

IRS Issues Final Regulations for Automatic Contribution Arrangements Under 401(k) and Similar Plans

The Pension Protection Act of 2006 (PPA) included two significant provisions that encourage automatic contribution arrangements for elective pre-tax deferrals under 401(k), 403(b) and governmental 457(b) plans. Under an automatic contribution arrangement, if a participant fails to make any election to contribute or not to contribute pre-tax salary deferrals, pre-tax deferrals are automatically deducted at a specified, uniform percentage of pay, and continue to be deducted unless and until the participant affirmatively elects not to contribute or to contribute at a different percentage of pay.

The first of these PPA provisions applies only to 401(k) plans and provides a discrimination testing safe harbor (i.e., no discrimination test needs to be performed) for plans that adopt a "qualified automatic contribution arrangement" (QACA). A QACA requires automatic pre-tax deferrals at an increasing minimum percentage of pay, subject to a ten (10%) percent cap; minimum employer nonelective or matching contributions; two-year vesting for employer contributions; 401(k) restrictions on withdrawals; and the provision of an initial written notice and annual written notices thereafter.

The second PPA provision is available to 401(k), 403(b) and governmental 457(b) plans that adopt an "eligible automatic contribution arrangement" (EACA). If a plan with an EACA permits it, a participant for whom automatic pre-tax salary deferrals have been made may elect within the first ninety (90) days of eligibility under the EACA to withdraw all such deferrals. In addition, a 401(k) plan with an EACA, that fails 401(k) or 401(m) discrimination tests (an EACA that is not a QACA has no discrimination testing safe harbor), may make corrective distributions without penalty within six months (rather than 2 ½ months) after the end of the plan year. An EACA requires automatic pre-tax deferrals at a uniform percentage of pay, and provision of initial and annual written notices similar to those required for a QACA.

The IRS issued proposed regulations for QACAs and EACAs in November 2007. You can read a summary of the highlights of the proposed regulations by clicking on the attached link - [IRS Issues Proposed Regulations For Automatic Contribution Arrangements Under 401\(k\) And Similar Plans](#). The following are some of the key changes and other significant provisions under the final regulations:

- The preamble to the final regulations expressly confirms that the regulations do not apply to an automatic contribution arrangement that is not intended to be a QACA or EACA. Plan sponsors that are not interested in a 401(k) discrimination testing safe harbor, permitted withdrawals of initial automatic pre-tax deferrals, or an extended period for penalty-free distributions to correct discrimination testing failures need not adhere to these regulatory requirements and restrictions.
- An EACA need not invest automatic pre-tax deferrals in a qualified default investment alternative (QDIA). This change was made by the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) and is reflected in the final regulations.
- The proposed regulations appeared to require that an EACA cover all employees eligible to make pre-tax deferrals under the plan. The final regulations eliminate this requirement and allow the plan to designate those employees who are covered by one or more distinct EACAs under the plan. One implication of this change is that only employees covered by the EACA need receive the initial and annual written notices. Unless all employees eligible to make pre-tax deferrals under the plan are covered by the EACA, however, the plan cannot take advantage of the extended period for penalty-free distributions to correct discrimination testing failures. This extended correction period will not be available, for example, if the plan provides that an employee who makes an affirmative deferral election is no longer "covered" by the EACA.

- All EACAs under a plan must use the same default contribution as a percentage of compensation.
- If portions of a plan are mandatorily disaggregated for discrimination testing (e.g., portions of a plan covering union and non-union employees), those disaggregated portions of the plan may have different EACAs with different default contribution rates.
- The proposed regulations required that an employee who was immediately eligible under a QACA or EACA on his or her date of hire receive the required written notice no later than his or her hire date. The final regulations allow such an employee to receive the notice prior to the pay date for the payroll period that includes his or her hire date or other date of initial eligibility for the QACA or EACA.
- The proposed regulations required that an EACA be adopted before the beginning of the plan year. Commentators had requested that the regulations permit mid-year adoption of an EACA. The final regulations do not accommodate this request. EACAs must be adopted before the beginning of a plan year.
- EACA notices must include the comprehensive information required for QACA and other 401(k) safe harbor notices. Commentators had requested a less comprehensive notice requirement for EACAs, but the final regulations do not accommodate that request.
- If an EACA permits withdrawal of initial pre-tax deferrals, matching contributions relating to withdrawn pre-tax deferrals need not be made (and then forfeited) if those matching contributions would otherwise have been allocated prior to the withdrawal.
- A rehired participant who previously had contributions made under a QACA, but who had no contributions made under the QACA for at least a full plan year, can have contributions re-started under QACA at the lowest rate, as if he or she had not been covered by the QACA in prior years. Similarly, a rehired participant who had previously been covered by an EACA, but who had no contributions made under the EACA for a full plan year, will, if the plan so permits, be permitted to withdraw pre-tax deferrals made during the first ninety (90) days after he or she again becomes covered by the EACA, as if he or she had not been covered by the EACA in prior years.
- A QACA can provide for mid-year increases in the applicable minimum contribution percentage.
- Automatic pre-tax deferrals under a QACA or EACA must begin no later than the earlier of (a) the pay date for the second payroll period beginning after the date the employee receives the initial written notice, or (b) the first pay date that occurs at least thirty (30) days after receipt of the initial written notice.
- A QACA generally must enroll all employees eligible to make pre-tax deferrals and who have not made an affirmative election to participate or not to participate. In other words, if a current employee is not making pre-tax deferrals under a 401(k) plan, and the plan administrator has no evidence of an affirmative election not to participate, the employee must be automatically enrolled when the plan adopts a QACA.
- If a plan with a QACA does not automatically reinstate an affirmative deferral election after a six-month suspension following a hardship withdrawal, the employee must be automatically enrolled under the QACA.
- The QACA regulations generally apply to plan years beginning after 2007. The EACA regulations are effective for plan years beginning after 2009, subject to a good faith compliance standard for earlier years.

If you have questions or would like additional information about the final regulations for QACAs and EACAs, please feel free to contact Brian Dougherty at (215) 587-5919 or bdougherty@postschell.com.

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