirements

Q-2. CAN A 401(K) SAFE HARBOR PLAN MATCH ELECTIVE AND EMPLOYEE CONTRIBUTIONS ON A PAYROLL-BY-PAYROLL BASIS (INSTEAD OF ON AN ANNUAL BASIS) WITHOUT MAKING ADDITIONAL CONTRIBUTIONS AT THE END OF THE YEAR TO TAKE INTO ACCOUNT THE TOTAL AMOUNT OF AN EMPLOYEE'S COMPENSATION FOR THE PLAN YEAR?

A-2. Notwithstanding section VII.A. (or any other provision) of Notice 98-52, the requirements of sections V.B.1. and VI.B. of Notice 98-52 that relate to matching contributions may be met for a plan year by meeting such requirements either

(1) with respect to the plan year as a whole, or

(2) if the plan so provides, separately with respect to each payroll period (or with respect to all payroll periods ending with or within each month or plan-year quarter) taken into account under the arrangement for the plan year (the "payroll period method").

If the payroll period method is used, however, matching contributions with respect to elective or employee contributions made during a plan year quarter beginning after May 1, 2000 must be contributed to the plan by the last day of the following plan year quarter.

Accordingly, in the case of a calendar year plan that uses the payroll period method, matching contributions with respect to elective or employee contributions made during the calendar quarter beginning July 1, 2000, must be contributed to the plan by December 31, 2000. The payroll period method applies only for purposes of satisfying the ADP safe harbor matching contribution requirements of § 401(k)(12) (section V.B.1. of Notice 98-52) and the ACP safe harbor matching contribution requirements of § 401(m)(11) (section VI.B. of Notice 98-52).

Q-3. CAN A 401(K) SAFE HARBOR PLAN REQUIRE THAT EMPLOYEES MAKE ELECTIVE CONTRIBUTIONS IN WHOLE PERCENTAGES OF PAY OR WHOLE DOLLAR AMOUNTS?

A-3. Notwithstanding section V.B.1.c.ii. of Notice 98-52, a plan will not fail to satisfy the requirements of sections V.B.1. and VI.B. of Notice 98-52 that relate to matching contributions merely because the plan requires employees to make cash or deferred or employee contribution elections in whole percentages of compensation or whole dollar amounts.

Q-4. CAN A 401(K) SAFE HARBOR PLAN SUSPEND ADDITIONAL EMPLOYEE CONTRIBUTIONS FOR UP TO 12 MONTHS AFTER THE IN-SERVICE WITHDRAWAL OF EMPLOYEE CONTRIBUTIONS?

A-4. Notwithstanding section V.B.1.c. and section VI.B.3. of Notice 98-52, a plan will not fail to satisfy the ACP test safe harbor of section VI of Notice 98-52 merely because, after a withdrawal of employee contributions from the plan, the plan suspends additional employee contributions for a period that does not exceed 12 months. See section V.B.1.c.iv. of Notice 98-52 for a similar exception that applies for purposes of hardship distributions of elective contributions.

Q-5. HOW DO THE RULES OF SECTIONS V.B.1. AND VI.B.3. OF NOTICE 98-52 APPLY TO A PLAN THAT PROVIDES MATCHING CONTRIBUTIONS ON BOTH ELECTIVE CONTRIBUTIONS AND EMPLOYEE CONTRIBUTIONS?

A-5. A plan will not fail to satisfy the requirements of section V.B.1.a., V.B.1.b., or VI.B.3.(iii) of Notice 98-52 merely because the plan provides matching contributions on both elective contributions and employee

contributions if, under the terms of the plan, either

(1) the matching contributions provided on an employee's elective contributions are not affected by the amount of the employee's employee contributions or

(2) matching contributions are made with respect to the sum of an employee's elective and employee contributions under the same terms as matching contributions are made with respect to elective contributions.

For example, a plan will not fail to satisfy the matching contribution requirement of section V.B.1. or the ACP test safe harbor of section VI of Notice 98-52 merely because the plan provides a required matching contribution equal to 100 percent of the sum of each eligible employee's elective and employee contributions up to 4 percent of compensation.

This is the case even if, during a plan year, an eligible employee first makes employee contributions of 4 percent of compensation that are matched by the employer and subsequently makes elective contributions that go unmatched, provided that the same match would have been available if the employee had instead made only elective contributions.

Q-6. MAY A PLAN THAT USES THE 401(K) SAFE HARBOR MATCHING CONTRIBUTION METHOD SUSPEND MATCHING CONTRIBUTIONS ON FUTURE ELECTIVE AND EMPLOYEE CONTRIBUTIONS DURING A PLAN YEAR AND INSTEAD USE THE CURRENT YEAR ADP (AND, IF APPLICABLE, ACP) TESTING METHOD FOR THE PLAN YEAR?

A-6. A plan that uses the 401(k) safe harbor matching contribution method will not fail to satisfy § 401(k) (or § 401(m)) for a plan year merely because the plan is amended during the plan year to reduce or eliminate matching contributions, provided:

(1) A supplemental notice is given to all eligible employees explaining the consequences of the amendment and informing them of the effective date of the reduction or elimination of matching contributions and that they have a reasonable opportunity (including a reasonable period) to change their cash or deferred elections and, if applicable, their employee contribution elections;

(2) The reduction or elimination of matching contributions is effective no earlier than the later of

(i) 30 days after eligible employees are given the supplemental notice and

(ii) the date the amendment is adopted;

(3) Eligible employees are given a reasonable opportunity (including a reasonable period) prior to the reduction or elimination of matching contributions to change their cash or deferred elections and, if applicable, their employee contribution elections;

(4) The plan is amended to provide that the ADP test and, if applicable, the ACP test will be performed and satisfied for the entire plan year using the current year testing method; and

(5) All other safe harbor requirements are satisfied through the effective date of the amendment.

Notice Requirement

Q-7. CAN A PLAN USE ELECTRONIC MEDIA TO SATISFY THE 401(K) SAFE HARBOR NOTICE REQUIREMENT?

A-7. The Service and Treasury are currently reviewing the legal and policy issues relating to the satisfaction of the safe harbor notice requirement through the use of electronic media. Prior to the issuance of additional guidance on this matter, however, a plan will not fail to satisfy the notice requirement of section V.C. of Notice 98-52 (as modified by this notice) with respect to an employee merely because, instead of receiving the notice on a written paper document, the employee receives the notice through an electronic medium reasonably accessible to the employee, provided that

(1) the system under which the electronic notice is provided is reasonably designed to provide the notice in a manner no less understandable to the employee than a written paper document and

(2) under such system, at the time the notice is provided, the employee is advised that the employee may request and receive the notice on a written paper document at no charge, and, upon request, that document is provided to the employee at no charge.

This Q&A-7 also applies for purposes of providing the supplemental notices under Q&A-1 and Q&A-6 of this notice.

Q-8. CAN A SAFE HARBOR NOTICE CROSS-REFERENCE THE PLAN'S SUMMARY PLAN DESCRIPTION FOR A PORTION OF THE INFORMATION REQUIRED IN THE NOTICE?

A-8. Section V.C. of Notice 98-52 provides that the notice requirement of that section is satisfied if each eligible employee for the plan year is given written notice of the employee's rights and obligations under the plan and the notice satisfies the content requirement of paragraph 1 of that section and the timing requirement of paragraph 2 of that section.

Notwithstanding paragraph 1.a. of section V.C. of Notice 98-52, a plan will not fail to satisfy the content requirement merely because, in the case of the information described in items(ii) (relating to any other contributions under the plan), (iii) (relating to the plan to which safe harbor contributions will be made), (iv) (relating to the type and amount of compensation that may be deferred), and (vii) (relating to withdrawal and vesting provisions) of paragraph 1.a., the notice instead cross-references the relevant portions of an up-to-date summary plan description that has been provided (or concurrently is provided) to the employee.

However, the notice contribution formula used under the plan (including a description of the levels of matching must still accurately describe

(1) the safe harbor matching or nonelective contributions, if any, available under the plan) and state that these contributions (as well as elective contributions) are fully vested when made and

(2) how to make cash or deferred elections (including any administrative requirements that apply to such elections) and the periods available under the plan for making such elections.

In addition, the notice must also provide information that makes it easy for eligible employees to obtain additional information about the plan (including an additional copy of the summary plan description) such as telephone numbers, addresses and, if applicable, electronic addresses, of the individuals or offices from whom employees can obtain such plan information.

Q-9. BY WHAT DATE MUST THE SAFE HARBOR NOTICE BE PROVIDED TO EMPLOYEES IN THE CASE OF A PLAN THAT ADOPTS A 401(K) SAFE HARBOR METHOD FOR THE FIRST TIME IN THE YEAR 2000?

A-9. Generally, the notice required under section V.C. of Notice 98-52 must be provided in accordance with the timing requirements of section V.C.2. (i.e., the notice must be provided within a reasonable period before the beginning of the plan year (or, in the year an employee becomes eligible, within a reasonable period before the employee becomes eligible)).

However, in an effort to allow plan sponsors that are considering the adoption of a 401(k) safe harbor method to fully utilize the guidance provided in this notice for plan years beginning in the year 2000, the Service and Treasury have determined that transition relief is appropriate.

Accordingly, in the case of a plan sponsor that adopts a 401(k) safe harbor method for the first time with respect to a plan for a plan year that begins on or after January 1, 2000 and on or before June 1, 2000, the notice described in section V.C. of Notice 98-52 satisfies the timing requirement for that plan year if the notice is given on or before May 1, 2000. This transition relief applies whether the 401(k) safe harbor method is adopted under a newly established 401(k) plan or under a preexisting 401(k) plan.

In order to satisfy the 401(k) safe harbor requirements for the plan year, however, a plan that uses the transition relief provided under this Q&A-9 still must satisfy the otherwise applicable requirements of Notice 98-52 (as modified by this notice) with respect to the entire plan year. Thus, for example, in the case of a 401(k) plan that uses the 401(k) safe harbor matching contribution method, matching contributions still must be made with respect to elective contributions made prior to the date the safe harbor notice is provided to employees in the same amount as if the 401(k) safe harbor matching contribution method had been in place since the beginning of the plan year.

Interaction Between Safe Harbor Methods and § 410(b)(4) Election

Q-10. IS A PLAN REQUIRED TO PROVIDE SAFE HARBOR MATCHING OR NONELECTIVE CONTRIBUTIONS TO PARTICIPANTS WHO HAVE NOT YET ATTAINED AGE 21 AND COMPLETED A YEAR OF SERVICE IF THE PLAN USES ONE OF THE 401(K) SAFE HARBOR METHODS?

A-10. As provided in section IX.B.1. of Notice 98-52, if, pursuant to § 410(b)(4)(B), an employer applies § 410(b) separately to the portion of a plan (within the meaning of § 414(l)) that benefits only employees who satisfy age and service conditions under the plan that are lower than the greatest minimum age and service conditions permitted under § 410(a), the plan is treated as two separate plans for purposes of § 401(k), and the ADP test safe harbor need not be satisfied with respect to both plans in order for one of the plans to take advantage of the ADP test safe harbor.

Accordingly, a plan that uses one of the 401(k) safe harbor methods is not required to provide safe harbor matching or nonelective contributions to participants who have not yet attained age 21 and completed a year of service. Those employees do not have to be treated as eligible employees for purposes of the 401(k) safe harbors, so long as the employer has elected to treat them separately for coverage purposes pursuant to § 410(b)(4). However, in such a case, the plan must specifically provide that elective contributions (and, if applicable, matching contributions) on behalf of those employees will satisfy the ADP test (and, if applicable, the ACP test).

Addition of 401(k) Safe Harbor Provisions to Existing Profit-Sharing Plans

Q-11. CAN A CODA THAT IS ADDED TO AN EXISTING PROFIT-SHARING PLAN FOR THE FIRST TIME DURING A PLAN YEAR USE A 401(K) SAFE HARBOR METHOD FOR THAT PLAN YEAR?

A-11. Generally, the safe harbor requirements must be satisfied for the entire plan year (see sections V.A. and VI.A. of Notice 98-52). In addition,

except in the case of a newly established plan, the plan year must be 12 months long (see section X of Notice 98-52).

Notwithstanding these requirements, however, in the case of a CODA that is added to an existing profit-sharing, stock bonus, or pre-ERISA money purchase pension plan for the first time during a plan year, the requirements of section V of Notice 98-52 will be treated as being satisfied for the entire plan year and the CODA will not be treated as failing to satisfy the requirements of section X of Notice 98-52, provided:

(1) the plan is not a successor plan (within the meaning of Notice 98-1),

(2) the CODA is made effective no later than 3 months prior to the end of the plan year, and

(3) the requirements of Notice 98-52 are otherwise satisfied for the entire period from the effective date of the CODA to the end of the plan year.

Thus, an existing calendar-year profit-sharing plan that does not contain a CODA may be amended as late as October 1 to add a CODA that uses a 401(k) safe harbor method for that plan year.

A similar rule applies for purposes of section VI of Notice 98-52 in the case of the addition of matching contributions for the first time to an existing defined contribution plan at the same time as the adoption of the CODA.

IV. SIMPLIFYING THE LIMITATION ON MULTIPLE USE

The limitation on multiple use applies to the current and prior year ADP and ACP testing methods (i.e., the nondiscrimination testing methods that § 401(k) plans must satisfy if they do not satisfy the 401(k) safe harbors or the SIMPLE 401(k) requirements).

The limitation on multiple use is a nondiscrimination provision intended to limit the extent to which highly compensated employees receive greater benefits (as a percentage of pay) than nonhighly compensated employees, primarily under § 401(k) plans that provide for matching contributions.

The Service and Treasury are considering approaches that would substantially

simplify the limitation on multiple use administratively, while retaining most of the value of this limitation in ensuring a fairer distribution of benefits under § 401(k) plans and, in many cases, encouraging employers to make fully-vested nonelective contributions on behalf of nonhighly compensated employees.

Generally, the average rate of elective contributions under a § 401(k) plan on behalf of highly compensated employees may not exceed 125 percent of the average rate of elective contributions on behalf of nonhighly compensated employees.

However, the Code provides an "alternative limitation" that permits the average rate of elective contributions under a § 401(k) plan on behalf of highly compensated employees to exceed 125 percent of the average rate on behalf of nonhighly compensated employees, provided that average rate for highly compensated employees is not greater than 2 percentage points more than the average rate for nonhighly compensated employees and is not greater than 200 percent of that of nonhighly compensated employees.

The alternative limitation is particularly relevant where the average rate of elective contributions on behalf of nonhighly compensated employees is relatively low.

For example, if the average rate of elective contributions on behalf of nonhighly compensated employees is 4 percent of pay, then the average rate of elective contributions on behalf of highly compensated employees may not exceed 6 percent of pay.

Absent the alternative limitation, the average rate of elective contributions on behalf of highly compensated employees could not exceed 5 percent in such a case. Similar rules apply separately to the average rate of matching and employee after-tax contributions of highly compensated employees under a § 401(m) plan.

Section 401(m)(9) requires the Secretary of the Treasury to "prescribe such regulations as may be necessary to carry out the purposes of this subsection and subsection (k) including . . . such regulations as may be necessary to prevent the multiple use of the alternative limitation with respect to any highly compensated employee." Accordingly, while the alternative limitation may be used to satisfy either the nondiscrimination test for elective contributions or the nondiscrimination test for matching

> and employee after-tax contributions, the alternative limitation is not available to satisfy both tests.
>
> Absent the statutorily contemplated limitation on multiple use, the combined rates of elective and matching contributions on behalf of highly compensated employees under a § 401(k) plan that provides for matching contributions could, for example, be as much as 8 percent (i.e., an ADP of 4 percent and an ACP of 4 percent) while the combined rates for nonhighly compensated employees could be as little as 4 percent (i.e., an ADP of 2 percent and an ACP of 2 percent). In this case, the limitation on multiple use would reduce this 4-percentage-point disparity to 2½ percentage points.

While many employers choose to comply with the limitation on multiple use by reducing or limiting the elective and/or matching contributions on behalf of highly compensated employees, other employers instead increase the employer contributions made on behalf of nonhighly compensated employees. Accordingly, because of the limitation on multiple use, some moderate-income employees covered under 401(k) plans that provide matching contributions receive employer-provided benefits that amount to hundreds of dollars a year.

However, the approach taken under existing regulations in implementing the limitation on multiple use may be unnecessarily complicated. As a result, the Service and Treasury are reviewing potential changes to these regulations that would substantially simplify the application of the limitation on multiple use.

Under one possible approach, the multi-step mathematical test used in determining the aggregate limit on the rates of contributions for highly compensated employees would be replaced by a simple "look-up" table that is based on ranges of aggregate contribution rates for nonhighly compensated employees. For example, such a table could provide that if the combined ADP and ACP on behalf of nonhighly compensated employees is between 5 percent and 6 percent, then the combined ADP and ACP on behalf of highly compensated employees could be as much as 3 percentage points higher.

Alternatively, or in addition, the scope of the limitation's application might be narrowed slightly in order to give relief in cases where the value of the limitation would be inconsequential in comparison to the administrative expense of compliance. For example, where the combined ADP and ACP on behalf of nonhighly compensated employees exceeds a certain level (e.g., 9 percent or 10 percent), the limitation on multiple use might be deemed satisfied.

The Service and Treasury welcome comments on these and other potential approaches for simplifying the limitation on multiple use. Comments on the effect of the SBJPA changes to the methods for correcting excess contributions and excess aggregate contributions and the relation of those changes to corrections of multiple use limitation failures are also welcome. In addition, comments are welcome regarding whether it is more appropriate (as a matter of authority or otherwise) for simplification of the limitation on multiple use to be effected administratively or legislatively.

V. POTENTIAL APPROACHES FOR APPLYING VARIOUS QUALIFICATION REQUIREMENTS IN MERGERS, ACQUISITIONS, DISPOSITIONS, AND SIMILAR TRANSACTIONS

The Service and Treasury are in the process of developing guidance regarding the application of the nondiscrimination requirements under § 401(k) and § 401(m), and the highly compensated employee definition under § 414(q), in situations where the entities sponsoring the plans are involved in mergers, acquisitions, dispositions, or similar transactions. Uncertainty among plan sponsors regarding the appropriate application of various qualification requirements in the context of business transactions and reorganizations may be leading to reduced employee protections, increased transaction costs for employers, and the inconsistent application of these requirements among different employers.

The guidance developed by the Service and Treasury will be designed to balance the need to protect employees' pension rights and benefits and provide for the fair distribution of tax-favored pension benefits with the potential burdens on employers of data collection and compliance in the context of business transactions and reorganizations. Simplified alternatives may be provided to address those types of transactions in which the information flow between the selling and purchasing entities or other entities involved in the transactions traditionally has been minimal.

As part of this process, the Service and Treasury are seeking comments from plan participants, plan sponsors, and other interested parties regarding the following:

(1) The types of business transactions and reorganizations (e.g., stock acquisitions, acquisitions of substantially all the assets of a trade or

business, or other economically similar transactions) that reasonably would warrant continuity of treatment for purposes of the nondiscrimination requirements under § 401(k) and § 401(m) and the highly compensated employee definition under § 414(q), as well as the degree of specificity that is desirable or appropriate in describing these transactions.

(2) The application of the nondiscrimination requirements under § 401(k) and § 401(m) and the highly compensated employee definition under § 414(q) in cases where plans are combined or divided during (instead of at the beginning of) a plan year as a result of a business transaction or reorganization that occurs during a plan year.

(3) Whether more than one testing alternative may be appropriate when applying the nondiscrimination requirements under § 401(k) and § 401(m) in the case of mid-year transactions. For example, under certain circumstances, one approach to mid-year business transactions that also involve combining plans might be to give plan sponsors the option of applying the § 401(k) and § 401(m) nondiscrimination requirements on a pre-transaction and post-transaction basis as if there were separate short plan years for the uncombined and combined plans, or applying these requirements once on the basis of the entire plan year for the combined plan. A similar approach might apply in cases where plans are divided as a result of mid-year business transactions.

(4) The application of other plan qualification provisions (in addition to the nondiscrimination requirements for § 401(k) and § 401(m) plans and the highly compensated employee definition under § 414(q)) in the context of business transactions and reorganizations, whether or not such transactions occur in the middle of a plan year. For example, § 414(a)(2) grants the Secretary of the Treasury the authority to prescribe regulations regarding the treatment of service with a predecessor employer as service with a successor employer. Comments are invited on whether regulations should be proposed to address situations in which participants experience an interruption of their vesting service under § 411(a) and eligibility service under § 410(a) by reason of certain business transactions or reorganizations.

V. REQUEST FOR COMMENTS

In addition to inviting comments on the potential approaches for

simplifying the limitation on multiple use and for applying various qualification requirements in cases where plan sponsors are involved in mergers, acquisitions, and similar transactions, the Service and Treasury invite comments on the 401(k) safe harbor guidance provided in this notice. It is anticipated that further guidance in these areas would take the form of proposed regulations.

Comments should be submitted by March 24, 2000, in writing, and should reference Notice 2000-3. Comments can be addressed to CC:DOM:CORP:R (Notice 2000-3), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 2000-3), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may transmit comments electronically via the following Internet site: Cynthia.Grigsby@m1.irscounsel.treas.gov.

VII. EFFECT ON OTHER DOCUMENTS

Notice 98-52 is modified.

PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1669.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this notice are in section III, Q&As 1 and 2. The collections of information are required to enable personnel in the Tax Exempt and Government Entities Division of the Internal Revenue Service to determine if an employer's retirement plan satisfies the requirements to obtain favorable tax treatment and to inform plan participants of their rights and obligations under the plan. The likely respondents are businesses or other for-profit institutions, and not-for-profit institutions.

The estimated total annual reporting burden is 8,000 hours.

The estimated annual burden per respondent is 1 hour and 20 minutes. The estimated number of respondents is 6,000. The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers) between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.