January 28, 2005

FINAL IRS RULES FOR 401(k)/(m) PLANS – WHAT THEY CHANGE

A. GENERAL RULES FOR 401(k) DEFERRALS

	Existing Guidance	Final Regulations
Reference to salary reduction agreement eliminated	In the definition of a cash or deferred arrangement ("CODA"), the regulations provide that a CODA includes a salary reduction agreement between an employee and the employer.	The final regulations do not change the basic definition of a CODA, but eliminate the reference to a salary reduction agreement. The Preamble to the proposed regulations indicates that a salary reduction agreement can still qualify as a CODA, but the specific reference to a salary reduction agreement is viewed as unnecessary.
Automatic enrollment ("negative" 401(k) deferral elections)	The rules regarding automatic enrollment in 401(k) plans, which allow a plan to provide for an automatic salary deferral election for an employee unless the employee affirmatively elects otherwise, are contained in Revenue Ruling 2000-8.	The final regulations permit plans to provide for negative deferral elections, with the Preamble indicating that any percentage of contribution rate may apply. The final regulations do not include the employee notice requirements described in Rev. Rul. 2000-8. However, the IRS has indicated that it intends to issue separate guidance addressing employee notice standards applicable to 401(k) plans generally. Also, the Preamble notes that a negative deferral election is not considered a participant investment election for purposes of the ERISA section 404(c) rules; the DOL takes the position that the plan fiduciary retains responsibility over the investment of contributions until the participant provides investment direction.
Contributions in excess of a deferral election	The existing regulations do not state how plan contributions in excess of the cash available to a participant should be characterized.	The final regulations provide that if an employee may elect between cash or a plan contribution in excess of the cash, the portion of the contribution in excess of the available cash is a matching contribution.
Employee deferral election process that applies where there is no	The existing regulations do not provide specific rules for salary deferral elections.	The final regulations require a plan to provide employees with an effective opportunity to make (or change) a cash or deferred election at least once during each plan year. Whether an

	Existing Guidance	Final Regulations
automatic enrollment		employee has an effective opportunity is determined on the basis of all the relevant facts and circumstances, including notice of the availability of the election, the period of time during which an election may be made, and any other conditions on elections.
Certain one-time elections	The existing regulations permit an employee to make a one-time irrevocable election upon commencing employment to have contributions equal to a specified percentage of compensation contributed to the employer's defined contribution plans, or to receive accruals under a defined benefit plan, for the duration of the employee's employment with the employer.	The final regulations extend the time during which the one-time election can be made until the time when the employee first becomes eligible under the plan. They also clarify that, in addition to plans, a one-time irrevocable election also applies to any benefit "arrangement" described in Code section 219(g)(5)(A), which includes section 403(a) and (b) annuity plans and contracts, governmental plans, SEP and SIMPLE plans, and VEBAs.
Contributions may not precede election	Some employers pre-fund future elective contributions and matching contributions in order to accelerate the tax deduction. In Notice 2002-48, the IRS indicated that contributions before the end of the employer's tax year made in anticipation of future elective or matching contribution obligations could be deducted in the year of contribution.	The final regulations provide that a contribution will be treated as a CODA only if it is made: • after the employee's deferral election is made; and • after the employee performs the services with respect to which the contribution is made (or after the date the compensation would have been paid, if earlier), unless the exception for bona fide administrative considerations applies. The exception for administrative considerations permits contributions to be made occasionally to a plan before the services are performed if this accommodates a bona fide administrative concern and is not for the principal purpose of accelerating deductions. The regulations provide one example: the temporary absence of the bookeeper with responsibility to transmit contributions to the plan. Under these rules, any pre-funding is treated as an employer profit-sharing contribution and cannot be used to offset amounts required to be contributed on account of future employee

	Existing Guidance	Final Regulations
		salary deferrals. Thus, employers are no longer able to accelerate the timing of their deduction, and Notice 2002-48 no longer applies. Similar rules apply to the pre-funding of matching contributions, except that forfeitures and ESOP shares released from an ESOP suspense account generally will be treated as matching contributions even though the employer contributions may have been made before an employee's services were performed.

B. DISTRIBUTION RULES

	Existing Guidance	Final Regulations
General distribution restrictions – change in status to leased employee	Because of the repeal (in EGTRRA) of the "same desk" rule, distributions of amounts attributable to 401(k) contributions are now available upon an employee's "severance from employment," which generally includes any termination of the common-law employee relationship with the employer maintaining the plan.	The repeal of the "same desk" rule and related statutory changes to the 401(k) distribution limitations (and published IRS guidance regarding these changes) are reflected in the final regulations. The final regulations provide that a change in status from an employee to a leased employee is not a severance of employment that permits a distribution to the participant.
Hardship distributions	The existing regulations contain detailed rules regarding hardship distributions, including safe harbors.	The hardship distribution rules reflect the change made by EGTRRA to shorten, from 12 months to 6 months, the required contribution suspension period following a safe harbor hardship distribution. The final regulations also reflect the related elimination of the deferral limitation that had applied in the year after the suspension period. In addition, the hardship rules have been reorganized and revised to clarify the following points: • Each of the two basic requirements (*i.e.*, immediate and heavy financial need, and distribution is necessary to satisfy need) have separate safe harbor rules that the plan may separately elect to apply. • The employee representation that a distribution is necessary to satisfy the need must provide that the need cannot reasonably be relieved from other sources, including by any available plan distribution or loan. The final regulations in this regard are virtually identical to the existing regulations. Some have interpreted the existing regulations to allow a hardship distribution unless the *entire* hardship can be relieved by one of the listed sources in the regulations. However, a parenthetical statement in the Preamble to the proposed regulations suggests that other sources must be utilized to help relieve the hardship before a hardship distribution is

	Existing Guidance	Final Regulations
		permissible, even if the other sources cannot relieve the entire hardship need. The one exception is a commercial loan, which must be used only if the loan can entirely satisfy the hardship need.
Hardship distributions – Safe harbor for "immediate and heavy financial need"	The prior regulations included a safe-harbor provision addressing what circumstances would be considered as imposing an immediate and heavy financial need. These circumstances were limited to (a) medical expenses, (b) costs associated with purchasing a principal residence, (c) tuition and related educational expenses, and (d) payments necessary to prevent eviction.	The final regulations expand the list of circumstances which satisfy the safe-harbor for an immediate and heavy financial need to include: • expenses for medical care for a non-custodial child; • funeral expenses for the employee's deceased parent, spouse, children or dependents; and • expenses for the repair of damage to the employee's principal residence that qualify for the casualty loss deduction under section 165 (without regard to whether the loss exceeds 10% of adjusted gross income)
Hardship distributions – definition of dependent	The prior regulations included a safe-harbor provision addressing what circumstances would be considered as imposing an immediate and heavy financial need. These circumstances included: • medical expenses defined in section 213(d), incurred by the employee, the employee's spouse or any dependents, as defined in section 152; and • tuition payments for the employee, the employee's spouse, children or dependents, as defined in section 152.	After the proposed regulations were issued, Congress changed the definition of dependent in section 152 to narrow its scope. The final regulations address this change to section 152 by modifying the medical expenses and tuition payment provisions in such a way that these provisions apply generally in the same manner that they applied before the change to section 152. This change is effective when the change to section 152 becomes effective, *i.e.*, January 1, 2005.
Hardship distributions – "determination of immediate and heavy financial need"	The prior regulations permitted an employer to rely on an employee's representation that his or her immediate and heavy financial need cannot be relieved by other resources, provided the representation was in writing.	The final regulations permit a plan to rely on an employee's representation that his or her immediate and heavy financial need cannot be relieved by other resources, provided the representation is in writing "or such other form as may be prescribed by the Commissioner." The IRS has indicated that it intends to issue separate guidance addressing employee notice

	Existing Guidance	Final Regulations
		standards applicable to 401(k) plans generally.
Hardship distributions – availability of ESOP dividends to meet an "immediate and heavy financial need"	The prior 401(k) regulations did not include distributable ESOP dividends as a resource available for meeting an immediate and heavy financial need. However, this was addressed in recent regulations under section 404(k).	The final regulations incorporate the prior IRS guidance under section 404(k), which provides that an employee may not elect to reinvest ESOP dividends in his or her plan account if the employee wishes to take a hardship distribution – ESOP dividends are listed as a potential resource for relieving an immediate and heavy financial need. The length of the period during which this restriction applies is not addressed.
Distributions following plan termination	Distributions on account of plan termination are not permitted if the employer maintains a successor defined contribution plan. A successor plan does not include an ESOP or SEP.	The final regulations provide that a successor defined contribution plan (called an "alternative" defined contribution plan in the final regulations) does not include a SIMPLE IRA, a 403(b) plan, or a 457 plan. Thus, distribution upon a plan's termination is not prohibited by maintenance of such a plan (nor by maintenance of an ESOP or SEP).
Plan-to-plan transfers and distribution restrictions	The 401(k) distribution limitations continue to apply under a plan that receives a plan-to-plan transfer (not a rollover contribution) of elective contributions.	The final regulations clarify that qualified nonelective contributions and qualified matching contributions must remain subject to the 401(k) distribution limitations following a plan-to-plan transfer. The new rules prohibit a plan from transferring accounts (except in the case of a direct rollover) to a plan that does not provide that the transferred amounts will remain subject to these limitations. The transferor plan would satisfy this requirement if it reasonably concludes that the transferee plan maintains the distribution limitations (under rules comparable to the rules for accepting rollover contributions).
Elective deferrals taken into account in determining if a participant is "nonvested" upon termination	Existing guidance provides that elective deferrals are "disregarded for purposes of applying section 411(a) to other contributions." Accordingly, for purposes of the rule of parity described in section 411(a)(6)(D), some plans have treated an employee credited with both elective deferral and matching contributions as a nonvested participant if his or her matching contributions were 0% vested.	The final regulations provide that elective contributions generally must be taken into account for purposes of section 411(a). Therefore, fully vested elective contributions must be taken into account in determining whether a participant is 0% vested for purposes of applying the rule of parity, as well as for the purposes of determining whether a participant's account may be deemed distributed upon his or her termination of

	Existing Guidance	Final Regulations
	This permitted such a participant's pre-break service to be disregarded if he or she terminated and was subsequently rehired after a 5-year break in service. In addition, if a participant were 0% vested in his or her employer contributions when he or she terminated employment, some plans have treated the participant's employer contributions as a deemed distribution and, accordingly, a forfeiture.	employment.

C. NONDISCRIMINATION TESTING

	Existing Guidance	**Final regulations**
Minimum coverage testing – Disaggregation of plans with different testing methodologies	The existing guidance does not address whether plans that use different methodologies to satisfy sections 401(k) and 401(m) – safe harbor or non-safe harbor plans – can be aggregated for minimum coverage testing.	The final regulations provide that all 401(k)/401(m) plans that are aggregated for purposes of 410(b) must employ the same testing method for ADP/ACP purposes. For example, a plan that satisfies the ADP test by testing may not be aggregated with a plan that uses the ADP safe harbor.
ADP/ACP testing – Incorporation by reference	The existing regulations allow plans to incorporate the ADP and ACP testing provisions by reference. However, if there are optional choices that may be applied, the plan must specify which option will be applied. For example, the plan must specify whether current year or prior year testing will be used.	The final regulations do not change the existing regulations in this regard. However, they clarify that a plan may not include provisions relevant to both ADP/ACP testing and the ADP/ACP safe harbor, and provide that ADP/ACP testing will be performed only if the plan does not meet the safe harbor. The regulations also authorize the IRS to establish default options that will apply unless a plan document specifically states otherwise.
ADP/ACP testing – Aggregation of ESOP and non-ESOP portions of a plan for testing purposes	In general, all CODAs included in a plan are aggregated for purposes of applying the ADP/ACP tests. However, the mandatory disaggregation rules of Reg. § 1.410(b)-7(c) apply. These regulations provide for the mandatory disaggregation of the ESOP and non-ESOP portions of a plan. This has meant that any 401(k) or 401(m) plan that includes both an ESOP and non-ESOP portion must perform separate ADP and ACP tests for the ESOP and non-ESOP portions of the plan.	The final regulations retain the general aggregation rules. However, noting the increased use of ESOPs as an investment fund in 401(k) plans, and the increased expense and administrative difficulty that the disaggregation rule creates for these plans, the final regulations eliminate the mandatory disaggregation of ESOPs and non-ESOPs for ADP/ACP testing. This exception from the mandatory ESOP disaggregation rule do not apply for other nondiscrimination testing purposes, including the 410(b) coverage test.
ADP/ACP testing – Aggregation of contributions of HCEs	The deferral ratio of any HCE who is eligible to participate in 2 or more CODAs of the same employer is calculated by aggregating his or her elective deferrals under all CODAs that may be aggregated under 410(b). Where the elective deferrals are made under plans that have different plan years, the elective deferrals made under each plan for the plan year that ends with or within a	The final regulations retain the general rule regarding the aggregation of elective deferrals of an HCE. However, the HCE aggregation rule is modified to reflect the new rule that ESOPs may be aggregated with non-ESOPs. In addition, the final regulations address the problem of aggregating plans with different plan years by providing that the deferral ratio for an HCE is determined by aggregating his

	Existing Guidance	Final regulations
	single calendar year are aggregated. This methodology for aggregating elective deferrals for plans with different plan years can result in elective deferrals for more than a 12-month period being taken into account in the ADP testing. Aggregation is also required for purposes of ACP testing.	or her elective deferrals made within the plan year of the plan being tested. In addition, in determining the HCE's compensation, only compensation paid during the plan year of the plan being tested, using the definition of compensation in that plan, is included. The result is that the deferral ratio of an HCE who participates in multiple CODAs is based on 12 months of elective contributions and 12 months of compensation. Finally, the final regulations clarify that elective deferrals of HCEs under plans using inconsistent testing methods can be aggregated. These rules also apply for purposes of ACP testing.
ADP/ACP testing – QNECs	Currently, plans may meet the ADP/ACP tests by contributing "targeted" Qualified Nonelective Contributions ("QNECs"), *i.e.*, QNECs that are targeted to a small number of employees with low compensation to minimize the nonelective contribution necessary to satisfy the ADP/ACP test.	The final regulations add a new requirement for QNECs, designed to limit the use of "targeted" QNECs. The final regulations place restrictions on QNECs that exceed a participant's compensation multiplied by the greater of (i) 5% (10% if the QNECs are made in connection with an employer's obligation to pay prevailing wages under the Davis-Bacon Act or other similar legislation) or (ii) two times the plan's representative contribution rate. The plan's representative contribution rate is defined as the lowest contribution rate among a group of NHCEs that is half of all the eligible NHCEs under the arrangement (or, if greater, the lowest contribution rate among all eligible NHCEs under the arrangement who are employed on the last day of the year, if greater). A participant's contribution rate is the sum of the QMACs and QNECs taken into account under the ADP test for the plan year divided by the employee's compensation for the same period. (Any QNEC that is taken into account in determining the representative contribution rate for ADP test purposes cannot be taken into account in determining the representative rate for ACP test purposes.)

	Existing Guidance	Final regulations
		The final regulations provide essentially the same restriction on targeted QNECs for ACP test purposes. The difference is that the relevant contribution rate is the sum of the matching contributions and QNECs made on behalf of a participant divided by the participant's compensation. Because QNECs that do not exceed 5% are not subject to the limits on targeted QNECs under either the ADP test or the ACP test, a plan may take into account up to 10% in QNECs without regard to the restrictions on QNECs: 5% in ADP testing and 5% in ACP testing.
ADP/ACP testing – Limit on QMACs	Currently, plans may meet the ADP/ACP tests by making "targeted" Qualified Matching Contributions ("QMACs"), *i.e.*, QMACs that are targeted to a small number of employees with low compensation to minimize the employer contribution necessary to satisfy the ADP/ACP test.	The final regulations add a new requirement designed to limit the use of "targeted" QMACs. The final regulations place restrictions on QMACs that exceed the greatest of (1) 5% of compensation (10% if the QNECs are made in connection with an employer's obligation to pay prevailing wages under the Davis-Bacon Act or other similar legislation), (ii) 100% of elective deferrals, or (iii) 2 times the plan's representative matching rate multiplied by the employee's elective deferrals for the year. The plan's representative matching rate is the lowest matching rate for all eligible NHCEs among a group of NHCEs that consists of half of all eligible NHCEs who make elective deferrals or employee contributions (or, if greater, the lowest matching rate for all eligible NHCEs in the plan who are employed on the last day of the plan year and who make elective deferrals or employee contributions). The matching rate is the amount of matching contributions divided by elective deferrals and/or employee contributions being matched. If the matching rate is not the same for all levels of elective deferrals, the matching rate is determined by assuming that an employee elects a 6% rate of elective deferrals.

	Existing Guidance	Final Regulations
ADP/ACP testing – Timing of QNEC/QMAC contributions	Under the existing guidance, the timing rules applicable to contributions of QNECs/QMACs used to satisfy the ADP test using prior year testing are unclear.	The final regulations clarify that, with respect to a plan that uses prior year testing, QNECs and QMACs must be contributed to the plan no later than the end of the plan year being tested.
ADP/ACP testing – Double counting	The existing guidance includes a prohibition on "double counting" QNECs. Generally, QNECs used (i) in an ADP or ACP test, (ii) to satisfy the safe harbor under section 401(k), or (iii) under a SIMPLE 401(k) plan cannot be used again to demonstrate compliance with another test under Code section 401(k)(3) or 401(m)(2).	The final regulations retain the prohibition against double counting in the existing guidance. However, they continue to permit elective contributions and matching contributions to be moved between the ADP and ACP tests. In addition, the final regulations provide an exception from double counting for a new plan that elects prior year testing and, for its first plan year, elects to use the ADP for NHCEs during that first year (instead of the 3% method). In this case, the prohibition on double counting QNECs would not apply to the testing for the second plan year.
ACP test – Use of elective deferrals	Elective deferrals may be used to help a plan pass the ACP test, provided they met certain requirements.	The final regulations add an additional restriction on the use of elective deferrals to pass the ACP test: elective deferrals under a safe harbor plan (or other plan that is not subject to ADP testing) cannot be taken into account for ACP test purposes.
ADP/ACP testing – Prior year testing	The existing guidance is unclear about whether the ADP and ACP tests must be consistent with respect to the election of prior year or current year testing.	The final regulations provide that plans need not be consistent with respect to ADP and ACP testing. However, if the methodologies are inconsistent, then the following corrective procedures are prohibited: (i) elective deferrals cannot be recharacterized as after-tax contributions; (ii) elective deferrals cannot be taken into account under the ACP test; and (iii) QMACs cannot be taken into account under the ADP test.
ADP/ACP testing – Anti-abuse provision	Existing guidance includes an anti-abuse provision which provides that a plan will not be treated as satisfying the requirements of section 401(k) if there are repeated changes to plan testing procedures or plan provisions that have	This anti-abuse provision has been retained in the final regulations, despite many comments requesting that it be excluded.

	Existing Guidance	Final Regulations
	the effect of distorting the tests to benefit HCEs.	
ADP/ACP testing – Change from prior year to current year testing	Under existing guidance, a plan may be amended to change from prior year to current year testing for "any subsequent plan year."	The final regulations provide that such a change is permitted for "any plan year." Therefore, a plan sponsor may adopt current year testing after the start of the plan year.
ADP/ACP testing – Impact of plan coverage changes on use of prior year testing	The existing guidance provides that, where there has been a plan coverage change affecting more than 10% of the NHCEs covered by a plan, the ADP and ACP for NHCEs for the prior year is the weighted average of the ADPs and ACPs of the NHCEs in the plans in which the NHCEs participated in the prior year.	The final regulations incorporate the existing guidance. They also clarify that a plan coverage change includes a change in the group of eligible employees under a plan resulting from the establishment or amendment of a plan, a plan merger or spin-off or a change in the way plans are combined or separated under the section 410(b) rules, as well as a reclassification of a substantial group of employees that has the same effect as amending the plan. They provide that a plan that merely experiences a spin-off is not required to recalculate the ADP for the NHCEs.
ADP/ACP correction – Correction of excess contributions where HCE participates in multiple 401(k) or 401(m) plans	The existing regulations provide that a plan's failure to meet the ADP test can be corrected by distributing or recharacterizing excess contributions. The total amount of excess deferrals for all HCEs is based on lowering the deferral ratios of HCEs to the point where the ADP test is met. Then the excess amount is apportioned among the HCEs by assigning the excess to those HCEs with the greatest dollar amount of contributions. A corresponding rule applies for ACP test purposes.	The final regulations adopt the same manner of correcting a plan's failure to meet the ADP test. In addition, they provide a special rule for correction in the case of an HCE who participates in multiple plans. In that case, the final regulations provide that, for purposes of determining which HCE will be apportioned a share of the total excess contributions to be distributed or recharacterized, all elective deferrals of an HCE are aggregated and the HCE with the highest dollar amount of contributions is apportioned excess contributions first. However, only elective deferrals made to the plan being corrected – rather than elective deferrals under all plans in the aggregate – may be distributed. If correction is needed in more than one plan, the deferral ratios of HCEs who have received corrective distributions from one plan are not recalculated. Similar rules apply for ACP test purposes.

	Existing Guidance	Final Regulations
ADP/ACP correction – Net income associated with excess contributions	Under the existing guidance, income on any excess contributions that are distributed must be distributed as well. However, income attributable to the "gap period" can be disregarded. The gap period is the period after the end of the plan year and before the date of distribution.	The final regulations provide that income on excess contributions, including income attributable to the "gap period," must be distributed along with the excess contributions. For administrative convenience, the amount of income may be determined up to 7 days before the actual distribution. In general, the final regulations provide the same methodologies to determine the gap period income as the current regulations.
ADP/ACP correction – Corrective distributions in context of plan termination	The existing guidance is unclear about how to address an ADP failure where a plan is terminated and accounts distributed before the ADP test reveals that corrective distributions are necessary.	The final regulations provide a special rule applicable to corrective distributions from a plan that has been terminated, and accounts distributed, before the results of the ADP test are known. In that case, the distributions are deemed to have been corrective distributions of excess contributions to the extent that a corrective distribution would otherwise have been required. Similar rules apply for purposes of ACP test purposes.
ADP/ACP correction – Recharacteriza-tion of excess contributions	The existing guidance provides for different tax treatment of elective deferrals that are distributed and those that are recharacterized.	The final regulations provide that the tax treatment of amounts that are recharacterized is the same as the treatment of amounts that are distributed.

D. ADP/ACP SAFE HARBOR ISSUES

	Existing Guidance	Final regulations
ADP safe harbor – Aggregation of contributions	The existing guidance provides that in order to satisfy the ADP safe harbor using matching contributions, the rate of matching contributions for any elective deferral of any HCE cannot exceed the rate of matching contributions that would apply to any NHCE with the same rate of elective contributions. This determination is made in accordance with the general rule whereby contributions of HCEs who participate under more than one CODA are aggregated.	The final regulations do not require that CODAs be aggregated for purposes of satisfying the requirement that the rate of matching contributions of any HCE must not exceed the rate of any NHCE with the same rate of elective deferrals. Accordingly, the rate of matching contributions of any HCE is based only on matching contributions associated with elective deferrals under the safe harbor plan.
ADP safe harbor – Catch-up contributions	The existing guidance does not address whether catch-up contributions that are recharacterized as 401(k) contributions must be matched in a safe harbor plan.	Although commentators requested that the final regulations include an exception from the safe harbor matching requirements so that plans would not be required to match catch-up contributions that were recharacterized as 401(k) contributions, the final regulations do not include such an exception. The Preamble notes that the drafters determined that no exception was necessary. This means that a plan will have to match recharacterized catch-up contributions, to the extent necessary to meet the safe harbor requirements.
ADP safe harbor – Electronic transmission of safe harbor notice requirement	ADP safe harbor plans must provide participants with a notice informing them of the safe-harbor contributions. Existing guidance permits the use of electronic media to satisfy the notice requirement (Notice 2000-3, Q&A 7).	The final regulations provide that the notice must be in writing "or in such other form as may be approved by the Commissioner." The IRS has indicated that it intends to issue separate guidance addressing employee notice standards applicable to 401(k) plans generally. Until then, the Preamble states that plan sponsors may continue to rely on Notice 2000-3, Q&A 7.
ADP safe harbor – Plan must be in place for 12-month plan year	Under the existing guidance, a safe harbor plan must be maintained for a full 12-month plan year. However, a short plan year is permitted in the first plan year, provided the first plan year is at least 3 months.	The final regulations allow a short plan year in additional circumstances: • When a plan terminates, if the plan termination is in connection with a merger or acquisition involving the employer, or the employer incurs a substantial business hardship comparable to a substantial

	Existing Guidance	Final regulations
		business hardship described in section 412(d); • When a plan terminates, provided the employer makes safe harbor contributions for the short year, employees are provided notice of the change, and the plan passes the ADP test; and • Where a plan changes its plan year and, thus, has a short plan year, provided the short plan year is followed by a 12-month plan year (or 12-month period if the following plan year is a short plan year) during each of which the plan is a safe harbor plan.
ADP safe harbor – early participation rule	Under existing guidance, a plan may be disaggregated into two separate plans for testing purposes, as permitted under Code section 410(b)(4), so that the portion of the plan benefiting employees with less than 1 year of service can be subject to ADP testing and the ADP safe harbor can be applied to the rest of the plan.	The final regulations clarify that this is still permissible.
ACP safe harbor – HCEs receiving matching contributions under more than one plan	Under existing guidance, matching contributions made on behalf of an HCE who is eligible to participate in more than one plan must be aggregated for testing purposes, even if the plan is an ACP safe harbor plan.	The final regulations generally retain the aggregation rules. However, they provide that a plan does not fail to satisfy the ACP safe harbor if an HCE participates in more than one plan with matching contributions, provided that the HCE does not participate simultaneously under the plans, and the participant's compensation is based only on the portion of the year during which he or she participates in the safe harbor plan.

E. OTHER ISSUES

	Existing Guidance	Final Regulations
Contingent benefit restrictions	A CODA does not satisfy the 401(k) rules if the provision of other benefits (other than matching contributions) are conditioned upon the employee's election to make (or not to make) elective contributions.	The final regulations specify that a benefit (such as a plan loan) that results in payroll withholding (*e.g.*, periodic plan loan repayments) that reduces the compensation subject to a deferral election does not violate the contingent benefit restrictions.
Rules applicable to partnerships and sole proprietors	The existing regulations specifically address the 401(k) plan rules for partnerships, but do not specifically address sole proprietors.	The final regulations extend the partnership rules to sole proprietors. Elective deferral and after-tax contributions may be made from earned income paid to a self- employed person during a year. In the case of a partner, if a partnership provides cash advances during the year, elective deferrals may be deducted from such advances, even though the contribution is made before the partner's earned income is finally determined.
SIMPLE 401(k) plans	Rules for SIMPLE 401(k) plans are contained in Code section 401(k)(11) and, generally, in Revenue Procedure 97-9.	The final regulations provide a new section to reflect the rules for SIMPLE 401(k) plans, based on the positions reflected in the model amendments provided in Revenue Procedure 97-9.
Roth Contributions are not treated as an after-tax contribution	Existing guidance does not address the treatment of Roth Contributions.	The final regulations provide that Roth 401(k) Contributions are treated as elective contributions for purposes of the qualification requirements (specifically, sections 401(a), 401(k), 402, 404, 409, 411, 412, 415, 416, and 417) and that the right to make Roth Contributions is subject to testing as a benefit, right, or feature. Otherwise, the regulations do not address Roth 401(k) Contributions.