

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

Current Developments-Negative Elections

TABLE OF CONTENTS

CURRENT DEVELOPMENTS-NEGATIVE ELECTIONS.....	574
REV. RUL. 2000-8 –“NEGATIVE ELECTION”-401(K) PLAN	575
ISSUE	575
FACTS	575
<i>Situation 1</i>	575
<i>Situation 2</i>	577
LAW AND ANALYSIS	577
HOLDING	579
EFFECT ON OTHER DOCUMENTS	580
DRAFTING INFORMATION.....	581
REV. RUL. 2000-35-“NEGATIVE ELECTION”-403(B) PLAN	582
SECTION 403(B) PLANS; ELECTIVE DEFERRALS.....	582
ISSUE	582
FACTS	582
LAW AND ANALYSIS	585
HOLDING	587
PAPERWORK REDUCTION ACT	587
DRAFTING INFORMATION.....	588
REV. RUL. 2000-33-“NEGATIVE ELECTION”-457 PLAN.....	589
ISSUE	589
FACTS	589
LAW AND ANALYSIS	590
HOLDING	591
DRAFTING INFORMATION.....	592
ANNOUNCEMENT 2000-60 AUTOMATIC ENROLLMENT FEATURES IN PROTOTYPE SECTION 401(K) PLANS	593

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

Rev. Rul. 2000-8 --“Negative election”-401(k) plan

Section 401. --Qualified Pension, Profit-Sharing, Stock Bonus Plans, etc.

26 CFR 1.401(k)-1: Certain cash or deferred arrangements

February 14, 2000

ISSUE

Will employer contributions to a profit-sharing plan fail to be considered elective contributions, within the meaning of § 1.401(k)-1(g)(3) of the Income Tax Regulations, made under a qualified cash or deferred arrangement, within the meaning of § 401(k) of the Internal Revenue Code, merely because they are made pursuant to an arrangement under which a fixed percentage of an employee's compensation is contributed to the plan unless the employee affirmatively elects to receive the amount in cash?

FACTS

SITUATION 1

Employer X maintains Plan A, a profit-sharing plan intended to satisfy the requirements of § 401(a), including § 401(k) and 401(m), and maintained on a calendar-year basis. Under Plan A, any employee of Employer X, including a newly hired employee, may elect to have Employer X make contributions on the employee's behalf to Plan A in lieu of receiving that amount as cash compensation that would otherwise be payable to the employee. The employee may designate the amount of these compensation reduction contributions as a percentage of the employee's compensation, subject to certain limitations set forth in the plan.

Under Plan A, if a newly hired employee does not affirmatively elect to receive cash or have a specified amount contributed to Plan A, his or her compensation is automatically reduced by 3 percent and this amount is contributed to Plan A. An election by any employee not to make compensation reduction contributions or to contribute a different percentage of compensation can be made at any time. The election is effective for the first pay period and subsequent pay periods (until superseded by a subsequent

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

election) if filed when the employee is hired or if filed within a reasonable period thereafter ending before the compensation for the first pay period is currently available. Thus, if an employee files an election to receive cash in lieu of compensation reduction contributions and the election is filed when the employee is hired or within a reasonable period thereafter ending before the compensation is currently available, then no compensation reduction contributions for the first pay period or subsequent pay periods are made on the employee's behalf to Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. Elections filed at a later date are effective for payroll periods beginning in the month next following the date the election is filed.

At the time an employee is hired, the employee receives a notice that explains the automatic compensation reduction election and the employee's right to elect to have no such compensation reduction contributions made to the plan or to alter the amount of those contributions, including the procedure for exercising that right and the timing for implementation of any such election. Each participant in Plan A is notified annually of his or her compensation reduction percentage and the participant's right to change the percentage, including the procedure for exercising that right and the timing for implementation of any such election.

Plan A provides that compensation reduction contributions are immediately nonforfeitable and, if the employee has not attained age 59 1/2, cannot be distributed prior to the employee's retirement, death, or separation from service, except in the case of hardship (as defined in the plan). Plan A also provides that, for each employee who has at least 1 year of service, Employer X will make matching contributions to Plan A on account of the employee's compensation reduction contributions up to a specified percentage of the employee's compensation. Plan A does not permit after-tax employee contributions.

Plan A provides that both matching contributions and compensation reduction contributions will be invested in accordance with the participant's election among a broad range of investment funds held by the trustee or, if no investment election is made by the participant, in the trust's balanced fund which includes both diversified equity and fixed income investments.¹⁹

¹⁹ The Department of Labor has advised Treasury and the Service that, under Title I of the Employee Retirement Income Security Act of 1974 (ERISA), fiduciaries of a plan must ensure that the plan is administered prudently and solely in the interest of plan participants and beneficiaries. While ERISA § 404(c) may serve to relieve certain fiduciaries from liability when participants or beneficiaries exercise control over the assets in their individual accounts, the Department of Labor has taken the position that a participant or beneficiary will not be considered to have exercised control when the participant or beneficiary is merely apprised of investments that will be made on his or her behalf in the absence of instructions to the contrary. See 29 CFR § 2550.404c-1 and 57 F.R. 46924

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

SITUATION 2

The facts are the same as in Situation 1, except Plan A is amended, effective the next January 1, to apply the same rule to both current and newly hired employees. Thus, under Plan A as amended, if an employee hired before January 1 who has not elected compensation reduction contributions of at least 3 percent of compensation does not affirmatively elect during a specified reasonable period ending on the January 1 effective date to receive cash or have a specified amount contributed to Plan A, his or her compensation is automatically reduced by 3 percent and this amount is contributed to Plan A beginning the first pay period that begins after the January 1 effective date.

Under the terms of Plan A as amended, if a current employee files an election to receive cash in lieu of compensation reduction contributions and the election is filed during the reasonable period ending on the January 1 effective date, then no compensation reduction contributions for the first pay period beginning on or after the January 1 effective date or for subsequent pay periods are made on the employee's behalf to Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. In the case of a current employee who has a compensation reduction contribution election in effect for less than 3 percent, who does not make a new compensation reduction contribution election during the reasonable period ending on the January 1 effective date, and whose compensation is therefore automatically reduced by 3 percent beginning on that January 1, if that employee thereafter makes an affirmative election to reduce his or her compensation by another amount (or no amount), then that affirmative election will continue in effect until the employee makes a subsequent affirmative election for a different amount.

At the beginning of the reasonable period ending on the January 1 effective date, each current employee receives a notice that explains the new automatic compensation reduction election and the employee's right to elect to have no such compensation reduction contributions made to the plan or to alter the amount of those contributions, including the procedure for exercising that right and the timing for implementation of any such election. Thereafter, each employee receives the annual notice described above in Situation 1.

LAW AND ANALYSIS

Section 401(k) provides that a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan can meet the requirements of § 401(a) even if it includes a qualified cash or deferred arrangement. Section 401(k) also sets forth the requirements that a cash or deferred arrangement must satisfy in order to be a qualified cash or deferred arrangement.

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

Section 1.401(k)-1(a)(2)(i) defines a cash or deferred arrangement as an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of § 401(a). Section 1.401(k)-1(a)(2)(ii) provides that a cash or deferred arrangement does not include an arrangement under which amounts contributed under a plan at an employee's election are designated or treated at the time of contribution as after-tax employee contributions.

Section 1.401(k)-1(a)(3)(i) defines a cash or deferred election as any election (or modification of an earlier election) by an employee to have the employer either provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available or contribute an amount to a trust (or provide an accrual or other benefit) under a plan deferring the receipt of compensation. Section 1.401(k)-1(a)(3)(iv) provides that a cash or deferred election does not include a one-time irrevocable election, made at the time an employee commences employment with the employer or upon the employee's first becoming eligible under any plan of the employer, to have contributions made by the employer on the employee's behalf to the plan (or to any other plan of the employer) equal to a specified amount or percentage of the employee's compensation.

Section 1.401(k)-1(e)(2) provides generally that a qualified cash or deferred arrangement must provide that the amount that each eligible employee may defer as an elective contribution is available to the employee in cash.

Section 1.401(k)-1(g)(3) defines elective contributions as employer contributions made to a plan that were subject to a cash or deferred election under a cash or deferred arrangement. Such contributions are elective contributions without regard to whether the cash or deferred arrangement is a qualified cash or deferred arrangement.

The definition of a cash or deferred election in § 1.401(k)-1(a)(3)(i) requires that the employee have an election between the employer paying cash (or some other taxable benefit) to the employee or making a contribution to a trust on behalf of the employee. The regulation does not require that the employee receive an amount in cash in any case in which the employee does not make an affirmative election to have that amount contributed to the trust. Thus, a cash or deferred election will not fail to be made under a qualified cash or deferred arrangement merely because, when an employee fails to make an affirmative election with respect to an amount of compensation, that amount is contributed on the employee's behalf to a trust, provided that the employee had an effective opportunity to elect to receive that amount in cash. The employee has an effective opportunity to elect to receive an amount in cash as required under § 1.401(k)-1(a)(3)(i) if the employee receives notice of the availability of the election and the

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

employee has a reasonable period before the cash is currently available to make the election.

If Plan A were to permit after-tax employee contributions, then the amounts contributed to the plan would have to be designated or treated, at the time of the contribution, as pre-tax compensation reduction contributions or after-tax employee contributions.

In Situation 1, compensation reduction contributions made by Employer X to Plan A, including those made on behalf of a newly hired employee who has not filed an election to the contrary, are amounts contributed pursuant to a procedure under which the employee receives a notice explaining his or her rights to have no compensation reduction contributions made and, after receiving the notice, the employee has a reasonable period before the cash is currently available to elect to receive the cash in lieu of having it contributed to the plan. Similarly, in Situation 2, compensation reduction contributions made by Employer X to Plan A, including those made on behalf of a newly hired employee who has not filed an election to the contrary and those made on behalf of a current employee who has elected less than 3 percent compensation reduction contributions, are amounts contributed pursuant to a procedure under which the employee receives a notice explaining his or her rights to have no compensation reduction contributions made and, after receiving the notice, the employee has a reasonable period before the cash is currently available to elect to receive the cash in lieu of having it contributed to the plan.

Thus, in Situation 1 and Situation 2, an eligible employee has an effective opportunity to elect to receive cash or have a contribution made to the plan on the employee's behalf. In addition, compensation reduction contributions made under the plan are not contributions made pursuant to a one-time irrevocable election because the employee can change the election in the future. Consequently, the compensation reduction contributions described in Situation 1 and Situation 2 are made pursuant to cash or deferred elections and satisfy the requirement in § 1.401(k)-1(a)(3)(i) that the amount that each eligible employee may defer as an elective contribution be available to the employee in cash. The result would be the same if the plan required a period of service (permitted under § 401(k)(2)(D)) before an employee became eligible for elective contributions.

HOLDING

Where, as in Situation 1 and Situation 2, a newly hired or a current employee has an effective opportunity to elect to receive an amount in cash or have that amount contributed by the employer to a profit-sharing plan, those employer contributions made on the employee's behalf to the plan in lieu of receipt of cash compensation will not fail

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

to be considered elective contributions within the meaning of § 1.401(k)-1(g)(3) made under a qualified cash or deferred arrangement within the meaning of § 401(k) merely because they are made pursuant to an arrangement under which, in any case in which an employee does not affirmatively elect to receive cash, the employee's compensation is reduced by a fixed percentage and that amount is contributed on the employee's behalf to the plan.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 98-30, 1998-25 I.R.B. 8, is amplified and superseded.

PAPERWORK REDUCTION ACT

The collection of information contained in this revenue ruling 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 1545-1605.

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 revenue ruling are in the third, sixth, and last paragraphs in the section headed "FACTS" and in the sixth paragraph in the section headed "LAW AND ANALYSIS." 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 enable certain employee elections to meet the requirements of § 401(k). The collections of information are 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 burden is 1,750 hours. The estimated average annual burden per respondent is 1 hour and 10 minutes. The estimated number of respondents is 1,500. 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.

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

DRAFTING INFORMATION

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

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

Rev. Rul. 2000-35-“Negative Election”-403(b) plan

Section 403.--Taxation of Employee Annuities

26 CFR 1.403(b)-1: Taxability of beneficiary under annuity contract purchased by a section 501(c)(3) organization or public school.

July 31, 2000

Section 403(b) plans; elective deferrals.

This revenue ruling specifies the criteria to be met in order to automatically reduce an employee's compensation by a certain amount and have that amount contributed as an elective deferral to an employer's section 403(b) plan.

ISSUE

Will employer contributions to an annuity contract described in § 403(b) of the Internal Revenue Code (the "Code") fail to be considered to be made under a salary reduction agreement merely because they are made pursuant to an arrangement under which a fixed percentage of an employee's compensation is contributed to the annuity contract unless the employee affirmatively elects to receive the amount in cash?

FACTS

Employer X, an organization described in § 501(c)(3) which is exempt from tax under § 501(a), maintains Plan A, a plan described in § 403(b) of the Code and § 3(2) of the Employee Retirement Income Security Act of 1974 ("ERISA"). Under Plan A, any employee of Employer X, including a newly hired employee, may elect to have Employer X make contributions on the employee's behalf towards the purchase of an annuity contract in lieu of receiving that amount as cash compensation that would otherwise be payable to the employee. The employee may designate the amount of these compensation reduction contributions as a percentage of the employee's compensation, subject to certain limitations set forth in the plan. These compensation reduction contributions satisfy the § 403(b) requirements applicable to contributions made pursuant to a salary reduction agreement, and are treated for all purposes as made pursuant to a salary reduction agreement under the plan.

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

Plan A also provides that Employer X will make matching contributions on account of an employee's compensation reduction contributions up to a specified percentage of the employee's compensation. Plan A does not permit any other contributions.

Plan A is amended, effective the next January 1, to add an automatic compensation reduction election feature. Under this feature, each employee's compensation will automatically be reduced by 4 percent and this amount will be contributed towards the purchase of an annuity contract under Plan A unless the employee affirmatively elects to receive cash or have a different percentage contributed. Both before and after the amendment, the employee is not able to receive, prior to a distributable event described in § 403(b)(11), amounts contributed towards the purchase of an annuity contract. Both before and after the amendment, Plan A and the annuity contracts purchased thereunder satisfy the requirements of § 403(b). An election not to make compensation reduction contributions or to contribute a different percentage of compensation can be made at any time.

Under Plan A as amended, in the case of a newly hired employee, an election not to make compensation reduction contributions or to contribute a different percentage is effective for the first pay period and for subsequent pay periods (until superseded by a subsequent election) if filed when the employee is hired or if filed within a reasonable period thereafter ending before the compensation for the first pay period is currently available. Thus, if a newly hired employee files an election to receive cash in lieu of compensation reduction contributions and the election is filed when the employee is hired or within a reasonable period thereafter ending before the compensation is currently available, then no compensation reduction contributions for the first pay period or subsequent pay period are made on the employee's behalf to Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. Elections filed at a later date are effective for payroll periods beginning in the month next following the date the election is filed.

At the time an employee is hired, the employee will receive a notice that explains the automatic compensation reduction election and the employee's right to elect to have no such compensation reduction contributions made to the plan or to alter the amount of those contributions, including the procedure for exercising that right and the timing for implementation of any such election.

In the case of an employee hired before the January 1 effective date who has not elected compensation reduction contributions of at least 4 percent, Plan A as amended provides that the automatic election will become effective on the first pay period beginning on or after January 1 unless the employee elects during a specified reasonable period ending on January 1 to receive cash or have a different amount contributed to Plan A. Thus, if a current employee files an election to receive cash in

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

lieu of compensation reduction contributions and the election is filed during the reasonable period ending on the January 1 effective date, then no compensation reduction contributions for the first pay period beginning on or after the January 1 effective date or for subsequent pay periods are made on the employee's behalf to Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. In the case of a current employee who has a compensation reduction contribution election in effect for less than 4 percent, who does not make a new compensation reduction contribution election during the reasonable period ending on the January 1 effective date, and whose compensation is therefore automatically reduced by 4 percent, if that employee thereafter makes an affirmative election to reduce his or her compensation by another amount (or no amount), then that affirmative election will continue in effect until the employee makes a subsequent affirmative election for a different amount.

At the beginning of the reasonable period ending on the January 1 effective date, each current employee receives a notice that explains the new automatic compensation reduction election and the employee's right to elect to have no such compensation reduction contributions made to the plan or to alter the amount of those contributions, including the procedure for exercising that right and the timing for implementation of any such election.

Each employee is notified annually of his or her compensation reduction percentage, and of his or her right to change the percentage, including the procedure for exercising that right and the timing for implementation of any such election.

Plan A provides that both matching contributions and compensation reduction contributions will be invested in accordance with the participant's election among a broad range of annuity contracts. If no investment election is made by a participant, contributions are invested in an annuity contract providing an investment return based on the return on a balanced fund that includes both diversified equity and fixed-income investments.²⁰

²⁰ The Department of Labor has advised Treasury and the Service that, under Title I of the Employee Retirement Income Security Act of 1974 (ERISA), fiduciaries of a plan must ensure that the plan is administered prudently and solely in the interest of plan participants and beneficiaries. While ERISA § 404(c) may serve to relieve certain fiduciaries from liability when participants or beneficiaries exercise control over the assets in their individual accounts, the Department of Labor has taken the position that a participant or beneficiary will not be considered to have exercised control when the participant or beneficiary is merely apprised of investments that will be made on his or her behalf in the absence of instructions to the contrary. See 29 CFR § 2550.404c-1 and 57 F.R. 46924.

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

LAW AND ANALYSIS

Section 403(b)(1) of the Code provides that amounts contributed by certain employers, including an employer described in § 501(c)(3) which is exempt from tax under § 501(a), for the purchase of an annuity contract for an employee of such an employer are excluded from the gross income of the employee if certain requirements are satisfied.

Contributions to purchase annuity contracts under § 403(b) may be made either pursuant to a salary reduction agreement or not pursuant to a salary reduction agreement. Contributions made pursuant to a salary reduction agreement are subject to different requirements than are contributions not made pursuant to a salary reduction agreement. (See, for example, §§ 403(b)(1)(E), 403(b)(7)(A)(ii), 403(b)-(11) and 403(b)(12).) In general, a contribution is not treated as made pursuant to a salary reduction agreement if under the agreement it is made pursuant to a one-time irrevocable election made by the employee at the time of initial eligibility to participate in the agreement. See §§ 402(g)(3)(C) and 403(b)(12).

Section 1.403(b)-1(b)(3)(i) of the regulations prescribes rules applicable to contributions made pursuant to a salary reduction agreement, including rules relating to the frequency and revocability of such agreements and to the salary to which such agreements apply.

Section 1450(a) of the Small Business Job Protection Act of 1996 ("SBJPA") provides that, for purposes of § 403(b) of the Code, the frequency that an employee is permitted to make a salary reduction agreement, the salary to which such an agreement may apply and the ability to revoke such an agreement shall be determined under the rules applicable to cash or deferred elections under § 401(k). Section 1450(a) of SBJPA is effective for taxable years beginning after December 31, 1995. Thus, § 1.403(b)-1(b)(3)(i) of the regulations does not reflect current law, and the rules relating to these aspects of salary reduction agreements are the same as those for cash or deferred elections under § 401(k).

Section 401(k) provides that a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan can meet the requirements of § 401(a) even if it includes a qualified cash or deferred arrangement. Section 401(k) also sets forth the requirements that a cash or deferred arrangement must satisfy in order to be a qualified cash or deferred arrangement.

Section 1.401(k)-1(a)(2)(i) defines a cash or deferred arrangement as an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of § 401(a).

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

Section 1.401(k)-1(a)(3)(i) defines a cash or deferred election as any election (or modification of an earlier election) by an employee to have the employer either provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available or contribute an amount to a trust (or provide an accrual or other benefit) under a plan deferring the receipt of compensation. Section 1.401(k)-1(a)(3)(iv) provides that a cash or deferred election does not include a one-time irrevocable election, made at the time an employee commences employment with the employer or upon the employee's first becoming eligible under any plan of the employer, to have contributions made by the employer on the employee's behalf to the plan (or to any other plan of the employer) equal to a specified amount or percentage of the employee's compensation. Section 1.401(k)-1(g)(3) defines elective contributions as employer contributions made to a plan that were subject to a cash or deferred election under a cash or deferred arrangement.

Revenue Ruling 2000-8, 2000-7 I.R.B. 617 (February 14, 2000), holds that where a newly hired or a current employee has an effective opportunity to elect to receive an amount in cash or have that amount contributed by the employer to a profit-sharing plan, those employer contributions made on the employees' behalf to the plan in lieu of receipt of cash compensation will not fail to be considered elective contributions within the meaning of § 1.401(k)-1(g)(3) made under a qualified cash or deferred arrangement within the meaning of § 401(k) merely because they are made pursuant to an arrangement under which, in any case in which an employee does not affirmatively elect to receive cash, the employee's compensation is reduced by a fixed percentage and that amount is contributed on the employee's behalf to the plan.

The definition of a cash or deferred election in § 1.401(k)-1(a)(3)(i) requires that the employee have an election between the employer paying cash (or some other taxable benefit) to the employee or making a contribution to a trust on behalf of the employee. The regulation does not require that the employee receive an amount in cash in any case in which the employee does not make an affirmative election to have that amount contributed to the trust. Similarly, under § 403(b), there is no requirement that an employee receive an amount in cash in any case in which the employee does not make an affirmative election to have that amount contributed to an annuity contract. Thus, a contribution to purchase an annuity contract under § 403(b) will not fail to be made under a salary reduction agreement merely because, when an employee fails to make an affirmative election with respect to an amount of compensation, that amount is contributed on the employee's behalf to an annuity contract, provided that the employee had an effective opportunity to elect to receive that amount in cash. The employee has an effective opportunity to elect to receive an amount in cash as required under § 1.401(k)-1(a)(3)(i) if the employee receives notice of the availability of the election and the employee has a reasonable period before the cash is currently available to make the election.

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

In this case, compensation reduction contributions made by Employer X to Plan A, including those made on behalf of a newly hired employee who has not filed an election to the contrary and those made on behalf of a current employee who has elected less than 4-percent compensation reduction contributions, are amounts contributed pursuant to a procedure under which the employee receives a notice explaining his or her rights to have no compensation reduction contributions made and, after receiving the notice, the employee has a reasonable period before the cash is currently available to elect to receive the cash in lieu of having it contributed towards the purchase of an annuity contract. Thus, an employee has an effective opportunity to elect to receive cash or have a contribution made towards the purchase of an annuity contract. In addition, the employee is not able to receive, prior to a distributable event described in § 403(b)(11), amounts contributed towards the purchase of an annuity contract. Finally, compensation reduction contributions made under the plan are not contributions made pursuant to a one-time irrevocable election because the employee can change the election in the future. Consequently, the compensation reduction contributions under Plan A as amended are contributions made pursuant to a salary reduction agreement described in § 403(b).

HOLDING

Where, as in this case, a newly hired or current employee has an effective opportunity to elect to receive an amount in cash or have that amount contributed by the employer to an annuity contract described in § 403(b), those contributions made on the employee's behalf to the annuity contract in lieu of receipt of cash compensation will not fail to be considered to be made under a salary reduction agreement merely because they are made pursuant to an arrangement under which, in any case in which an employee does not affirmatively elect to receive cash, the employee's compensation is reduced by a fixed percentage and that amount is contributed on the employee's behalf to the annuity contract. This holding would be the same if (1) Plan A were described in § 403(b)(1)(A)(ii) (relating to arrangements maintained by State and local school systems), or (2) the funding vehicles under Plan A were custodial accounts described in § 403(b)(7) or retirement income accounts described in § 403(b)(9), provided the requirements of such respective Code sections are otherwise satisfied.

PAPERWORK REDUCTION ACT

The collection of information contained in this revenue ruling 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 1545-1694.

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

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 revenue ruling are in the third, fifth, seventh and eighth paragraphs in the section headed "FACTS" and in the tenth paragraph in the section headed "LAW AND ANALYSIS." 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 enable certain employee elections to meet the requirements of § 403(b). The collections of information are required to obtain a benefit. The likely respondents are State and local government entities and not-for-profit institutions.

The estimated total annual reporting burden is 175 hours. The estimated annual burden per respondent is 1 hour and 45 minutes. The estimated number of respondents is 100. 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 revenue ruling is Roger Kuehnle of the Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, call the Employee Plans' taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers) between 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.