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New Sample Plan Amendments and Added Guidance on Automatic 401(k) Contributions

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On September 5, 2009, the Obama administration issued several Internal Revenue Service Notices and Revenue Rulings aimed to provide additional guidance and sample plan amendments for automatic contribution arrangements in 401(k) and other eligible plans.

Background

Automatic contribution arrangements ("ACAs") provide for default deferral elections under 401(k) or other eligible defined contribution plans for participants who do not affirmatively elect to "opt-out" of participation in the plan or to contribute at a different rate than provided in the default election. ACAs facilitate participation in employer-sponsored retirement savings plans by permitting participants to begin saving for retirement without having to take any affirmative action, thereby increasing retirement savings.

In addition to the basic form of an ACA as described above, Treasury regulations established two safe harbor ACAs to provide plans with an ACA structure that would be deemed to meet anti-discrimination testing requirements. A Qualified Automatic Contribution Arrangement ("QACA") is an ACA that will be deemed to satisfy the Internal Revenue Code of 1986, as amended ("Code") 401(k) anti-discrimination requirements for certain types of eligible plans. To be a QACA, the amount of the default deferral must be a specified percentage of the participant's eligible compensation based on the number of years he or she has been participating in the QACA, with a maximum deferral percentage of 10% of eligible compensation. In addition, employer-matching contributions must be made to all QACA participants based on a specified formula and vesting requirements. Last, participants must be provided with proper notice of the QACA program upon initial enrollment in the plan, as well as annually. Once all these requirements are met, the QACA will be deemed to have met the Code's 401(k) non-discrimination requirements.

The second safe harbor ACA is an Eligible Automatic Contribution Arrangement ("EACA"). An EACA addresses tax implications when a plan makes an early distribution to a participant of contributions made pursuant to an automatic deferral once a participant determines he does not want to participate in the default program. Under an EACA, the default deferral amount must be a uniform percentage for all participants and the deferral contributions must be invested in a Qualified Default Investment Alternative (an investment option that meets certain statutory requirements). Also, timely notice of the EACA must be pro-

vided to all plan participants. Once these requirements are met, an EACA participant who determines he did not wish to participate in any automatic deferral program within 90 days of his first EACA deferral, can withdraw the amount deferred (adjusted for any gain or loss incurred, and excluding any employer matching contributions made to the account) without being subject to normal early withdrawal penalties. In addition, even though an EACA is still subject to non-discrimination testing, the period to correct excessive deferrals is expanded to 6 months from the general 2 ½-month period.

Additional Treasury Guidance

Final regulations for qualified ACAs were issued on February 24, 2009. On September 5, 2009, the Treasury issued additional guidance to encourage employers to expand or create ACAs within applicable retirement plans to increase individual retirement savings. Following are brief summaries of the three notices and one revenue ruling issued by the Treasury:

Revenue Ruling 2009-30

This revenue ruling provides guidance for employers to 1) gradually increase default deferral percentages over time while still maintaining the default contributions as elective contributions (thereby maintaining ERISA Section 404(c) fiduciary protection) and 2) maintain qualification under the above-mentioned safe harbor for qualified ACAs. Default contributions will continue to be viewed as elective contributions, even if the default deferral percentage increases over time pursuant to the plan terms. In addition, if the plan is not intended to qualify as an EACA or QACA, then the structure to increase the deferral percentage over time does not need to result in a uniform deferral percentage for all participants who participated an equal amount of time in the plan. Also, a plan will still have a qualified ACA if the default deferral percentage increases on a date other than the first day of the plan year, as long as all other requirements are met (such as, uniformity and minimum deferral percentage requirements).

Notice 2009-65

This notice provides sample plan amendments for an employer who wants to include an ACA in its 401(k) plan. The sample amendment language is drafted for adoption in a master and prototype or volume submitter plan. Regardless, all employers may use these sample plan amendments as a guide, while tailoring such amendments to meet the needs of the employer and the particular plan. Any plan sponsor who wishes to add the sample amendments to its 401(k) plan must do so by the later of: 1) the end of the plan year in which the amendments become effective or 2) the deadline to adopt amendments under the Pension Protection Act of 2006, if applicable (in general, the Pension Protection Act of 2006 requires all plan amendments to be made no later than the last day of the first plan year beginning on or after January 1, 2009). In addition, all statutorily required notices must be provided to participants before the amendment establishing the ACA will become effective.

Notices 2009-66 & 2009-67

These two notices address similar issues and provide sample plan amendments as Notice 2009-65, except as it applies to a SIMPLE IRA plan. A SIMPLE IRA plan essentially combines elements of a 401(k) plan (cash or deferred arrangements) with an IRA (individual retirement account), and is typically used by small to mid-size employers. By providing guidance on establishing ACAs for a SIMPLE IRA plan, small and mid-size employers have additional resources to develop and implement ACAs in an efficient manner. Notice 2009-66 provides a question and answer format to assist employers in setting up an ACA in a SIMPLE IRA plan. It states that SIMPLE IRA plans may utilize ACAs, increase default deferral percentages, meet certain notice requirements, and take advantage of the applicable fiduciary relief as a 401(k) plan

does. Notice 2009-67 includes sample plan amendment language comparable to the language provided in Notice 2009-65 but drafted for a SIMPLA IRA plan.

Conclusion

The Obama administration is moving ACAs into the public spotlight as a way to increase individual retirement savings through employer-sponsored retirement plans. The Pension Protection Act of 2006, final Treasury regulations and this current set of IRS guidance are all meant to assist employers of all sizes in the adoption of an ACA as soon as possible. Employers should review their current 401(k) or SIMPLE IRA plans to determine if an ACA, or one of the qualified ACAs, would be appropriate and beneficial for its participants and advantageous to the company.

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