

employee plans news

PROTECTING RETIREMENT BENEFITS THROUGH EDUCATING CUSTOMERS

Internal Revenue Service
Tax Exempt and Government
Entities Division

A Publication of Employee Plans

Summer Shower of Regulations

It's the middle of summer and the weather isn't the only thing heating up. In the past few days, the IRS has issued proposed and final regulations on a number of topics. The new guidance provides rules on everything from 401(k) plans to retroactive annuity starting dates to welfare benefit funds. Below are capsule summaries of each of the new pieces of guidance. We follow this summary list with an article on the new 401(k) regs.

- **Sections 401(k) and 401(m)** – In proposed regulations published on July 17, 2003, the IRS incorporated several pieces of guidance issued since 1994. The regulations also include provisions arising from statutory changes since 1994. Among the areas affected by the new regulations are the ADP and ACP tests, SIMPLE 401(k) plans and what constitutes an elective deferral.
- **Section 419A(f)(6)** – Also on July 17th, the IRS issued final regulations under section 419A(f)(6) relating to welfare benefit plans. The new regulations concern the special deduction rules for welfare benefit plans maintained by 10 or more employers. In general, these rules are effective for contributions paid or incurred in taxable years of an employer beginning on or after July 11, 2002, and for certain other purposes are effective for taxable years of a welfare benefit plan beginning on or after July 17, 2003.
- **Section 417(a)(7)** – Final regulations regarding the application of the retroactive annuity starting date provisions contained in the Small Business Job Protection Act of 1996 were published on July 16th. Proposed regulations on this subject were issued on January 17, 2001. These regulations, which permit the required written explanations of certain annuity benefits to be provided to plan participants after the annuity starting date, do not apply to defined contribution plans. As under the proposed regulations, the final regulations provide that a retroactive annuity starting date can be used only if the plan provides for it and if the participant elects to use it.
- **Section 457** – The IRS released final regulations under section 457 on July 10th. These regulations generally apply to taxable years beginning after December 31, 2001, subject to certain specific transition rules. There is also a special delayed effective date for the rule where an eligible governmental plan cannot distribute rollover account benefits to a participant who is not yet eligible for a distribution. The final regulations extend self-correction of excess deferrals to eligible plan of tax-exempt employers; the proposed regulations had only extended self-correction to eligible governmental plans. The final regulations also provide guidance on such topics as plan terminations, ineligible plans and the deferral of sick, vacation and back pay.
- **Section 411(d)(6)** – On July 8th, the IRS issued proposed regulations under section 411(d)(6) as it relates to optional forms of benefit under defined contribution (“DC”) plans. Under these regulations, a DC plan can be amended to eliminate or restrict a particular optional form of benefit without violating section 411(d)(6) if, once the plan amendment takes effect, the alternative forms of payment that remains available includes payment in the form of a single-sum distribution that is “otherwise identical” to the eliminated or restricted optional form. Participants were previously required to receive a 90-day notice. The new regulations remove the 90-day notice condition.

New 401(k) Regs Are Out

On July 17, 2003, the IRS published proposed regulations providing guidance for plans under sections 401(k) and 401(m). These regulations consolidate guidance issued in this area since 1994 (when the existing final regulations under sections 401(k) and 401(m) were last amended) and also include provisions arising from statutory changes made since 1994.

Some minor changes have been made to the existing guidance; however, substantial changes have been made in the areas of targeted contributions and pre-funding of contributions. The regulations restrict the practice sometimes referred to as “bottom-up leveling”: where contributions are targeted to the lowest paid non-highly compensated employees (NHCEs) to satisfy the actual deferral percentage (ADP) test or the actual contribution percentage (ACP) test. And to address the issue of pre-funding of elective and matching contributions, the regulations modify the definition of elective contributions and matching contributions.

Since the 1994 regulations, a number of items of guidance affecting section 401(k) and 401(m) plans have been issued by the Service, including:

- [Notice 97-2](#) providing initial guidance on prior year ADP and ACP testing and on the correction of excess contributions and excess aggregate contributions, including distribution to the HCEs with the largest contributions.
- [Rev. Proc. 97-9](#) providing a model amendment for SIMPLE 401(k) plans.
- [Notice 98-1](#) providing additional guidance on the prior year testing method.
- [Notice 98-52](#) and [Notice 2000-3](#) providing guidance on safe harbor section 401(k) plans.
- [Rev. Rul. 2000-8](#) addressing the use of automatic enrollment features in section 401(k) plans.
- [Notice 2001-56](#) and [Notice 2002-4](#) providing initial guidance related to the changes made by EGTRRA.

These items of guidance are incorporated into the proposed regulations with some modification.

The proposed regulations add a new requirement that a qualified nonelective contribution (QNEC) must satisfy in order to be considered in the ADP test. This requirement is designed to limit the use of the targeted QNECs. The proposed regulations under section 401(m) provide parallel restrictions on QNECs taken into account in ACP testing, as well as a new rule that limits the use of targeted matching contributions in the ACP test.

The proposed regulations specify when a contribution is considered an “elective contribution”. What this means, in general, is that a contribution made in anticipation of an employee’s cash or deferred election is not treated as an elective contribution. Also, a contribution made in anticipation of future performance of services generally would not be treated as an elective contribution under section 401(k). Similar principles are in the proposed regulations under section 401(m) to curtail the pre-funding of matching contributions.

The regulations are proposed to be effective for plan years beginning no sooner than 12 months after publication of the final regulations. However, it is anticipated that the preamble for the final regulations will permit plan sponsors to implement the final regulations for the first plan year beginning after publication of the final regulations.

Coming in the Fall 2003 Edition of *Employee Plans News*

Upcoming topics include:

- An EP Connection interview
- A recap of new guidance items
- The Fall/Winter Benefits Conferences Round-Up
- An update on new web-based products

... and much more. Look for us in your email box in September.

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