Cash or Deferred Arrangements; Nondiscrimination

Notice 98–52

I. PURPOSE

This notice provides guidance on the design-based alternative or "safe harbor" methods in § 401(k)(12) and § 401(m)(11) of the Internal Revenue Code for satisfying the § 401(k) and § 401(m) nondiscrimination tests.

Specifically, under this notice:

- A section 401(k) plan generally satisfies the actual deferral percentage ("ADP") test if a prescribed level of safe harbor matching or nonelective contributions are made on behalf of all eligible nonhighly compensated employees ("NHCEs") and if employees are provided a timely notice describing their rights and obligations under the plan. See section V.
- Employee notices for the 1999 plan year are not required to be provided before March 1, 1999. See the transition rule in section V.C.2.
- A plan that satisfies the ADP test safe harbor by providing a basic level of safe harbor matching contributions automatically satisfies the actual contribution percentage ("ACP") test with respect to matching contributions. Plans that provide additional matching contributions satisfy the ACP test if matching contributions do not exceed specified limitations. See section VI.
- A special rule allows § 403(b) plans to take advantage of the ACP test safe harbor. See section VI.C.
- Plan amendments needed to implement the safe harbor methods generally may be deferred until the date other SBJPA plan amendments are required (for calendar year plans, December 31, 1999). See section XI.

Among other matters, this notice also addresses the timing of safe harbor contributions (section VII), the interaction of the safe harbor methods with other qualification rules and testing methods (section VIII), and how the safe harbor methods work where an employer maintains multiple CODAs or plans (section IX).

II. BACKGROUND

Section 1433(a) of the Small Business Job Protection Act of 1996 ("SBJPA"), Pub. L. 104–188, added new §§ 401(k)-(12) and 401(m)(11) to the Code, effective for plan years beginning after December 31, 1998, which provide design-based safe harbor methods for satisfying the ADP test contained in § 401(k)(3)(A)(ii) and the ACP test contained in § 401(m)(2). Section 401(k)(12) provides that a cash or deferred arrangement ("CODA") is treated as satisfying the ADP test if the CODA meets certain contribution and notice requirements. Section 401(m)(11) provides that a defined contribution plan is treated as satisfying the ACP test with respect to matching contributions if the plan meets the contribution and notice requirements contained in § 401(k)(12) and, in addition, meets certain limitations on the amount and rate of matching contributions available under the plan.

Previous guidance on other SBJPA amendments to §§ 401(k) and 401(m) was provided in Notice 97–2, 1997–1 C.B. 348, and Notice 98–1, 1998–3 I.R.B. 42.

III. EFFECT ON REGULATIONS

Because of the amendments made to §§ 401(k) and 401(m) by SBJPA, as well as by other recent legislation, certain portions of §§ 1.401(k)–1, 1.401(m)–1 and 1.401(m)–2 of the Income Tax Regulations no longer reflect current law. However, these regulations continue to apply to the extent they are not inconsistent with the Code, Notices 97–2 and 98–1, this notice, and any subsequent guidance.

IV. DEFINITIONS

A. In General

Except as provided in this section IV, any term used in this notice that is defined in Notice 98–1 or the regulations under §§ 401(k) and 401(m) has the same meaning as in Notice 98–1 or those regulations. For example, the definition of "plan" in § 1.401(k)–1(g)(11) applies for purposes of this notice.

B. Compensation

Except as provided in section V.B.1.c.iii, "compensation" for purposes of this notice means compensation as defined in § 1.401(k)–1(g)(2) (which incorporates by reference the definition of compensation in § 414(s) and § 1.414(s)–1); provided, however, that the rule in the last sentence of § 1.414(s)–1(d)(2)(iii) (which generally permits a definition of compensation to exclude all compensation in excess of a specified dollar amount) does not apply in determining the compensation of NHCEs. The annual compensation limit under § 401(a)(17) applies for purposes of the safe harbor methods.

Thus, a uniform definition of compensation described in this section IV.B must be used for purposes of the basic matching formula or an enhanced matching formula under section V.B.1.a, the nonelective contribution requirement under section V.B.2, and the matching contribution limitations under section VI.B. As provided under § 1.401(k)–1(g)(2), an employer may limit the period used to determine compensation for a plan year to that portion of the plan year in which the employee is an eligible employee, provided that this limit is applied uniformly to all eligible employees under the plan for the plan year.

C. Basic Matching Formula

For purposes of this notice, the "basic matching formula" is the formula described in section V.B.1.a.i.

D. Enhanced Matching Formula

For purposes of this notice, an "enhanced matching formula" is a formula described section V.B.1.a.ii.

E. Rate of Elective Contributions

For purposes of this notice, an employee's "rate of elective contributions" means the ratio of an employee's elective contributions under the plan for a plan year to the employee's compensation for that plan year.

F. Rate of Employee Contributions

For purposes of this notice, an employee's "rate of employee contributions" means the ratio of an employee's employee contributions under the plan for a plan year to the employee's compensation for that plan year.

G. Rate of Matching Contributions

For purposes of the ADP test safe harbor under section V, a "rate of matching contributions" means the ratio of matching contributions on behalf of an employee under the plan for a plan year to the employee's elective contributions for that plan year. For purposes of the ACP test safe harbor under section VI, a "rate of matching contributions" means the ratio of matching contributions on behalf of an employee under the plan for a plan year to the employee's respective employee contributions or elective contributions for that plan year.

H. Safe Harbor Matching Contributions and Safe Harbor Nonelective Contributions

For purposes of this notice, safe harbor matching contributions and safe harbor nonelective contributions are matching and nonelective contributions, respectively, that (1) are nonforfeitable within the meaning of § 1.401(k)–1(c), (2) are subject to the withdrawal restrictions of § 401(k)(2)(B) and § 1.401(k)–1(d), and (3) are used to satisfy the safe harbor contribution requirement of section V.B. Accordingly, pursuant to § 401(k)(2)(B) and § 1.401(k)–1(d), such contributions (and earnings thereon) must not be distributable earlier than separation from service, death, disability, an event described in § 401(k)(10), or, in the case of a profit-sharing or stock bonus plan, the attainment of age 59½. 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.

V. ADP TEST SAFE HARBOR

A. General Rule

A CODA is treated as satisfying the ADP test under § 401(k)(3)(A)(ii) and § 1.401(k)–1(b)(2) for a plan year if, for the entire plan year, the arrangement satisfies the safe harbor contribution requirement of subsection B of this section V and the notice requirement of subsection C of this section V.

B. Safe Harbor Contribution Requirement

The safe harbor contribution requirement of this section V.B is satisfied for a plan year if the plan satisfies either (1) the matching contribution requirement of paragraph 1 of this section V.B or (2) the nonelective contribution requirement of paragraph 2 of this section V.B. Pursuant to § 401(k)(12)(E)(ii), the safe harbor contribution requirement of this section V.B must be satisfied without regard to § 401(l).

1. Matching Contribution Requirement

a. In General

The matching contribution requirement of this section V.B.1 is satisfied if, under the terms of the plan, safe harbor matching contributions under either the basic matching formula or an enhanced matching formula described below are required to be made on behalf of each NHCE who is an eligible employee.

i. Basic Matching Formula

The basic matching formula provides matching contributions on behalf of each NHCE who is an eligible employee in an amount equal to (A) 100 percent of the amount of the employee's elective contributions that do not exceed 3 percent of the employee's compensation and (B) 50 percent of the amount of the employee's elective contributions that exceed 3 percent of the employee's compensation but that do not exceed 5 percent of the employee's compensation.

ii. Enhanced Matching Formula

An enhanced matching formula provides matching contributions on behalf of each NHCE who is an eligible employee under a formula that, at any rate of elective contributions, provides an aggregate amount of matching contributions at least equal to the aggregate amount of matching contributions that would have been provided under the basic matching formula. In addition, under an enhanced matching formula, the rate of matching contributions may not increase as an employee's rate of elective contributions increases.

b. Limitation on Matching Contributions for HCEs

The matching contribution requirement of this section V.B.1 is not satisfied if, at any rate of elective contributions, the rate of matching contributions that would apply with respect to any highly compensated employee ("HCE") who is an eligible employee is greater than the rate of matching contributions that would apply with respect to any NHCE who is an eligible employee and who has the same rate of elective contributions.

c. Permissible Restrictions on Elective Contributions by NHCEs

The matching contribution requirement of this section V.B.1 is not satisfied if elective contributions by NHCEs are restricted, unless the restrictions are permitted as described below.

i. Restrictions on Election Periods

A plan sponsor may limit the frequency and duration of periods in which eligible employees may make or change cash or deferred elections under a plan, provided that, after receipt of the notice described in subsection C of this section V, an employee has a reasonable opportunity (including a reasonable period) to make or change a cash or deferred election for the plan year. For purposes of the preceding sentence, a 30-day period is deemed to be a reasonable period.

ii. Restrictions on Amount of Elective Contributions

A plan sponsor may limit the amount of elective contributions that may be made by an eligible employee under a plan, provided that each NHCE who is an eligible employee is permitted (unless the employee is restricted under paragraph 1.c.iv of this section V.B) to make elective contributions in an amount that is at least sufficient to receive the maximum amount of matching contributions available under the plan for the plan year, and the employee is permitted to elect any lesser amount of elective contributions.

iii. Restrictions on Types of Compensation That May be Deferred

A plan sponsor may limit the types of compensation that may be deferred by an eligible employee under a plan, provided that each NHCE who is an eligible employee is permitted to make elective contributions under a definition of compensation that would be a reasonable definition of compensation within the meaning of § 1.414(s)–1(d)(2). (Thus, the definition

is not required to satisfy the nondiscrimination requirement of § 1.414(s)-1(d)(3).) However, see section IV.B regarding the definition of compensation for purposes of the basic matching formula or an enhanced matching formula under paragraph 1.a of this section V.B, the nonelective contribution requirement under paragraph 2 of this section V.B, and the matching contribution limitations under section VI.B.

iv. Restrictions Due to Limitations under the Code

A plan sponsor may limit the amount of elective contributions made by an eligible employee under a plan (A) because of the limitations under § 402(g) or § 415 or (B) because, on account of a hardship distribution, an employee's ability to make elective contributions has been suspended for 12 months in accordance with § 1.401(k)–1(d)(2)(iv)(B)(4) or limited in accordance with § 1.401(k)–1(d)(2)(iv)(B)(3).

2. Nonelective Contribution Requirement

The nonelective contribution requirement of this section V.B.2 is satisfied if, under the terms of the plan, the employer is required to make a safe harbor nonelective contribution on behalf of each NHCE who is an eligible employee equal to at least 3 percent of the employee's compensation.

3. Examples

The safe harbor contribution requirement of this section V.B is illustrated by the following examples:

Example 1

(a) Beginning January 1, 1999, Employer A maintains Plan L covering employees (including HCEs and NHCEs) in Divisions D and E. Plan L contains a CODA and provides a required matching contribution equal to 100 percent of each eligible employee's elective contributions up to 4 percent of compensation. For purposes of the matching contribution formula, compensation is defined as all compensation within the meaning of § 415(c)(3) (a definition that satisfies § 414(s)). Also, each employee is permitted to make elective contributions from all compensation within the meaning of § 415(c)(3) and may change a cash or deferred election at any time. Plan L limits the amount of an employee's elective contributions for purposes of § 402(g) and § 415, and, in the case of a hardship distribution, suspends an employee's ability to make elective contributions for 12 months in accordance with § 1.401(k)–1(d)(2)(iv)(B)(4) and limits an employee's elective contributions in accordance with § 1.401(k)–1(d)(2)(iv)(B)(3). All contributions under Plan L are nonforfeitable and are subject to the withdrawal restrictions of § 401(k)(2)(B). Plan L provides for no other contributions and Employer A maintains no other plans. Plan L is maintained on a calendar-year basis and all contributions for a plan year are made within 12 months after the end of the plan year.

(b) Based on these facts, matching contributions under Plan L are safe harbor matching contributions because they are nonforfeitable, are subject to the withdrawal restrictions of § 401(k)(2)(B), and are used to satisfy the safe harbor contribution requirement of section V.B.

(c) Plan L's formula is an enhanced matching formula because each NHCE who is an eligible employee receives matching contributions at a rate that, at any rate of elective contributions, provides an aggregate amount of matching contributions at least equal to the aggregate amount of matching contributions that would have been received under the basic matching formula, and the rate of matching contributions does not increase as the rate of an employee's elective contributions increases.

(d) Plan L satisfies the safe harbor contribution requirement of this section V.B because safe harbor matching contributions under an enhanced matching formula are required to be made on behalf of each NHCE who is an eligible employee.

(e) Plan L would satisfy the ADP test safe harbor if Plan L also satisfied the notice requirement of subsection C of this section V. (Plan L then would also satisfy the ACP test safe harbor. See section VI.)

Example 2

(a) The facts are the same as in Example 1, except that instead of providing a required matching contribution equal to 100 percent of each eligible employee's elective contributions up to 4 percent of compensation, Plan L provides a matching contribution equal to 150 percent of each eligible employee's elective contributions up to 3 percent of compensation.

(b) Plan L's formula is an enhanced matching formula and Plan L satisfies the safe harbor contribution requirement of this section V.B.

(c) Plan L would satisfy the ADP test safe harbor if Plan L also satisfied the notice requirement of subsection C of this section V. (Plan L then would also satisfy the ACP test safe harbor. See section VI.)

Example 3

(a) The facts are the same as in Example 1, except that instead of permitting each employee to make elective contributions from compensation within the meaning of § 415(c)(3), each employee's elective contributions under Plan L are limited to 15 percent of the employee's "basic compensation." Basic compensation is defined under Plan L as compensation within the meaning of § 415(c)(3), but excluding overtime pay.

(b) The definition of basic compensation under Plan L is a reasonable definition of compensation within the meaning of § 1.414(s)–1(d)(2).

(c) Plan L will not fail to satisfy the safe harbor contribution requirement of this section V.B merely because Plan L limits the amount of elective contributions and the types of compensation that may be deferred by eligible employees, provided that each NHCE who is an eligible employee may make elective contributions equal to at least 4 percent of the employee's compensation under § 415(c)(3) (that is, the amount of elective contributions that is sufficient to receive the maximum amount of matching contributions available under the plan).

Example 4

(a) The facts are the same as in Example 1, except that Plan L provides that only employees employed on the last day of the plan year will receive a safe harbor matching contribution.

(b) Even if the section 401(m) plan satisfies the minimum coverage requirements of § 410(b)(1) taking into account this last-day requirement, Plan L would not satisfy the safe harbor contribution requirement of this section V.B because safe

harbor matching contributions are not made on behalf of all NHCEs who are eligible employees and who make elective contributions.

(c) The result would be the same if, instead of providing safe harbor matching contributions under an enhanced formula, Plan L provides for a 3-percent safe harbor nonelective contribution that is restricted to eligible employees under the CODA who are employed on the last day of the plan year.

Example 5

(a) The facts are the same as in Example 1, except that instead of providing safe harbor matching contributions under the enhanced matching formula to employees in both Divisions D and E, employees in Division E are provided safe harbor matching contributions under the basic matching formula, while matching contributions continue to be provided to employees in Division D under the enhanced matching formula.

(b) Even if Plan L satisfies § 1.401(a)(4)–4 with respect to each rate of matching contributions available to employees under the plan, the plan would fail to satisfy the safe harbor contribution requirement of this section V.B because the rate of matching contributions with respect to HCEs in Division D at a rate of elective contributions between 3 and 5 percent would be greater than that with respect to NHCEs in Division E at the same rate of elective contributions. For example, an HCE in Division D who would have a 4-percent rate of elective contributions would have a rate of matching contributions of 100 percent while an NHCE in Division E who would have the same rate of elective contributions would have a lower rate of matching contributions.

C. Notice Requirement

The notice requirement of this section V.C is satisfied if each eligible employee for the plan year is given written notice of the employee's rights and obligations under the plan and the notice satisfies the content requirement of paragraph 1 of this section V.C and the timing requirement of paragraph 2 of this section V.C.

1. Content Requirement

a. General Rule

The content requirement of this section V.C.1 is satisfied if the notice (1) is sufficiently accurate and comprehensive to inform the employee of the employee's rights and obligations under the plan and (2) is written in a manner calculated to be understood by the average employee eligible to participate in the plan. For purposes of the preceding sentence, a notice is not considered sufficiently accurate and comprehensive unless the notice accurately describes (i) the safe harbor matching or nonelective contribution formula used under the plan (including a description of the levels of matching contributions, if any, available under the plan); (ii) any other contributions under the plan (including the potential for discretionary matching contributions) and the conditions under which such contributions are made; (iii) the plan to which safe harbor contributions will be made (if different than the plan containing the CODA); (iv) the type and amount of compensation that may be deferred under the plan; (v) how to make cash or deferred elections, including any administrative requirements that apply to such elections; (vi) the periods available under the plan for making cash or deferred elections; and (vii) withdrawal and vesting provisions applicable to contributions under the plan.

b. 1999 Transition Relief for Content Requirement

For a plan adopting the safe harbor provisions for a plan year that begins before January 1, 2000, a notice will not fail to satisfy the content requirement for that plan year merely because the notice does not include all of the items listed in paragraph 1.a of this section V.C, provided that the notice satisfies a reasonable good faith interpretation of the notice requirements under §§ 401(k)(12) and 401(m)(11).

2. Timing Requirement

a. General rule

The timing requirement of this section V.C.2 is satisfied if the notice is provided within a reasonable period before the beginning of the plan year (or, in the year an employee becomes eligible, within a reasonable period before the employee becomes eligible). The determination of whether a notice satisfies the timing requirement of this section V.C.2 is based on all of the relevant facts and circumstances.

b. Deemed Satisfaction of Timing Requirement

The timing requirement of this section V.C.2 is deemed to be satisfied if at least 30 days (and no more than 90 days) before the beginning of each plan year, the notice is given to each eligible employee for the plan year. In the case of an employee who does not receive the notice within the period described in the previous sentence because the employee becomes eligible after the 90th day before the beginning of the plan year, the timing requirement is deemed to be satisfied if the notice is provided no more than 90 days before the employee becomes eligible (and no later than the date the employee becomes eligible). Thus, for example, the preceding sentence would apply in the case of any employee eligible for the first plan year under a newly established section 401(k) plan, or would apply in the case of the first plan year in which an employee becomes eligible under an existing section 401(k) plan.

c. 1999 Transition Relief for Timing Requirement

For a plan year that begins on or before April 1, 1999, the notice described in this section V.C satisfies the timing requirement for that plan year (with respect to an existing section 401(k) plan or a newly established one) if the notice is given on or before March 1, 1999. However, in order to satisfy the ADP or ACP test safe harbor for the plan year, a plan that is using the transition relief provided under this section V.C.2.c still must satisfy the otherwise applicable requirements of this Notice 98-52 with respect to the entire plan year.

VI. ACP TEST SAFE HARBOR

A. General Rule

A defined contribution plan is treated as satisfying the ACP test under § 401(m)(2) and § 1.401(m)-1(b) with respect to matching contributions for a plan year if, for the entire plan year, (i) each NHCE eligible to receive an allocation of matching contributions under the plan is also an eligible employee under a CODA that satisfies the ADP test safe harbor of

section V and (ii) the plan satisfies the matching contribution limitations of subsection B of this section VI. See section VIII.F.1 regarding the continued application of the ACP test to employee contributions.

B. Matching Contribution Limitations

1. Harbor Matching Contributions Under Basic Matching Formula

A plan satisfies the matching contribution limitations of this section VI.B if (i) the plan satisfies the matching contribution requirement of section V.B.1 using the basic matching formula and (ii) no other matching contributions are provided under the plan.

2. Safe Harbor Matching Contributions Under an Enhanced Matching Formula

A plan satisfies the matching contribution limitations of this section VI.B if (i) the plan satisfies the matching contribution requirement of section V.B.1 using an enhanced matching formula under which matching contributions are only made with respect to elective contributions that do not exceed 6 percent of the employee's compensation and (ii) no other matching contributions are provided under the plan.

3. Other Matching Contributions

In the case of any other plan, the matching contribution limitations of this section VI.B are satisfied if, under the plan, (i) matching contributions are not made with respect to employee contributions or elective contributions that in the aggregate exceed 6 percent of the employee's compensation, (ii) the rate of matching contributions does not increase as the rate of employee contributions or elective contributions increases, and (iii) at any rate of employee contributions or elective contributions, the rate of matching contributions that would apply with respect to any HCE who is an eligible employee is no greater than the rate of matching contributions that would apply with respect to an NHCE who is an eligible employee and who has the same rate of employee contributions or elective contributions. If a plan provides matching contributions with respect to employee contributions or elective contributions, those employee contributions or elective contributions may be restricted only to the extent permitted under section V.B.1.c.

4. Matching Contributions Generally Must be Required Under Plan Terms

a. ADP Test Safe Harbor

As provided under section V.B.1.a, a matching contribution may be taken into account in determining whether the matching contribution requirement of the ADP test safe harbor is satisfied only if the contribution is required to made under the terms of a plan. Even though matching contributions made at the employer's discretion may not be taken into account in determining whether the matching contribution requirement of section V.B.1 is satisfied, a plan that satisfies the safe harbor contribution requirement of section V.B will not fail to satisfy the ADP test safe harbor merely because additional matching contributions are made at the employer's discretion.

b. ACP Test Safe Harbor

A plan fails to satisfy the ACP test safe harbor for a plan year if the plan provides for matching contributions made at the employer's discretion on behalf of any employee that, in the aggregate, could exceed a dollar amount equal to 4 percent of the employee's compensation. This limitation on matching contributions made at the employer's discretion does not apply to plan years beginning before January 1, 2000.

C. Special Rule for Matching Contributions Under a § 403(b) Plan

For purposes of § 403(b)(12)(A)(i), a § 403(b) plan is treated as satisfying the requirements of § 401(m) with respect to matching contributions if the plan satisfies the safe harbor contribution requirement of section V.B, the notice requirement of section V.C, and the matching contribution limitations of subsection B of this section VI. For purposes of applying the requirements of section V and this section VI, salary reduction contributions under a § 403(b) plan are treated as elective contributions under a CODA.

D. Examples

The following examples illustrate the requirements of the ACP test safe harbor described in this section VI:

Example 1

(a) An employer's only plan, Plan M, contains a CODA that satisfies the ADP test safe harbor using safe harbor matching contributions under the basic matching formula. No contributions, other than elective contributions and contributions under the basic matching formula, are made to Plan M.

(b) Because the CODA under Plan M satisfies the ADP test safe harbor using the basic matching formula and Plan M provides for no other matching contributions, Plan M automatically satisfies the ACP test safe harbor.

Example 2

(a) Beginning January 1, 2000, Employer B maintains Plan N, the only plan maintained by Employer B. Plan N contains a CODA that satisfies the ADP test safe harbor using a 3-percent safe harbor nonelective contribution. Plan N also provides matching contributions equal to 50 percent of each eligible employee's elective contributions up to 6 percent of compensation. Under Plan N, elective contributions are limited to 10 percent of an employee's compensation and are limited in accordance with § 402(g) and § 415. Under Plan N, an employee may change a cash or deferred election at any time. Plan N provides a definition of compensation that satisfies § 414(s) and that same definition is used for all purposes under Plan N. Matching contributions under Plan N are fully vested after 3 years of service. No other matching contributions are provided for under Plan N. The plan is maintained on a calendar-year basis and all contributions for a plan year are made within 12 months after the end of the plan year.

(b) Based on these facts, Plan N satisfies the ACP test safe harbor with respect to matching contributions because each NHCE eligible to receive an allocation of matching contributions under Plan N is also an eligible employee under a CODA that satisfies the ADP test safe harbor of section V and because the matching contribution limitations of subsection B of this section VI are satisfied.

Example 3

(a) The facts are the same as in Example 2, except that Plan N also provides matching contributions equal to 50 percent of each eligible employee's employee contributions up to 6 percent of compensation.

(b) Plan N does not satisfy the matching contribution limitations of subsection B of this section VI because matching contributions can be made with respect to elective contributions and employee contributions that, in the aggregate, equal 12 percent of compensation (and thus exceed 6 percent of compensation).

Example 4

(a) The facts are the same as in Example 2, except that Plan N also provides that Employer B, in its discretion, may make additional matching contributions up to 50 percent of each eligible employee's elective contributions that do not exceed 6 percent of compensation.

(b) Plan N does not fail to satisfy the ACP test safe harbor on account of discretionary matching contributions, because, under Plan N, the amount of discretionary matching contributions cannot exceed 4 percent of an employee's compensation.

VII. TIMING OF PLAN CONTRIBUTIONS

A. In General

As provided in subsections B and C of this section VII, matching and nonelective contributions under a plan using the safe harbor methods must be made to the plan within the same time period that would apply if these contributions were made to a plan using the current year testing method for ADP or ACP testing purposes (that is, no later than 12 months after the close of the plan year).

Matching and nonelective contributions also may be made from time to time during the plan year, instead of at one time after the close of the plan year. Regardless of the timing of employer contributions, however, the total amount of matching or nonelective contributions for the plan year still must satisfy the requirements of sections V and VI, taking into account the total amount of compensation for the plan year, in order for a CODA to satisfy the ADP test safe harbor.

B. Contributions Under the ADP Test Safe Harbor

A CODA will not satisfy the ADP test safe harbor for a plan year unless safe harbor matching and nonelective contributions needed to satisfy the safe harbor contribution requirement of section V.B are made in accordance with the allocation and timing rules of § 1.401(k)–1(b)(4).

C. Matching Contributions Under the ACP Test Safe Harbor

Matching contributions are taken into account for a plan year under the ACP test safe harbor of section VI in accordance with the allocation and timing rules of § 1.401(m)-1(b)(4)(ii)(A).

VIII. INTERACTION WITH OTHER RULES AND TESTING METHODS

A. In General

A CODA that is treated as satisfying the ADP test under § 401(k)(3)(A)(ii) and § 1.401(k)-1(b)(2) will not be treated as a qualified CODA unless the arrangement satisfies the other requirements of § 401(k). For example, under § 401(k)-(3)(A)(i), the group of eligible employees under the section 401(k) plan must satisfy the requirements of § 410(b), under § 401(k)(4)(A), benefits (other than matching contributions) must not be contingent on an election to defer, and elective contributions must satisfy the allocation and timing rules of § 1.401(k)–1(b)(4). A plan that satisfies the ADP or ACP test safe harbor must satisfy all other qualification requirements of the Code that are applicable to the plan, such as the nondiscriminatory availability of benefits, rights, and features under § 401(a)(4) and the limitations of §§ 401(a)(17), 401(a)(30) and 415.

B. Use of Safe Harbor Nonelective Contributions to Satisfy Other Nondiscrimination Tests

A safe harbor nonelective contribution used to satisfy the nonelective contribution requirement under section V.B.2 may also be taken into account for purposes of determining whether a plan satisfies § 401(a)(4). Thus, these contributions are not subject to the limitations on qualified nonelective contributions under § 1.401(k)–1(b)(5)(ii), but are subject to the rules generally applicable to nonelective employer contributions under § 401(a)(4). See § 1.401(a)(4)–1(b)(2)(ii). However, pursuant to § 401(k)(12)(E)(ii), to the extent they are needed to satisfy the safe harbor contribution requirement of section V.B, safe harbor nonelective contributions may not be taken into account under any plan for purposes of § 401(l) (including the imputation of permitted disparity under § 1.401(a)(4)–7).

C. Top-Heavy Rules

1. Safe Harbor Nonelective Contributions

Safe harbor nonelective contributions may be counted under § 416 toward the minimum contribution requirement for top-heavy plans. Thus, if a plan allocates to all eligible employees a 3-percent safe harbor nonelective contribution, the plan generally would also satisfy the top-heavy minimum contribution requirement. See § 1.416–1, M-18 for a similar rule applicable to qualified nonelective contributions.

2. Safe Harbor Matching Contributions

If a plan uses contributions allocated to employees on the basis of elective contributions or employee contributions to satisfy the top-heavy minimum contribution requirement under § 416, these contributions are not treated as matching contributions for purposes of §§ 401(k) and 401(m). Therefore, safe harbor matching contributions may not be counted toward the minimum contribution requirement for top-heavy plans under § 416. See § 1.416–1, M–19.

D. Qualified Matching Contributions and Qualified Nonelective Contributions

To the extent they are needed to satisfy the safe harbor contribution requirement of section V.B, safe harbor matching and nonelective contributions may not be used as qualified matching contributions and qualified nonelective contributions, respectively, under any plan for any plan year. For example, if a plan satisfies the safe harbor contribution requirement using a safe harbor nonelective contribution by allocating a 7-percent safe harbor nonelective contribution to all eligible

employees, contributions in an amount equal to the first 3 percent of each employee's compensation may not be used as a qualified nonelective contribution under the ACP test. However, safe harbor nonelective contributions in an amount equal to the remaining 4 percent of each employee's compensation may be used to satisfy the ACP test (subject to the requirements of § 1.401(m)–1(b)(5)).

E. Testing Methods Under Notice 98–1

For purposes of Notice 98–1, a plan that uses the safe harbor methods to satisfy the ADP or ACP test for a plan year is treated as using the current year testing method for that year and, thus, is subject to the rules contained in section VII of Notice 98–1 (relating to changes from current year to prior year testing).

In addition, in the case of a plan that is not maintained on a calendar plan year basis, the anti-abuse provision of section VIII of Notice 98–1 applies in a similar manner to changes between the safe harbor methods and the current or prior year testing method.

F. Continued Application of the ACP Test to Certain Contributions

1. Employee Contributions

Even if a defined contribution plan satisfies the ACP test safe harbor of section VI with respect to matching contributions, the plan still must satisfy the ACP test in the manner described in paragraph 3 of this section VIII.F with respect to employee contributions made under the plan.

2. Matching Contributions that Fail to Satisfy the ACP Test Safe Harbor

If a plan satisfies the ADP test safe harbor of section V.A, but fails to satisfy the ACP test safe harbor with respect to matching contributions under the plan, then the plan must satisfy the ACP test in the manner described in paragraph 3 of this section VIII.F.

3. Special Rules for ACP Test

If paragraph 1 or 2 of this section VIII.F applies, then the plan must satisfy the ACP test under § 401(m)(2), and under § 1.401(m)–1(b), as modified by Notices 97–2 and 98–1, using the current year testing method. However, in applying the ACP test, an employer may elect to disregard with respect to all eligible employees (i.e., all HCEs and NHCEs) (1) all matching contributions, if the ACP test safe harbor of section VI is satisfied or (2) matching contributions that do not exceed 4 percent of each employee's compensation, if the matching contribution requirement of section V.B.1 is satisfied. Except as otherwise provided in section VIII.D, qualified nonelective contributions may be treated as matching contributions to the extent permitted under § 1.401(m)–1(b)(5). Finally, in applying the ACP test (i) matching contributions may not be treated as elective contributions under § 401(k)(3)(D) to a CODA that satisfies the ADP test safe harbor (and thus excluded from the ACP test under § 401(m)(3)) and (ii) elective contributions under a CODA that satisfies the ADP test safe harbor may not be treated as matching contributions under § 401(m)(3).

G. Multiple Use Test

The restrictions on multiple use under § 1.401(m)–2 do not apply to a CODA that satisfies the ADP test safe harbor. In addition, the restrictions on multiple use under § 1.401(m)–2 do not apply to a defined contribution plan that satisfies the ACP test safe harbor, if the plan does not permit employee contributions. In determining whether multiple use of the alternative limitation under § 401(k)(3)(A)(ii)(II) or § 401(m)(2)(A)(ii) occurs with respect to another plan of an employer, (1) a CODA that satisfies the ADP test safe harbor and (2) a defined contribution plan that satisfies the ACP test safe harbor and does not permit employee contributions, are disregarded for purposes of § 1.401(m)–2(b). In the case of a defined contribution plan to which subsection F.1 or F.2 of this section VIII applies (that is, a defined contribution plan that satisfies the ACP test safe harbor but permits employee contributions, or a defined contribution plan that fails to satisfy the ACP test safe harbor), the special rules of subsection F.3 of this section VIII (relating to ACP testing) also apply for purposes of § 1.401(m)–2(b) in determining whether the multiple use of the alternative limitation occurs.

H. Early Participation Rules

Sections 401(k)(3)(F) and 401(m)(5)-(C), which provide alternative nondiscrimination rules for certain plans that provide for early participation, do not apply for purposes of the safe harbor methods. However, see section IX.B.1 for application of the § 410(b)(4)(B) rule permitting the separate testing of employees who satisfy age and service conditions under the plan that are lower than the greatest age and service conditions permitted under § 410(a).

IX. MULTIPLE CODAS OR MULTIPLE PLANS

A. Satisfying Safe Harbor Contribution Requirement Under Another Defined Contribution Plan

1. In General

Safe harbor matching or nonelective contributions may be made to the plan that contains the CODA or to another defined contribution plan that satisfies § 401(a) or § 403(a). If safe harbor contributions are made to another defined contribution plan, the safe harbor contribution requirement of section V.B must be satisfied in the same manner as if the contributions were made to the plan that contains the CODA. Consequently, each employee eligible under the plan containing the CODA must be eligible under the same conditions under the other defined contribution plan.

2. Plan Year Requirement

In order for safe harbor contributions to be made to another defined contribution plan, that plan must have the same plan year as the plan containing the CODA. However, for plan years of plans containing CODAs beginning before January 1, 2000, contributions used to satisfy the safe harbor contribution requirement of section V.B for a CODA also may be made to another defined contribution plan that does not have the same plan year as the plan containing the CODA, provided that the safe harbor contribution is allocated as of a date within the plan year of the plan containing the CODA and is made no later than 12 months after the close of that plan year.

3. Section 410(b) Aggregation Not Required

In order for safe harbor contributions to be made to another defined contribution

plan, it is not necessary that the other plan be capable of being aggregated with the plan containing the CODA for purposes of § 410(b). Therefore, notwithstanding §§ 1.410(b)–7(c)(2) and 54.4975–11(e), a contribution to an ESOP may be used to satisfy the safe harbor contribution requirement of section V.B for a CODA that is not part of the ESOP.

4. Contributions Used Only Once

Safe harbor matching or nonelective contributions cannot be used to satisfy the safe harbor contribution requirement of section V.B with respect to more than one plan.

B. Aggregation and Disaggregation Rules

1. Plans

The rules that apply for purposes of aggregating and disaggregating CODAs and plans under §§ 401(k) and 401(m) also apply for purposes of §§ 401(k)(12) and 401(m)(11), respectively. See §§ 1.401(k)–1(b)(3) and 1.401(m)–1(b)(3).

Accordingly, all CODAs included in a plan are treated as a single CODA that must satisfy the safe harbor contribution requirement of section V.B and the notice requirement of section V.C. Moreover, two plans (within the meaning of § 1.410(b)–7(b)) that are treated as a single plan pursuant to the permissive aggregation rules of § 1.410(b)–7(d) are treated as a single plan for purposes of the safe harbor methods. Conversely, a plan (within the meaning of § 414(l)) that includes a CODA covering both collectively bargained employees and noncollectively bargained employees 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. Similarly, if, pursuant to § 410(b)(4)(B), an employer applies § 410(b) separately to the portion of a plan (within the meaning of § 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.

2. Highly Compensated Employees

In accordance with §§ 401(k)(3) and 401(m)(2), elective or matching contributions under a plan made on behalf of an HCE who is eligible to participate in more than one plan of the same employer providing such contributions must generally be aggregated and treated as made under each of the plans, even if one or more of the plans is intended to satisfy the ADP or ACP test safe harbor. Thus, for example, if an HCE is simultaneously an eligible employee under two plans maintained by an employer for a plan year, only one of which one is intended to satisfy the ADP and ACP tests using the safe harbor methods, and the matching contribution formula of the plan that is not using the safe harbor methods provides greater matching contributions than the formula under the plan that is intended to satisfy the ADP and ACP tests using the safe harbor methods, the rules in sections V.B.1.b and VI.B.3 (prohibiting an HCE from receiving a greater rate of matching contributions than an NHCE) could be violated. These issues could also arise, for example, when an HCE is transferred from a plan maintained for one group of employees to a plan maintained for another group of employees.

X. PLAN YEARS OF FEWER THAN 12 MONTHS

A plan will fail to satisfy the ADP test safe harbor or the ACP test safe harbor for a plan year unless (i) the plan year is 12 months long or (ii) in the case of the first plan year of a newly established plan (other than a successor plan), the plan year is at least 3 months long (or, any shorter period in the case of a newly established employer that establishes the plan as soon as administratively feasible after the employer comes into existence).

XI. PLAN PROVISIONS RELATING TO SAFE HARBORS

A. General Rules

1. Plan Must Include Safe Harbor Provisions

Sections 1.401(k)–1(b)(2)(iii) and 1.401(m)–1(b)(2) require that a plan to which § 401(k) or § 401(m) applies provide that the ADP or ACP test will be met. Because, effective for plan years beginning after December 31, 1998, a plan may use the SIMPLE 401(k) plan formula or safe harbor provisions as alternatives to the ADP and ACP tests, a plan must specify which of these alternatives it is using. Generally, a plan sponsor that intends to use the safe harbor provisions for a plan year must adopt those provisions before the first day of that plan year. However, see section XI.B for the remedial amendment period applicable to plan changes incorporating the safe harbor provisions.

2. Safe Harbor Contributions Made to Another Plan

If, pursuant to section IX.A, safe harbor matching or nonelective contributions will be made to another plan, the name of the other plan must be specified in the plan containing the CODA. Moreover, if safe harbor matching or nonelective contributions will be made to another plan for a plan year, the other plan must also adopt, before the first day of that plan year, provisions specifying that the safe harbor contributions will be made and providing for the withdrawal and vesting restrictions required by § 401(k)(12)-(E)(i). However, see section XI.B for the remedial amendment period applicable to plan changes incorporating the safe harbor provisions.

3. Disaggregated Plans

If a plan, within the meaning of § 414(l), is composed of disaggregated plans under § 1.410(b)–7(c), the plan provisions must specify which disaggregated plans are subject to the safe harbor provisions.

B. Remedial Amendment Period

Section 1.401(b)–1T(b)(3) authorizes the Commissioner to designate a plan provision as a disqualifying provision that either (1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements or (2) is integral to a qualification requirement that has been changed. Section 1.401(b)–1T(c)(3) authorizes the Commissioner, in the case of a disqualifying provision designated as described in the preceding sentence, to impose limits

and provide additional rules regarding the amendments that may be made with respect to that disqualifying provision.

Pursuant to § 1.401(b)-1T(b)(3) and (c)(3), a plan provision is hereby designated as a disqualifying provision if the plan provision is integral to a qualification requirement changed by a provision of SBJPA that becomes effective on the first day of the first plan year beginning after December 31, 1998, provided that the following conditions are satisfied. First, the plan provision must be amended to reflect the change made by SBJPA by no later than the last day of the first plan year beginning after December 31, 1998. (If an employer or plan administrator files a request for a determination letter on the qualified status of a plan by the last day of the first plan year beginning after December 31, 1998, then the date by which the plan provision must be amended shall be extended through the 91st day following the applicable date under § 1.401(b)–1(e)(3)(i) or (ii).) Second, the plan provision as amended must be effective as of the first day of the first plan year beginning after December 31, 1998. Thus, if a plan uses the safe harbor methods for the plan year beginning in 1999, the plan generally must be amended no later than the end of that plan year, retroactive to the first day of that year, to reflect the safe harbor methods. This remedial amendment period also applies to a plan amendment reflecting the use of the early participation rules under §§ 401(k)(3)(F) and 401(m)(5)(C).

The preceding paragraph does not permit a CODA to be adopted retroactively. See § 1.401(k)–1(a)(3)(ii).

A plan amendment described in this section XI.B shall not be treated as violating the requirements of § 411(d)(6) merely because the plan amendment imposes the withdrawal restrictions required by § 401(k)(12)(E)(i), provided that those withdrawal restrictions do not apply with respect to contributions allocated as of a date before the first day of the first plan year beginning after December 31, 1998.

REQUEST FOR COMMENTS

The Service and Treasury invite comments and suggestions concerning the guidance provided in this notice. Comments are specifically requested as to whether there are circumstances (in addition to the first plan year of a newly established plan) in which the use of the safe harbor methods would be appropriately allowed for a plan year of less than 12 months (e.g., certain corporate merger or acquisition transactions involving a plan sponsor maintaining a plan using the safe harbor methods, if appropriate conditions are satisfied).

Comments can be addressed to CC:DOM:CORP:R (Notice 98–52), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 98–52), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may transmit comments electronically via the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1624.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this notice is in section V.C, "Notice Requirement," and section XI, "Plan Provisions Relating to Safe Harbors." The collection of information is required to obtain a benefit. The likely respondents are businesses or other for-profit institutions, and not-for-profit institutions.

The estimated total annual reporting/recordkeeping burden is 80,000 hours.

The estimated annual burden per respondent/recordkeeper is 1 hour and 20 minutes. The estimated number of respondents/recordkeepers is 60,000.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Drafting Information

The principal author of this notice is Roger Kuehnle of the Employee Plans Division. For further information regarding this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers), between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.