COMMENTS CONCERNING PROPOSED TREASURY REGULATION §1.414(v)-1

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 of the Section of Taxation.

The comments were prepared by individual members of the Committee on Employee Benefits of the Section of Taxation (the “Committee”). Principal responsibility was exercised by Leonard S. Hirsh and Bernard F. O'Hare. Substantive contributions were made by Rosemary Pearce, Eva A. Rasmussen and Deborah A. Buyer. The comments were reviewed by Thomas R. Hoecker, Committee Chair-Elect, Priscilla E. Ryan, Committee Vice-Chair, James R. Raborn, Committee Vice-Chair, Greta E. Cowart (who will become a Committee Vice-Chair in July), and John L. Utz of the Section's Committee on Government Submissions and by Stuart M. Lewis, the Council Director for the Committee on Employee Benefits.

Although many members of the Section of Taxation who participated in the preparation of these comments necessarily have clients 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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EXECUTIVE SUMMARY

OF

COMMENTS CONCERNING

PROPOSED TREASURY REGULATION §1.414(v)-1

The Comment addresses a number of issues related to the universal availability requirement and its application to catch-up contributions. First, it is requested that collectively bargained plans be excluded from the universal availability requirement. Alternatively, we request that a good faith offer of the catch-up contribution feature by an employer during the collective bargaining process be deemed to satisfy the universal availability requirement. Second, we request that the proposed regulations be clarified to state that employers are not treated as "maintaining" any multiemployer or multiple employer plan to which their employees contribute for purposes of satisfying the universal availability requirement. Third, it is requested that the proposed regulations be clarified to provide an exception to the universal availability requirement for qualified separate lines of business.

The Comment also addresses certain concerns regarding the universal availability requirement that arise in the context of business organization transactions. First, we request that the proposed regulations be clarified to reflect changes made to the relief period following certain business organization transactions under the Job Creation and Worker Assistance Act of 2002, and to clarify that the elimination of a catch-up feature will not violate Code Section 411(d)(6). Second, the Comment requests clarification that the relief period which follows certain business organization transactions is not curtailed after there has been an unrelated significant change to the plan. The Comment also requests clarification that the addition or removal of the catch-up feature does not constitute a significant change that would end the transition relief following a business organization transaction for minimum coverage purposes.

The "employer-provided limit" which can trigger catch-up treatment also is addressed. Specifically, it is requested that the term "employer-provided limit" be redefined to include limits set by the plan administrator (or other fiduciary) in accordance with specific authorization under the plan document. Clarification is also requested that the Code Section 401(a)(17) compensation limits, if they are incorporated into the plan document, are "employer-provided limits" or "statutory limits" for purposes of eligibility to make catch-up contributions.

Additional other issues are addressed. First, it is requested that the regulations specifically state that an employee who will attain age 50 during a particular taxable year will be eligible for catch-up contributions in the plan year that ends within the taxable year in which the employee attains age 50. Second, clarification is requested permitting a payroll period method of determining catch-up contributions. Finally, the Comment requests clarification regarding certain matters related to matching contributions, 403(b) plans, distribution of catch-up contributions and the ADP limit.
ABA Comment Regarding Proposed Treasury Regulation §1.414(v)-1
Committee on Employee Benefits
Subcommittee on Qualified Cash or Deferred Arrangements

As part of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), Congress enacted new Section 414(v) of the Internal Revenue Code of 1986, as amended (the "Code"). New Code Section 414(v) provides that the otherwise applicable dollar limit on elective deferrals under a 401(k) plan, 403(b) plan, SEP, SIMPLE plan or 457 eligible governmental plan will be increased for individuals who have attained age 50, and who have otherwise already made the maximum permitted deferral under the Code or the plan or arrangement. The additional or "catch-up" contribution amount under a 401(k) plan, 403(b) plan or 457 plan is $1,000 for 2002, $2,000 for 2003, $3,000 for 2004, $4,000 for 2005 and $5,000 for 2006 (with certain limitations for 457 plans). The catch-up contribution amount under a SEP or SIMPLE IRA plan is $500 for 2002, $1,000 for 2003, $1,500 for 2004, $2,000 for 2005 and $2,500 for 2006. These limitations will be adjusted for inflation beginning in 2007.

Catch-up contributions are not subject to the limitations provided under Code Sections 402(g) and 415. They also are not subject to the special nondiscrimination requirements that usually apply to elective deferrals. The universal availability requirements of Code Section 414(v) require that if an employer includes the catch-up contribution feature in one plan it must also be included in all plans that permit elective deferrals within the employer's controlled group. Plans may be amended to include the new catch-up contribution feature beginning in taxable years beginning after December 31, 2001.

On October 23, 2001, the Internal Revenue Service (the "Service") issued Proposed Regulation §1.414(v)-1 to provide guidance concerning catch-up contributions. Specifically, the proposed regulations provide guidance on eligibility for catch-up contributions, the appropriate method of determining catch-up contributions, the treatment of catch-up contributions, the universal availability requirement, participants in multiple plans of an employer and the excludability of catch-up contributions from various Code limits.

This comment is intended to address a number of concerns regarding Proposed Regulation §1.414(v)-1 and to request clarification on certain matters. First, this comment will address the complications that may arise for many employers in meeting the universal availability requirements. Second, the application of Code Section 414(v) in the case of corporate transactions will be discussed. Third, the definition of "employer-provided limit" will be addressed. Fourth, specific issues related to non-calendar year plans, the annual determination requirement and matching contributions will be addressed. Fifth, issues are raised regarding the application of Code Section 414(v) to 403(b) plans. Finally, guidance is requested regarding the conflict between certain state laws and Code Section 414(v).
1. UNIVERSAL AVAILABILITY REQUIREMENT

Code Section 414(v)(4) provides that a plan will be treated as failing to meet the requirements of Code Section 401(a)(4) if the catch-up contribution feature is offered to participants under one or more of the employer's plans permitting elective deferrals but not under all similar plans maintained by the employer. For this purpose, all plans maintained by employers who are treated as a single employer under Code Sections 414(b), (c), (m) or (o) (e.g., all plans within the same controlled group) are treated as one plan. Thus, for example, if one employer in a controlled group of corporations elects to offer the catch-up feature under its 401(k) plan, all other controlled group employers also must provide the catch-up feature under their 401(k) plans. Conversely, if one employer within a controlled group of corporations does not offer catch-up contributions under its 401(k) plan, catch-up contributions will not be permitted under any other 401(k) plan within the controlled group. The proposed regulations do not contain any exception to this requirement for collectively bargained plans within the controlled group or for multiemployer or multiple employer plans to which an employer might contribute.

A. Bargaining Unit Employees. With respect to collectively bargained plans, the proposed regulations contain a transition rule stating that an employer's plan will not fail to satisfy the universal availability requirement merely because employees who are included in a unit of employees covered by a collective bargaining agreement in effect on January 1, 2002 are not permitted to make catch-up contributions until the first plan year beginning after the termination of the collective bargaining agreement. While this transition rule will allow employers with collectively bargained plans to offer the catch-up contribution feature immediately under their non-collectively bargained plans, it does not address what happens if the catch-up contribution feature is not ultimately accepted during the bargaining process. Thus, an employer with multiple 401(k) plans, some for bargaining unit employees and some for non-bargaining unit employees, could implement the catch-up feature in 2002 for its non-bargaining unit plans only to discover a few years later when its union contracts are being negotiated that the catch-up feature is not accepted by one or more of the participating unions. This employer (and all employers within its controlled group or otherwise aggregated with it under Code Section 414(b), (c), (m) or (o)) would then be required to eliminate catch-up contributions from its other plans.

Recommendation: It would be helpful if the Service were to clarify the proposed regulations to exclude collectively bargained plans from the universal availability requirement. Alternatively, it would be helpful if the good faith offer of the catch-up contribution feature by an employer during collective bargaining were deemed to satisfy the universal availability requirement with respect to the plan at issue even if the union rejects it.
B. **Multiemployer Plans.** Even more concerning is the impact of the universal availability requirements on employers who participate in multiemployer 401(k) plans. The proposed regulations do not address whether employers are treated as "maintaining" a multiemployer plan to which they contribute (or to which they allow their collectively bargained employees to contribute). If an employer is treated as "maintaining" any such multiemployer plan, then that employer (and all aggregated employers, including those within its controlled group) would not be permitted to offer catch-up contributions under their plans unless the multiemployer plan elected to offer catch-up contributions. Conversely, if the multiemployer plan chose to offer catch-up contributions, the employer (and all aggregated employers) would be required to offer catch-up contributions under its plans in order to satisfy the universal availability requirement. The benefit structure under a multiemployer plan generally is determined by a board of trustees consisting of employer representatives and union representatives. Except to the extent that a participating employer has a representative on the board of trustees, the participating employers would not exercise any control over the decision of whether catch-up contributions are offered under the multiemployer plan. Consequently, the ability to offer catch-up contributions under their own plans could largely be outside of the employer's control.

**Recommendation:** It would be helpful if the proposed regulations were clarified to state that employers are not treated as "maintaining" any multiemployer plan to which they or their employees contribute for purposes of satisfying the universal availability requirements.

C. **Multiple Employer Plans.** Further, it would be helpful if the impact of the universal availability requirement on employers who participate in a non-collectively bargained multiple employer plan (described in Code Section 413(c) and the Treasury Regulations thereunder) were clarified. In particular, if an employer participating in a multiple employer plan is treated as "maintaining" such plan, then that employer (and all other aggregated employers, including those within its controlled group) would not be permitted to offer catch-up contributions under their other plans unless the multiple employer plan elected to offer catch-up contributions. Conversely, if the multiple employer plan chose to offer catch-up contributions, each participating employer (and all other employers within its controlled group) would be required to offer catch-up contributions under its other plans in order to satisfy the universal availability requirement. While it is possible that a multiple employer plan would offer each participating employer the choice as to whether such catch-up feature will apply to that employer's employees, the threshold decision as to whether a catch-up feature should be added to the multiple employer plan will be made by a board of trustees whose members represent but a fraction of the participating employers. Thus, as in the case of a multiemployer plan, the decision as to whether to offer a catch-up feature under the other plans of an employer participating in a multiple employer plan could be outside such employer's control. Therefore, the catch-up contribution decision made by the multiple employer plan's board of trustees will govern the availability of catch-up contributions under any other plan maintained by a participating employer in the multiple employer plan.
Recommendation: It would be helpful if the proposed regulations were clarified to state that employers participating in a multiple employer plan are not treated as "maintaining" the multiple employer plan for purposes of satisfying the universal availability requirements.

D. Separate Lines of Business. The proposed regulations do not contain an exception to the universal availability requirements for qualified separate lines of business. Thus, an employer who has established qualified separate lines of business for purposes of Code Section 410(b) minimum coverage testing would still need to offer the catch-up feature consistently across all separate lines of business.

Recommendation: It would be helpful if the Service were to clarify the proposed regulations to provide an exception to the universal availability requirements for qualified separate lines of business.

E. Differing State Tax Treatment. While most state tax codes coordinate their definition of taxable income with the Code, some state laws have not been updated to reflect recent changes. As a result catch-up contributions would be includible as taxable income under state law unless the state amends its laws. An employer with a plan covering employees in many states may wish to provide catch-up contributions only to those employees who reside in states with conforming state tax codes.

Recommendation: It would be helpful if the Service were to clarify the proposed regulations to provide an exception to the universal availability requirements for employees who reside in states with nonconforming state tax codes.

2. MERGERS AND ACQUISITIONS

Code Section 414(v), as amended by the Job Creation and Worker Assistance Act of 2002, provides that the transition period under Code Section 410(b)(6)(C) is applicable for purposes of the universal availability rule. Thus, for plans of newly acquired companies, the universal availability requirement will not apply until the last day of the first plan year beginning after the date of the business organization transaction.

A. Business Organization Transactions. The addition of this transition relief to Code Section 414(v) was made under the Job Creation and Worker Assistance Act of 2002. However, the proposed regulations, which were issued prior to the statutory change, had incorporated the transition relief concept in a slightly different manner. Specifically, the proposed regulations required that the newly acquired plan be amended as soon as practicable, but in no event later than the end of the transitional period to comply with the universal availability
requirements of Code Section 414(v). The "as soon as practicable" requirement was not incorporated into the statutory changes under Code Section 414(v).

In addition, the proposed regulations only provide transition relief if the acquired plan does not provide for catch-up contributions and is being amended to provide for them. The proposed regulations do not contemplate that the acquiring employer might wish to amend its plans to eliminate the catch-up feature or address whether the decision to eliminate the catch-up feature would be a violation of Code Section 411(d)(6). The proposed regulations also do not provide transition relief where it is the acquired company's plan that has the catch-up feature and the acquiring company's plans that do not offer catch-up contributions. The amended Code Section 414(v) seems to apply the transition relief to each of these situations.

Recommendation: It would be helpful if the Service were to clarify the transition relief provided under the proposed regulations to conform with the changes made to Code Section 414(v) as part of the Job Creation and Worker Assistance Act of 2002. In addition, it would be helpful if the Service were to clarify that the elimination of a catch-up feature will not violate Code Section 411(d)(6).

B. Significant Change in Coverage. Under the amended Code Section 414(v), the employer has until the end of the transition period determined under clause (ii) of Code Section 410(b)(6)(C) to amend its plans to comply with the universal availability requirements. However, if a significant change in coverage occurs, which may be unrelated to catch-up contributions, the Code Section 410(b)(6)(C) relief is no longer applicable pursuant to clause (i) of said section, for purposes of complying with Code Section 410(b)'s minimum coverage requirements. Since Code Section 414(v)(4)(B) as amended by the Job Creation and Worker Assistance Act of 2002 refers only to termination of the transition period determined in accordance with clause (ii), it would be helpful to clarify that the transition relief for purposes of the universal availability requirement will remain available notwithstanding a termination of the transition period under clause (i).

Recommendation: It would be helpful if the Service were to clarify that pursuant to Code Section 414(v)(4)(B) as amended by the Job Creation and Worker Assistance Act of 2002 the transition period will continue to apply to the universal availability requirement of Code Section 414(v) after there has been an unrelated significant change.

C. Catch-up Feature as Significant Change. It is unclear whether the addition of the catch-up feature or the removal of the catch-up feature, would constitute a significant change in coverage under Code Section 410(b)(6)(C), thus ending the transition relief for minimum coverage purposes.
Recommendation: It would be helpful if the Service were to clarify that the addition or removal of the catch-up feature does not constitute a significant change under Code Section 410(b)(6)(C).

3. **EMPLOYER-PROVIDED LIMIT**

Catch-up contributions are contributions made by participants age 50 or over that exceed certain statutory limits, the actual deferral percentage ("ADP") limit of Code Section 401(k)(3), or an "employer-provided limit". The preamble to the proposed regulations indicates that an "employer-provided limit" must be included in the terms of the plan in order to trigger catch-up treatment. The purpose of this requirement, according to the Service, is to provide consistency with the requirement that a qualified plan have a definite written program and formula for allocating contributions.

A. **ADP Limit**. A practical problem arises with this requirement in the context of administering the ADP nondiscrimination test. Many employer plans specifically authorize the plan administrator to set yearly limits for highly compensated employees' contributions in order to ensure that the plan will meet the actual deferral percentage requirement of the nondiscrimination test for the year. Administratively, the plan would determine the applicable employer limit at the beginning of the plan year based on the participant contribution rates during the preceding year. Some administrators then run the nondiscrimination tests at various points throughout the plan year to determine whether the plan is passing. If it appears that the plan is not meeting the nondiscrimination requirements, the plan limits for highly compensated employees would be lowered for the remainder of the plan year to ensure that the test is passed.

The purpose of this plan design is to allow maximum flexibility in terms of the amount of contributions that can be made each year. Requiring a plan amendment for each year would be overly burdensome and restrict the plan administrator's ability to administer the plan effectively. If an amendment were required, many employers might instead impose a permanent limit on highly compensated employees' contributions that is overly restrictive in order to avoid violating the nondiscrimination tests if amendments could not be implemented. Consequently, the amount of elective deferrals that such employees could make might decrease as a result of the inclusion of the catch-up contribution feature.

Recommendation: It would be helpful if the Service were to redefine "employer-provided limit" to include limits set by the plan administrator (or other fiduciary) in accordance with specific authorization under the plan document.

B. **Code Section 401(a)(17) Compensation Limit**. In addition, it is unclear whether an employee who cannot make additional elective deferrals because he or she has exceeded the Code Section 401(a)(17) limits would be eligible to make catch-up contributions for that plan year.
Recommendation: It would be helpful if the Service were to clarify that the Code Section 401(a)(17) compensation limits, if they are incorporated into the plan document, are "employer-provided limits" or "statutory limits" for purposes of eligibility to make catch-up contributions.

4. NON-CALENDAR YEAR PLAN YEARS

The Job Creation and Worker Assistance Act of 2002 amended Code Section 414(v) to provide that an employee who attains 50 by the end of a taxable year (as opposed to the end of the plan year, as the statute previously required) will be treated as having attained age 50 as of January 1 of the year for purposes of determining eligibility to make catch-up contributions. Thus, with respect to an employee who will attain age 50 on October 1, 2003, if the employer maintains a plan with a July 1 to June 30 plan year and offers catch-up contributions under the plan, it appears that the employee would be eligible to make catch-up contributions for the plan year ending June 30, 2003 despite the fact that the employee will not have attained age 50 by the end of that plan year.

Recommendation: It would be helpful if the proposed regulations were clarified to conform with the changes made by the Job Creation and Worker Assistance Act of 2002 and specifically stated that an employee who will attain age 50 during a particular taxable year will be eligible for catch-up contributions in the plan year that ends within the taxable year in which the employee attains age 50.

5. PAYROLL PERIOD PLAN LIMITS

The proposed regulations specifically require the annual determination of whether contributions may be treated as catch-up contributions and do not permit employers to make that determination on a payroll period basis. This could raise administrative complications for employers who provide matching contributions on a payroll period basis but do not intend to match catch-up contributions. Applying the annual determination period to such plans would require administrators to analyze the contributions at the end of each year to determine which contributions are elective deferrals and which are catch-up contributions. Plans would then need to "true up" participants who should have received additional matching contributions (e.g., an individual was thought to have a "catch-up" that did not deserve a match under the terms of the employer plan but ended the year having a non-catch-up elective deferral that did deserve a match). If the payroll period method were an option for such employers, contribution levels could be analyzed at the outset of the year to determine which deferrals should be matched under the plan and which would qualify for catch-up treatment.
Recommendation: It would be helpful if the Service were to clarify the regulations to permit a payroll period method of determining catch-up contributions. Thus, a simple shift in the timing of eligibility determination would result in a more understandable participant process as well as a more realistic administrative process with today's daily valuation plans and payroll systems. Catch-up eligibility should be converted to a per pay period determination. The result would be an ongoing eligibility determination limited to that particular participant's pay cycle – a) if participant is over Section 402(g) that period or b) if current deferral is equal to the plan maximum deferral rate, a catch-up contribution would be allowed. If there is concern that someone would manipulate "the system" and contribute the entire amount (ex. $1000 for 2002) and then change ongoing rate, a maximum amount that is the equivalent of biweekly, the maximum allowed in one cycle is 1/26th of annual catch-up limit; if paid weekly, the maximum allowed in one cycle is 1/52nd of annual catch-up limit. However, this increases complexity for what is most likely a rare possibility. Preferably, if someone changes deferral behavior, continued catch-up contributions would be discontinued but catch-up contributions contributed year-to-date would remain eligible.

6. MATCHING CONTRIBUTIONS

A. **Matches on Catch-up Contributions.** If elective deferrals that would otherwise need to be distributed because they exceed the actual deferral percentage limits are not distributed because they qualify for catch-up treatment, the proposed regulations provide that matching contributions with respect to such deferrals may be forfeited. Presumably, if an employer does not offer matching contributions with respect to catch-up contributions, the preceding rule would apply. However, a plan that does provide matching contributions on catch-up contributions should not be required to forfeit such matching contributions (unless they are in excess of the actual contribution percentage limits).

Recommendation: It would be helpful if the Service were to clarify that matching contributions made on catch-up contributions need not be forfeited or distributed simply because the catch-up contributions represent amounts in excess of the actual deferral percentage limit.

B. **Safe Harbor Rules.** Representatives of the Service have indicated in conversations that it is not clear if a plan may rely on the safe harbor rules of Code Section 401(k)(12)(rather than an ACP test) where catch-up contributions are matched only up to the 6% matching cap.
Recommendation: It would be helpful if the Service were to clarify that if a 401(k) safe harbor plan matches catch-up contributions up to a 6% matching limit on elective deferrals under the plan’s terms, matching contributions on those catch-up contributions will be covered by the safe harbor of Code Section 401(k)(12)(B) and will not instead be subject to ACP testing.

7. CODE SECTION 403(B) PLANS

Code Section 402(g) generally establishes the maximum amount of elective deferrals that may be made in a given year to a Code Section 403(b) tax-sheltered annuity. Code Section 402(g)(7) increases this limit for employees of tax-exempt organizations who have completed at least 15 years of service with their current employer and have a history of low contribution rates. In essence, Code Section 402(g)(7) already provides a catch-up option for employees of tax-exempt entities who participate in a 403(b) plan. Code Section 414(v) does not appear to prohibit an employee from making additional 403(b) contributions under Code Section 402(g)(7) as well as catch-up contributions. However, the proposed regulations reserved a Section to address this issue. This implies that it is unclear whether 403(b) plan participants who take advantage of Code Section 402(g)(7)'s higher limits will be eligible to make catch-up contributions.

Recommendation: We recommend that guidance be issued concerning the coordination of Code Section 414(v) and Code Section 402(g)(7), making clear that both catch-up amounts are available under 403(b) plans.

8. Distribution of Catch-up Contributions

Neither the Code nor the proposed regulations address when catch-up contributions and related earnings may be distributable. Since catch-up contributions are additional elective deferrals, it seems appropriate to apply to them the distribution restrictions of Code Section 401(k)(2)(B). Therefore, in-service distributions after age 59.5 and hardship withdrawals would be permissible. In addition, plan loans of catch-up amounts should be permitted.

Recommendation: It would be helpful if the Service were to clarify that the distribution restrictions of Code Section 401(k)(2)(B) apply to catch-up contributions and related earnings.

9. ADP Limit

Catch-up contributions are contributions made by participants age 50 or over that exceed certain statutory limits, the ADP limit, or an employer-provided limit. The proposed regulations appear to define the ADP limit by reference to plans that fail the ADP test and correct by returning excess contributions. Specifically, the proposed regulations provide that in the case of a 401(k) plan that would fail the ADP test of Code Section 401(k)(3) if it did not correct under Code Section
401(k)(8), the ADP limit is the highest amount of elective deferrals that can be retained in the plan by a highly compensated employee under the rules of Code Section 401(k)(8)(C).

For plans that avoid an ADP test failure by making qualified nonelective contributions (QNECs) or qualified matching contributions (QMACs) on behalf of nonhighly compensated employees, pursuant to IRS Regs. Section 1.401(k)-1(b)(5), the proposed regulations do not make clear what the relevant ADP limit is for purposes of making catch-up contributions.

For instance, it is not clear whether plans that make QNECs and QMACs should determine the ADP limit AS IF the plan corrected under Code Section 401(k)(8). Alternatively, perhaps the ADP limit for those plans should be deemed to be the deferral amount actually contributed as of the plan year-end so that employees would be allowed to make catch-up contributions up to the full amount of the otherwise applicable annual limit on catch-up contributions.

Recommendation: It would be helpful if the proposed regulations were clarified to indicate how the ADP limit is determined for catch-up contribution purposes under plans that make QNECs and QMACs in order to avoid an ADP test failure.