COMMENTS CONCERNING 401(K) DESIGN BASED SAFE HARBORS

The following comments are the individual views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These comments were prepared by individual members of the Committee on Employee Benefits of the Section of Taxation. Principal responsibility was exercised by Leonard S. Hirsh, Karen M. Willsky and Russell E. Hall. Substantive contributions were made by Christine H. Grahl, Amanda Berlowe Jaffe, Barry L. Klein, Thomas R. Hoecker, Diane J. Fuchs and Adam C. Pozek. The comments were reviewed by Roger Siske of the Section’s Committee on Government Submissions and by Stuart M. Lewis, Council Director for the Committee on Employee Benefits.

Although many of the members of the Section of Taxation who participated in preparing these comments have clients who would be affected by the federal tax principles addressed by these comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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401(k) Design Based Safe Harbors

Introduction

This is in response to the request for comments by the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "Service") in Internal Revenue Service Notice 2000-3, 2000-4 I.R.B. 413 (1/24/00), relating to the design-based safe harbors for satisfying the actual deferral percentage ("ADP") and actual contribution percentage ("ACP") tests pursuant to Sections 401(k)(12) and 401(m)(11) of the Internal Revenue Code of 1986, as amended¹, as added by the Small Business Job Protection Act of 1996, P.L. 104-188 (SBJPA). It also is in response to the request for comments relating to Internal Revenue Service Notice 98-52, 1998-46 I.R.B. 16 (11/16/98). The Employee Benefits Committee previously filed comments on Notice 98-52 in a letter dated February 15, 2000. To the extent these comments were not addressed in Notice 2000-3, we felt it would be useful to reiterate those previous comments.

¹All Section references hereinafter are to the Internal Revenue Code of 1986, as amended, unless otherwise specified.
**Background**

Prior to SBJPA, the ADP and ACP for eligible highly compensated employees could not exceed the ADP and ACP for all other eligible employees by more than a specified percentage.

Effective for plan years beginning after December 31, 1998, the SBJPA added new Sections 401(k)(12) and 401(m)(11), to provide design-based safe harbors for satisfying the ADP and ACP tests in lieu of the tests required under prior law.

Under Section 401(k)(12), the ADP test is satisfied if the cash or deferred arrangement meets certain contribution and notice requirements. To satisfy the contribution requirement, the employer must contribute on behalf of each non-highly compensated employee who is an eligible employee either: a) a matching contribution equal to 100 percent of the first 3 percent of elective contributions and 50 percent of elective contributions between 3 and 5 percent (basic match), or an enhanced matching contribution which provides at least the same aggregate contribution as the basic match ("enhanced match"); or b) a nonelective contribution equal to at least 3 percent of compensation. Also, prior to the beginning of the plan year (or when an employee is first eligible, prior to entry into the plan), each eligible employee must be provided with a written notice describing the terms and conditions of the safe harbor contributions.
Section 401(m)(11) provides that the ACP test is satisfied if the plan meets the foregoing requirements of Section 401(k)(12), and also meets specified limits on the amount of matching contributions. Matching contributions satisfy the additional limits of the ACP safe harbor if: 1) matching contributions consist solely of the basic match; or 2) matching contributions consist solely of the enhanced match calculated without regard to elective contributions in excess of 6 percent of compensation; or 3) matching contributions do not exceed the first 6 percent of elective contributions and after-tax contributions, the rate of match does not increase as the rate of elective or after-tax contributions increase, and at any rate of elective or after-tax contributions, the rate of match for any highly compensated employee who is an eligible employee is no greater than the rate of match for any non-highly compensated employee who is an eligible employee.

Notice 98-52 provides additional guidance on the statutory safe harbors, including the timing and content of the notice, parameters for the safe harbor contributions, required plan terms, testing of after-tax contributions, and interaction with other non-discrimination tests. Notice 98-52 appears to be retroactively effective to the date of the statutory changes (i.e., plan years beginning in 1999). Notice 2000-3 provides still more guidance respecting plans intended to satisfy the 401(k) safe harbors in order to make it easier for employers both to adopt and to administer 401(k) safe harbor plans.
In addition, Notice 2000-3 solicited comments on two topics not directly related to 401(k) safe harbor plan issues: (i) potential approaches for simplifying the multiple use test applicable to Section 401(k) plans and (ii) when a plan sponsor is involved in a merger, acquisition, disposition, or similar transaction, potential approaches for applying the highly compensated employee definition under Section 414(q) and certain other requirements. The latter issue will be addressed in a separate comment.

**Summary of Issues Addressed**

This comment specifically addresses the following issues:

I. **Hardship Withdrawals**: Are hardship withdrawals from safe harbor contributions subject to the restrictions on such withdrawals under Section 401(k), or are they instead prohibited entirely?

II. **Testing of After-Tax Contributions**: Should after-tax contributions be excluded from the ACP safe harbor?

III. **Multiple Use**: Is it necessary to perform the multiple use test if the ADP or both safe harbors are satisfied?
IV. **Notice Requirement:** What standards should apply when electronic media are used to distribute the safe harbor notice? Also, in a plan with immediate eligibility, should guidance permit the notice to be provided within a specified period after initial eligibility?

V. **Interaction of Safe Harbor with Prior Year Testing:** Does the remedial amendment period exception in Notice 98-1 provide a transitional period during which employers switching from the safe harbor to traditional ADP and ACP testing also may immediately utilize prior year testing if desired? After the remedial amendment period, should the 5-year rule for changes from current to prior year testing be modified to provide flexibility for a safe harbor plan?

VI. **Employer Flexibility:** How frequently may changes be made between using one, both or neither of the safe harbors?

VII. **Failure to meet the Safe Harbors during the Plan Year:** How does a plan which intends to meet one or both safe harbor(s) correct a failure to do so during a plan year? Moreover, must a plan document specify the corrective methods?

VIII. **Multiple Employer Plans:** May each employer participating in a multiple employer
plan make an independent choice as to whether to use the safe harbor(s)?

IX. Mid-Year Additional of Safe Harbor CODAs: How are safe harbor contributions to a cash or deferred arrangement ("CODA") that is added mid-year to be calculated?

X. Multiple Use Simplification: In what manner should the multiple use test be modified to simplify administration?

XI. Interaction Between Safe Harbors and Section 410(b)(4): Additional guidance is needed on the interaction between the section 401(k) safe harbor rules and the 410(b)(4) election.

Discussion

I. Hardship Withdrawals

1. Issue

Are hardship withdrawals from safe harbor contributions subject to the restrictions on such withdrawals under Section 401(k), or are they instead prohibited entirely.
2. Analysis and Recommendation

We reiterate here our prior comment on Notice 98-52 with respect to this issue, since it is not addressed in Notice 2000-3. Current law permits withdrawal of matching and nonelective contributions in the event of a participant's financial hardship. The Service has acknowledged as recently as December 1998 in Notice 99-5 that matching and other nonelective contributions may be part of a hardship withdrawal. In fact, such provisions are common in defined contribution plans. Moreover, we understand that most such plans subject hardship withdrawals from employer contributions to the same restrictions that govern elective contributions in Treas. Reg. sec. 1.401(k)-1(d)(2)(ii), although not explicitly required by law.

Section IV(H) of Notice 98-52 states that "pursuant to 401(k)(2)(B) and 1.401(k)-1(d)(2)(ii), hardship is not a distributable event for contributions other than elective contributions. We interpret this to mean either that safe harbor employer contributions are not explicitly bound by the restrictions on hardship in Section 401(k) (consistent with other employer contributions), or to completely prohibit hardship withdrawals from safe harbor contributions. As noted above, the latter interpretation is inconsistent with the administration of many plans. The latter interpretation is also disadvantageous to participants with a financial hardship for whom the safe harbor contributions comprise a substantial portion of their accounts. Finally, barring a hardship distribution of these funds will to some extent compound the administrative burden imposed on
plan sponsors, as they will have to comply with multiple distribution standards.

Moreover, either interpretation of the foregoing language of Notice 98-52 appears inconsistent with the statute. Section 401(k)(12)(E)(i) states that the withdrawal requirements of Section 401(k)(2)(B) and (C), which includes hardship, must be met with respect to all employer contributions used to satisfy the safe harbor. While not entirely clear, we interpret this to mean that matching or nonelective contributions used to meet the safe harbor may be withdrawn for hardship, provided the withdrawal satisfies the restrictions under Treas. Reg. sec. 1.401(k)-1(d)(2)(ii). We recommend a revision to Notice 98-52 to reflect such interpretation.

II. Testing of After-Tax Contributions

1. Issue

Should after-tax contributions be excluded from the ACP safe harbor.

2. Analysis and Recommendation

We reiterate here our prior comment on Notice 98-52 with respect to this issue, since it is not addressed in Notice 2000-3. The ACP safe harbor is inapplicable to after-tax employee contributions, which must independently satisfy the ACP test (as modified by section VIII(F)(3)
of Notice 98-52). It is unclear from a policy perspective why after-tax contributions should be excluded from the ACP safe harbor in all circumstances. We do acknowledge that the statute and the legislative history omit support for such safe harbor. Nonetheless, we recommend that the Service consider development of a modified ACP safe harbor for after-tax contributions through administrative guidance. In particular, the Service has administrative authority to develop additional safe harbors under Section 401(a)(4). See Treas. Reg. Sec. 1.401(a)(4)-1(d).

Since the regulations under Section 401(a)(4) currently address testing of contributions under Sections 401(k) and (m), we believe it is reasonable to interpret the inherent authority of the Service thereunder to encompass guidance on a safe harbor for after-tax contributions.

We believe Section 415(c) would prevent abuse of such safe harbor, since it imposes a maximum limit on the total amount of contributions made for an individual. However, if the Service believes this is inadequate, other safeguards to prevent abuse could be considered. This might include a limit on after-tax contributions, such as a dollar limit or a percentage of compensation limit (such as the 10% limit adopted in Rev. Rul. 80-350).

III. Multiple Use

1. Issue

Is it necessary to perform the multiple use test if the ADP or both safe harbors are satisfied.
2. **Analysis and Recommendation**

We reiterate here our prior comment on Notice 98-52 with respect to this issue, since it is not addressed in Notice 2000-3. Restrictions on the multiple use of alternative limitations are contained in Treas. Reg. sec. 1.401(m)-2. These rules are designed to prevent the most liberal means of passing the ADP and ACP tests (the 200 percent or 2 percentage points limitation) to be used too extensively in the aggregate nondiscrimination test results. Because there will be no actual deferral percentage otherwise calculated if the safe harbor is available under Section 401(k), there should be no need to run a multiple use test if the plan satisfies either the ADP, or both the ADP and ACP tests, through use of the safe harbors.

Section VIII(G) of Notice 98-52 generally seems to agree with this conclusion, since it states that the restrictions on multiple use do not apply where the ADP safe harbor is satisfied. However, that section also states that multiple use may apply where a plan meets both safe harbors but permits employee contributions, or meets the ADP safe harbor but fails the ACP safe harbor because of an excess match. As discussed above, we believe there is no need to run a multiple use test if either the ADP or both safe harbors are satisfied. It would be useful to have Treasury guidance on this point. If the Service disagrees, guidance will be needed on how to apply the multiple use test in the absence of ADP test results (i.e., because the plan meets the ADP safe harbor).
IV. Notice Requirement

1. Issue

What are the standards that will be developed for satisfying the safe harbor notice requirement through electronic media. Also, in a plan with immediate eligibility, should guidance permit the notice to be provided within a specified period after initial eligibility.

2. Analysis and Recommendation

Notice 2000-3 provides that the safe harbor notice requirement may be satisfied through use of electronic media and indicates that the Service and Treasury intend to issue additional guidance on this matter. Until such guidance is issued, Notice 2000-3 adopts the standards set forth in the final regulations regarding the use of electronic media for notices and consents in connection with qualified plan distributions pursuant to Sections 402(f) and 411(a)(11). Specifically, Notice 2000-3 provides that the safe harbor notice requirement will be satisfied if the employee receives the notice through an electronic medium reasonably accessible to the employee, provided that (i) the system must be reasonably designed to provide the notice or summary in a manner no less understandable to the participant than a written paper document and (ii) at the time the notice is
provided, the employee is advised that the employee may request and receive the notice on a written paper document at no charge and, upon request, that document is provided to the participant at no charge.

We recommend that the standards set forth in Notice 2000-3 remain the only standards applied to the use of electronic media to satisfy the safe harbor notice requirement. We not believe that additional standards need to be established for the safe harbor notices because we believe that the standards set forth in Notice 2000-3 protect the interests of the participants. We also believe that issuing different standards for the safe harbor notice (as opposed to the qualified plan distribution consents and notices) would be needlessly confusing to plan sponsors and complicate administration.

Further, as stated in our prior comment on Notice 98-52, Section (V)(C) of that Notice requires that the safe harbor plan notice be provided within a "reasonable period" before an employee becomes eligible, and it is deemed reasonable if provided no more than 90 days before eligibility and no later than the date of eligibility. Where a plan provides for immediate eligibility upon an employee’s hire or rehire date, this timing requirement would often prove impracticable. Accordingly, in those circumstances we recommend that guidance permit a 30-day period after initial eligibility as the notice deadline. We note that such a rule would not conflict with Section 401(k)(12)(D), which simply requires that the notice be provided within a reasonable period.
before each year (i.e., the statute omits a specific notice requirement for new hires). This issue is not addressed in Notice 2000-3.

V. **Interaction of Safe Harbor with Prior Year Testing:**

1. **Issue**

Does the remedial amendment period exception in Notice 98-1 provide a transitional period during which employers switching from the safe harbor to traditional ADP and ACP testing also may immediately utilize prior year testing if desired.

2. **Analysis and Recommendation**

We reiterate here our prior comment on Notice 98-52 with respect to this issue, since it is not addressed in Notice 2000-3. Section VIII(E) of Notice 98-52 states that for purposes of Notice 98-1, a plan using the ADP or ACP safe harbors is deemed to use current year testing, and therefore, is subject to the rules in Notice 98-1 for changes from current to prior year testing. Section VII of Notice 98-1 requires use of the current year method for 5 plan years before a change to prior year testing is permitted, except for certain corporate transactions, new plans, or changes during the SBJPA remedial amendment period.
In most circumstances under an ongoing plan, the foregoing eliminates the flexibility of prior year testing for 5 years after implementation of the safe harbor. This could be a disincentive to adoption of the safe harbor, and hampers a plan sponsor’s ability to make design choices should the safe harbor prove impracticable.

Since our prior comment on Notice 98-52 with respect to this issue, we understand that a representative of the Service has informally indicated that the transitional relief provided in Notice 98-1 is intended to apply to safe harbor plans through the end of the SBJPA remedial amendment period, and that the 5 year rule is intended to apply for all safe harbor plans after the close of the remedial amendment period, consistent with the treatment of non-safe harbor plans using current year data. Therefore, we request that the Service issue formal guidance confirming that the remedial amendment period exception in Notice 98-1, until the close of the 2001 plan year, is also applicable to employers changing from the safe harbor(s) to traditional ADP or ACP testing. This currently gives employers a 3-year transitional period from the inception of the safe harbor option to evaluate its viability. This is consistent with both the stated intent of Notice 98-1 (to give employers with existing plans a period of time to decide whether to change to the new prior year testing method), and the transitional period therein (the close of the remedial amendment period).

After the close of the remedial amendment period, however, the Service’s position equating use of the safe harbors with an election to use the current year testing method, which thereby
imposes the 5-year rule, will hamper a plan sponsor’s ability to make legitimate design choices should the safe harbors prove impracticable. These issues are addressed in Section VI, below. Should the Service disagree with our recommendation in Section VI with respect to this issue, we recommend at a minimum that the Service confirm that years during which the safe harbor is used count towards the 5-year requirement of Notice 98-1 to change from current to prior year testing. This simply provides flexibility to an employer using a safe harbor that is comparable to an employer using current year testing for a non-safe harbor plan.

VI. Employer Flexibility

1. Issue

How frequently may changes be made between using one, both or neither of the safe harbors.

2. Analysis and Recommendation

We reiterate here our prior comment on Notice 98-52 with respect to this issue, since as discussed below it is addressed only in part in Notice 2000-3. Section XI(A) of Notice 98-52 requires adoption of safe harbor provisions before the beginning of a plan year, but does not specifically state how frequently employers should be permitted to determine whether the safe harbors will be used for a particular plan year. It may be presumed that such determinations may
be made annually. This is consistent with the flexibility employers currently have to change the maximum deferrals that will be permitted or the amount of the matching contribution for a subsequent year. Accordingly, guidance should specifically permit an employer to choose to use only the ADP safe harbor or alternatively both safe harbors, as determined by the employer annually. In order to also protect participants, we recommend that guidance permit employers to make these design choices at any time before the deadline for distribution of the notice if a safe harbor will be used. If the safe harbor will not be used, an employer should be permitted to make that decision (and rescind any safe harbor notice already distributed for the subsequent plan year) at any time before the beginning of the plan year. This approach is consistent with the purpose of the notice, which is to allow participants sufficient time to determine their rate of deferrals in light of the employer’s decision to use the safe harbor. Of course, plan provisions adopting the safe harbor(s) would also have to be in place before the beginning of the relevant plan year. See Notice 98-52, sec. XI(A).

Notice 2000-3 has addressed the above concerns to some extent. For example, Q&A-1 of Notice 2000-3 provides that an employer may amend its plan to adopt the safe harbor nonelective contribution method as late as 30 days before the last day of the plan year, while Q&A-6 permits plan sponsors to opt out of the ADP matching contribution safe harbor mid-year if certain requirements are met. Although these provisions imply that the Service will permit plan sponsors to make annual safe harbor elections, Notice 2000-3 does not expressly address this issue.
A plan sponsor’s flexibility with regard to use or non-use of the safe harbors continues to be limited to some extent by the Service’s position, discussed in Section V above, deeming use of the ADP and ACP safe harbors to be use of the current year testing method. This position seems inconsistent with the Service’s overall objective of providing more flexibility for safe harbor plan sponsors as stated in Section I of Notice 2000-3. In Section VIII of Notice 98-1, the Service indicated that its rules governing current and prior year testing were "designed to provide simple, practical rules that accommodate legitimate plan changes" and warned against "repeated changes in plan testing procedures or plan provisions that have the effect of distorting the ADP or ACP test so as to increase significantly the permitted ADP or ACP for HCE’s and if a principal purpose of the changes was to achieve such a result." A similar anti-abuse approach in the context of the safe harbors such as that espoused in Notice 98-1 would be preferable to the Service’s current position equating use of the safe harbors with use of the current year testing method. Such an approach would also be consistent with the Service’s intent to encourage safe harbor plans.

VII. Failure to meet the Safe Harbors during the Plan Year

1. Issue

How does a plan that intends to meet one or both of the safe harbor methods correct a failure to
meet the applicable requirements during a plan year, and must the plan specify the corrective methods.

2. Analysis and Recommendation

A plan that intends to meet one or both of the safe harbor methods at the beginning of the plan year may fail to satisfy the applicable requirements due to administrative error at some point during the plan year. Although Q&A-6 of Notice 2000-3 permits an employer to amend a plan mid-year to use the current year ADP (and, if applicable, ACP) testing method provided certain requirements are met, Q&A-6 provides that the safe harbor requirements must be met through the effective date of the amendment and therefore does not address a situation where an error is discovered mid-year after the error has occurred. The Service has informally indicated that a mid-year failure to meet the safe harbor requirements should be corrected under one of the plan correction programs of EPCRS. The Service has also informally indicated that a plan that experiences a mid-year failure to meet the safe harbor requirements should not be permitted to revert to the ADP/ACP testing methods to satisfy the nondiscrimination requirements.

We recommend that formal guidance be issued regarding how a plan should correct a mid-year failure to meet the safe harbor requirements. Such guidance should specifically address whether such a plan can revert to the ADP/ACP testing method to satisfy the nondiscrimination requirements. The guidance should also indicate whether the plan document is required to
include provisions regarding corrective methods. We recommend that a plan be permitted to correct a mid-year failure under one of the plan correction programs of EPCRS. We recommend that a plan be permitted to correct a mid-year failure under one of the plan correction programs of EPCRS under the provisions which are most analogous to the particular failure. For example, if contributions were not made as required, the correction would be to make up the required contributions. In addition, we recommend that specific guidance be issued regarding correction of certain errors, such as late or defective notices, for which makeup contributions would not provide a remedy.

VIII. Multiple Employer Plans

1. Issue

May each employer participating in a multiple employer plan make an independent choice as to whether to use the safe harbor(s).

2. Analysis and Recommendation

We reiterate here our prior comment on Notice 98-52 with respect to this issue, since it is not addressed in Notice 2000-3. In a multiple employer plan, ADP and ACP testing is done separately with respect to each employer participating in the plan. The statute and Notice 98-52
do not explicitly address if each participating employer may independently choose whether to use the safe harbors, if they may differ in their use of one safe harbor (instead of both), or if they may independently choose whether to use traditional ADP and ACP testing. We recommend that guidance permit each participating employer to independently choose whether (or not) to use the safe harbor(s), which is consistent with the separate ADP and ACP testing of each employer under current law.

IX. **Mid-Year Addition of Safe Harbor CODAs**

1. **Issue**

How are safe harbor contributions to a cash or deferred arrangement ("CODA") that is added mid-year to be calculated.

2. **Analysis and Recommendation**

Notice 2000-3 seeks to provide increased employer flexibility in Q&A-11, which permits plan sponsors to add a safe harbor CODA to an existing profit sharing plan during a plan year. A core principle of Notice 98-52 was that compensation on which safe harbor contributions are calculated must be compensation for the entire plan year, except to the extent that an employer elects to limit the period used to determine compensation to that portion of a plan year in which employees are eligible employees. That requirement has been liberalized to some extent in
Notice 2000-3, i.e., in elimination of the "true-up" requirements for safe harbor matching contributions made using the payroll period method in Q&A-2. While Q&A-11 states that a CODA added mid-year must, among other things, satisfy the requirements of Notice 98-52 from the effective date of the CODA to the end of the plan year, and that similar rules apply for purposes of the ACP test safe harbor, Q&A-11 does not indicate the compensation on which contributions made pursuant to a mid-year safe harbor must be calculated.

We recommend that the Service issue guidance clarifying whether safe harbor contributions made to a CODA that is added mid-year must be based upon compensation for the entire plan year, or only on compensation from the effective date of the CODA. Similar clarification should be provided with respect to the compensation on which matching contributions added mid-year must be based.

X. Multiple Use Simplification:

1. Issue

In what manner should the multiple use test be modified to simplify administration.

2. Analysis and Recommendation
Notice 2000-3 seeks comments on whether to make the multiple use test of Section 401(m)(9) easier to administer. The notice provides a description of several possible alternative approaches. One contemplates the use of a "look-up" table instead of the current formula. The other would suspend application of the limit where the combined ADP and ACP of NHCEs exceeds a certain level.

The method presently set forth in Treas. Reg. Sec. 1.401(m)-2 to determine the multiple use limit is indeed complex. However, as a practical matter, it is not so complex as to be beyond the capacity of most persons and organizations responsible for this aspect of plan administration. Moreover, we do not believe that the nature of the calculations currently required under the multiple use test injects significant additional costs or burdens into plan administration. In particular, the limit does not require any data to be gathered that is not otherwise needed for other tests and the actual calculation process for the multiple use test has become fairly standardized at many plan sponsors and third party administrators.

The multiple use test adds to the administrative burden of affected plans because it imposes an additional layer of testing requirements that must be met. The challenge and complexity of the multiple use test for plan administrators results primarily from the process of evaluating the ADP and ACP results to determine the appropriate corrective strategy to meet the multiple use test (and the basic ADP and ACP tests in some cases). That is, the administrator must decide whether to refund excess contributions or excess aggregate contributions, what the impact of refunding
excess contributions will be on any associated employer matching contributions, etc. It is the work associated with formulating the best correction strategy to meet all of the various limits, including multiple use, that creates an administrative burden, not the process of calculating the multiple use limit that must be satisfied.

Obviously, the best way to ease the administrative burdens described above would be to eliminate the multiple use test altogether. In this regard, we support elimination of the multiple use limit as has been proposed in H.R. 3081. We believe the additional limit is not needed as the ADP and ACP tests alone provide adequate safeguards against discrimination in favor of highly compensated employees. However, given the language of Code section 401(m)(9), we recognize that complete elimination of the limit may require legislative action.

Given our premise that the existence of the multiple use limit itself rather than the manner in which it is calculated is what creates an administrative burden, any action to reduce the situations in which the limit needs to be considered would be helpful. Thus, the Service’s proposal to suspend application of the limit at some level of total NHCE contributions would be a helpful change.

As for the "look-up" table approach described in Notice 2000-3, its merits in easing administrative burdens depend on whether or not it will uniformly increase the level at which a plan will be able to satisfy the limit under all combinations of NHCE ADP and ACP amounts.
This is because any change in the test will increase administrative costs on a one-time basis as sponsors and vendors have to change their current procedures to reflect the new test. And it is not likely that significant future costs will be saved by virtue of a simplified calculation methodology alone. However, if the change will uniformly increase the passing level, the one-time cost to change testing systems will be offset by the prospect of reductions in future administrative burdens associated with failing to satisfy the limit; e.g., calculating refund amounts. In contrast, if the change to a "simplified" multiple use test will reduce the passing level, either uniformly or at least in some cases, it is not likely to be very helpful in eliminating administrative burdens. All plans would face the one-time cost and burden of shifting to a new limit and many plans will not realize any administrative savings through a lower incidence of failing to satisfy the limit.

Further, we believe that a simplified testing approach should not be proposed as an alternative to the current test. This will only add complexity, as sponsors seeking the best way to satisfy the various limits would have to consider two different versions of the multiple use test.

XI. Interaction Between Safe Harbors and Section 410(b)(4) Election:

1. Issue
Additional guidance is requested on the interaction between the section 401(k) safe harbor rules and the 410(b)(4) election.

2. Analysis and Recommendation

In Notice 98-52, the Service stated as follows:

"[I]f, pursuant to 410(b)(4)(B), an employer applies 410(b) separately to the portion of a plan (within the meaning of section 414(l)) that benefits only employees who satisfy age and service conditions under the plan that are lower than the greatest minimum age and service conditions permitted under 410(a), the plan is treated as two separate plans for purposes of 401(k), and the ADP test safe harbor need not be satisfied with respect to both plans in order for one of the plans to take advantage of the ADP test safe harbor."

The Service provided additional guidance in Notice 2000-3, as follows:

"[A] plan that uses one of the 401(k) safe harbors is not required to provide safe harbor matching or nonelective contributions to participants who have not attained age 21 and completed one year of service."
We welcome the Service's attempt to clarify the interaction between the safe harbor methods of 401(k)(12) and the 410(b)(4) election. However, considerable confusion remains.

Consider the following example. An employer maintains a 401(k) plan that provides for immediate participation. However, matching contributions are delayed until employees complete one year of service as defined under 410(a) of the Code. The rate of matching contributions meets the requirements of 401(k). Thus, an employee who commences full-time employment in the covered group on July 1 would begin to be eligible for matching contributions as of the following July 1. It would appear that this plan would satisfy 401(k)(12) by virtue of the statement in Notice 2000-3 reproduced above.

However, it appears that the plan may not satisfy the statement in Notice 98-52 reproduced above. If this plan makes the section 410(b)(4) election, it must be disaggregated into two "plans" for testing purposes under section 410 for the year; one for participants who had met the service requirement and one for participants who had not met those requirements. See Treas. Reg. 1.410(b)-6(b)(3)(ii). For employees who satisfy the minimum age or service requirements during the plan year, the disaggregated plan to which they should be assigned isn't clear. If such employees are assigned to the plan covering employees who satisfied the minimum age or service requirements, this creates potential issues in satisfying the safe harbor matching requirements since they will have received such matching contributions for only part of a year. Consider a 2001 compliance test with respect to a full-time employee who commences
employment on July 1, 2000. Assuming this individual's status is determined as of the last day of the 2001 plan year (e.g., because, under Rev. Proc. 93-42, the plan has adopted as its snapshot date the last day of the year), he or she would be included in the group of employees who have met the service requirement and arguably would have to receive the safe harbor contribution for all of 2001. An employer using a payroll basis method of making matching contributions permitted under Q&A-2 of Notice 2000-3 would be placed in the untenable position of having to predict as of the beginning of each plan year which employees would meet the age and service requirements by the end of the year.

Specific guidance would be useful on the interaction of these provisions. In particular, such guidance should provide that the plan sponsor may use compensation and contributions from the date the participant satisfied the greatest permissible section 410(a) requirements in order to demonstrate satisfaction of the safe harbor requirements. This would encourage sponsors to allow immediate eligibility for salary deferrals with minimal financial and administrative impact, while allowing them to utilize the safe harbors of section 401(k)(12).