

Publications

Tracking the Comprehensive Proposed Rules for 401(k) and Matching Plans

PUBLISHED

08/04/2003

SERVICES

Author: Chuck Sherman

Comprehensive Proposed Rules for 401(k) and Matching Plans

The IRS released comprehensive proposed regulations under Code sections 401(k) and 401(m) on July 17. 68 Fed. Reg. 42476. These regulations would replace the existing regulations first published in 1991, and amended in 1994. The new regulations generally would be effective for plan years beginning on or after the date that is 12 months after the issuance of final regulations. Thus, plans are not required to follow them now.

Since the existing 401(k) and 401(m) regulations were issued, there have been numerous statutory changes. For example, 1996 legislation added design-based safe harbor methods for satisfying the ADP and ACP nondiscrimination tests, as well as the new SIMPLE plan. The 1996 legislation also made numerous changes to the existing ADP/ACP tests. TRA 97 and, most recently, EGTRRA made additional changes to sections 401(k) and 401(m). The IRS implemented these statutory changes by issuing numerous items of significant guidance, including:

- Notice 97-2 providing guidance on prior year testing, and correcting excess contributions and excess aggregate contributions;
- Rev. Proc. 97-9 and Notice 98-1 providing additional guidance on prior year testing;
- Notice 98-52 and Notice 2000-3 providing guidance on safe harbor section 401(k) and (m) plans;
- Rev. Rul. 2000-8 addressing the use of automatic enrollment features in section 401(k) plans; and
- Notice 2001-56 and Notice 2002-4 providing guidance on the changes made by EGTRRA.

The proposed regulations consolidate this existing guidance and add numerous examples, making mostly modest changes. (Unfortunately, the proposed regulations still provide no guidance on testing issues that arise in the context of mergers and acquisitions.) In fact, noting that the proposed regulations are not intended to require significant plan design or operational changes, the IRS and Treasury requested comments on points where the proposed regulations would have an unintended impact on administrative practices so that Treasury and IRS can evaluate whether such a change is appropriate or whether the regulations should be adjusted to avoid the change.

The proposed regulations make some changes to the existing guidance. These changes are described on a side-by-side chart attached below. The most significant changes made by the proposed regulations would:

- restrict the use of the “bottom-up leveling” method of satisfying the ADP/ACP tests by means of additional employer contributions in the form of QNECs and QMACs;
- allow the aggregation of ESOPs and non-ESOPs for ADP/ACP testing purposes – a change that will make it easier for companies to take advantage of the ESOP dividend deduction;
- prohibit employers from pre-funding 401(k) deferrals and matching contributions to accelerate tax deductions;
- require the transferor plan in a plan-to-plan transfer of 401(k) accounts to verify that the accepting plan will continue to apply the 401(k) distribution restrictions to the transferred amounts; and
- extend the 401(k) rules for partnerships to sole proprietors.

Comments on the proposed rules should be submitted by October 22. A public hearing has been scheduled for November 12.

[Proposed Rules for 401\(k\)/\(m\) Plans – What They Would ChangeDownload](#)