



## Federal Agencies Publish Year-End Guidance Affecting Plan Design and Administration

**WHO'S AFFECTED** This guidance applies to sponsors of qualified defined benefit and defined contribution plans. Some of the guidance also applies to 403(b) programs.

**BACKGROUND AND SUMMARY** Recently, both the IRS and Department of Labor (DOL) published guidance affecting the administration of qualified plans.

The IRS issued Notice 2002-4, providing additional guidance regarding certain provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). This guidance addresses:

- The application of the universal availability requirement for catch-up contributions;
- The ability of a 401(k) plan to distribute assets upon severance from employment rather than separation from service (i.e., the elimination of the "same desk rule"); and
- The special limitation on elective deferrals when a participant receives a distribution of 401(k) deferral contributions due to a serious financial hardship.

At the same time, the DOL published final rules regarding the Taxpayer Relief Act of 1997 (TRA'97) requirement that plan sponsors provide copies of Summary Plan Descriptions (SPDs) and Summaries of Material Modifications (SMMs) to the DOL upon request. These rules also specify the penalties that will apply when a plan sponsor fails to provide the documents when requested.

**ACTION AND NEXT STEPS** Plan sponsors should review these rules to make sure they understand their impact on their qualified plans or 403(b) programs. If you have questions about how these new rules affect your plan, please contact your Prudential Retirement representative.

\*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

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## More EGTRRA Guidance

In Notice 2002-4, the IRS has provided guidance regarding:

- The application of the universal availability requirement for catch-up contributions;
- The ability of a 401(k) plan to distribute assets upon severance from employment rather than separation from service (i.e., the elimination of the "same desk rule"); and
- The special limitation on elective deferrals when a participant receives a distribution of 401(k) deferral contributions due to a serious financial hardship.

### Universal Availability of Catch-Up Contributions

The IRS previously published proposed rules for accepting catch-up contributions to 401(k) plans, 403(b) programs, and governmental 457 plans. These rules subject catch-up contributions to a special "universal availability" requirement. Under this requirement, all eligible plans sponsored by a single employer must offer the catch-up opportunity, or none of the plans may do so. The rules emphasized that for purposes of this requirement, a controlled group or affiliated service group of employers is considered to be a single employer.

The IRS has since received comments indicating that in many situations it would be difficult for employers to satisfy the universal availability requirement. For example, if members of a controlled group use multiple payroll systems, some members' plans and payroll systems may not have the ability to offer catch-ups as of January 1, 2002. Also, if an employer sponsors a plan that is qualified under Puerto Rico tax law as well as under the U.S. Code, the employer would be prohibited from offering catch-up contributions to other U.S. qualified plans since the Puerto Rico tax law currently does not provide for catch-up contributions.

In response to these concerns, the IRS has provided a transition period for members of a controlled group to implement the catch-up contributions. Controlled group members may now implement catch-up contributions on different dates during 2002, as long as all members begin offering catch-up contributions no later than October 1, 2002. In addition, until further guidance is issued, an employer that sponsors a Puerto Rico qualified plan as well as a U.S. qualified plan may allow catch-up contributions in just the U.S. qualified plan.

Plan sponsors should be certain that all members of their controlled group will be able to administer catch-up contributions by the October 1, 2002, deadline before they allow catch-ups.

If any controlled group member does not meet the deadline, the catch-up contributions made to the related employers' plan may be considered invalid.

Unfortunately, the IRS still has not provided guidance about the application of the universal availability rule in situations involving multiemployer and multiple employer plans.

### **401(k) Plan Distributions upon Severance from Employment**

Prior to EGTRRA, the "same desk rule" limited an employee's ability to take a distribution from his 401(k) plan if he was terminated due to a business transaction (e.g., sale of the business to a new employer) and continued to perform substantially the same job functions for the new employer. In this situation, if the participant did not incur a separation from service, he was not eligible for a distribution until he later terminated employment with the new employer. EGTRRA replaced the "separation from service" requirement to allow for distribution upon a participant's "severance from employment" with the employer sponsoring the plan. Plan sponsors that want to permit distributions following an employee's severance from employment must amend their plan documents to substitute "severance from employment" for "separation from service." The plan may be amended to allow for distributions upon severance from employment on or after January 1, 2002, regardless of whether the severance from employment occurred before, on, or after January 1, 2002 (or on or after some other date specified in the plan). A plan is not required to adopt the severance from employment language, however, if the plan is not amended, distributions can only be made in accordance to the plan's current terms (e.g., upon separation from service).

The IRS's EGTRRA model amendments do include an amendment to allow distributions on severance from employment with a choice of effective date. The model amendments are described in more detail in our October 2001 *Pension Analyst* titled "[IRS Publishes Model Amendment for EGTRRA.](#)"

### **401(k) Plan Hardship Withdrawals**

Under the pre-EGTRRA 401(k) "safe harbor" hardship withdrawal rules, a participant who takes a hardship withdrawal of his elective deferral contributions must be prohibited from making pretax and after-tax contributions to the plan for a period of at least 12 months. The amount of pretax contributions he could make to the plan in the year following the hardship withdrawal was also limited to the deferral limit for that year (e.g., \$11,000 in 2002) minus any deferrals made for the year of the hardship (the "post-hardship pre-tax limit").

EGTRRA reduced the required suspension period from 12 months to six months. However, the law did not address how the shortened suspension period would affect the participant's posthardship pre-tax limit.

The new IRS guidance allows 401(k) plans to eliminate the special post-hardship pre-tax limit effective for *calendar* years beginning after December 31, 2001. This would apply to participants who received hardship withdrawals in 2001 or later. A plan that wishes to eliminate the post-hardship pre-tax limit must adopt a good-faith amendment by the end of the *plan* year in which it is first applicable.

Plan sponsors that have already adopted a good-faith amendment to reduce the suspension period are deemed to have also adopted the provision to eliminate the post-hardship pre-tax limit and no additional amendment is required. Adoption of the IRS model amendment for this provision is considered to be a good-faith amendment. Plan sponsors that have not adopted a good-faith amendment to reduce the suspension period can adopt a good-faith timely amendment to eliminate the post-hardship pre-tax limit even if the plan continues to apply a 12-month suspension period.

Any plan that relies on the ADP and ACP safe harbor plan design to satisfy testing must comply with both the reduced suspension period and the elimination of the post-hardship pre-tax limit. Plan sponsors that have already adopted the good-faith model amendment reducing the suspension period have already met this requirement. Plan sponsors that have not adopted this good-faith amendment must do so in a timely manner if they wish to maintain the ADP and ACP safe harbor status.

## **DOL Finalizes Plan Document Disclosure Rules**

Sponsors of qualified plans, other than governmental plans and non-electing church plans, are subject to ERISA's disclosure rules. Since 1977, these plan sponsors had been required to automatically file summary plan descriptions (SPDs, also called employee booklets) and summaries of material modifications (SMMs) with the Department of Labor (DOL). However, TRA'97 eliminated this filing requirement, effective August 5, 1997. Now, plan sponsors must provide copies of these and other documents to the DOL only upon request. TRA '97 also gave the DOL the authority to assess civil penalties for failures to provide requested materials.

On January 7, 2002, the DOL published final regulations regarding these new disclosure rules. These regulations limit the documents that the DOL can request from plan sponsors to copies of SPDs, SMMs, and other documents that can be requested by a plan participant or beneficiary. For qualified plan purposes, a participant or beneficiary is:

- A participant or beneficiary, as defined by ERISA;
- An alternate payee under a qualified domestic relations order (QDRO) or prospective alternate payee (spouse, former spouse, children, or other dependents); or
- A representative of any of the above.

The DOL will only request these documents when a participant or beneficiary has already requested, in writing, a copy from the plan administrator and the plan administrator has failed or refused to furnish them.

If a plan administrator does not provide the materials requested by the DOL within 30 days of the request, the DOL may assess a civil penalty of up to \$100 a day, to a \$1000 maximum per request. Generally, a document is considered to be furnished on the date it is received at the address listed in the request. However, if the document is sent by certified mail, it is considered furnished on the date that it is mailed to the DOL. The DOL will not impose a penalty if the plan administrator files a statement within 30 days of the request, showing the failure resulted from matters reasonably beyond his control.

The DOL also clarified that it will not keep copies of documents requested on behalf of participants and beneficiaries. However, the DOL will continue to keep copies of the SPDs and

SMMs that were filed prior to TRA '97.

These final regulations are effective beginning March 8, 2002.



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## COMPLIANCE CLIPS

### Additional Plan Amendments May Be Needed

As reported in our February 2001, *Pension Analyst* titled "[Year-End Developments Affect Qualified Plans](#)," the Consolidated Appropriations Act of 2001, which included the Community Renewal Tax Relief Act of 2000 (CRA), revised the definition of "compensation" used for various qualified plan purposes. This revised definition of compensation treats section 132(f)(4) salary reductions for qualified transportation fringe benefits just like section 125 cafeteria plan salary reductions and includes them in participants' "section 415 compensation." CRA made this change retroactively effective for years beginning after December 31, 1997, leaving plan sponsors wondering how to comply for years prior to 2001.

As a result, the IRS published Notice 2001-37, providing guidance for applying this change and reflecting it in plan documents. Plan sponsors that do not offer qualified transportation fringe benefit salary reductions do not need to take any action. Plan sponsors that do offer these programs need to operate their plans in accordance with the CRA compensation definition for plan years and limitation years beginning on or after January 1, 2001. In addition, they must adopt the appropriate plan amendment by the plan's GUST\* amendment deadline. The IRS provided a model amendment that plan sponsors may adopt to meet this requirement.

The GUST amendment deadline for individually designed plans is February 28, 2002, at the earliest. Plans that use prototype or volume submitter documents, and plans that were directly affected by the September 11, 2001, terrorist attacks may have later amendment deadlines. Our November 2001, *Pension Analyst* Compliance Bulletin titled "IRS Extends GUST Amendment Deadline" provides a detailed discussion of these revised deadlines.

If Prudential provides document services for your plan, we will be contacting you to make sure your document is updated in a timely fashion. In some situations, plan sponsors may have to adopt a separate CRA amendment.

\* "GUST" refers to: The Uruguay Round Agreements Act, the Uniformed Service Employment and Reemployment Rights Act of 1994, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, the Internal Revenue Service Restructuring and Reform Act of 1998, and the Community Renewal Tax Relief Act of 2000.

### EGTRRA ESOP Dividend Reinvestment Rules

Effective for tax years beginning after December 31, 2001, an employer may deduct dividends paid to an ESOP that are reinvested in employer stock. To be able to take this deduction, the plan must be an ESOP as of the record date of the dividends and the participants must be provided an election to have the dividend paid in cash or paid to the ESOP and reinvested in employer stock or distributed.

Recent IRS guidance clarifies that participants must be provided an election to:

- Receive the payment of dividends in cash, or have the dividend paid to the ESOP and distributed in cash no later than 90 days after the close of the plan year in which the dividends are paid by the corporation; or
- Have the dividends paid to the ESOP and reinvested in employer stock; or
- Choose a combination of the above options.

Participants must be given a reasonable opportunity before the dividend is paid or distributed to make an election and must be able to change the election at least annually. If a participant does not make an election, the employer may provide for a default election.

The tax year in which an employer may take a deduction for these dividends depends on whether the dividend is reinvested or is paid or distributed as cash.

In addition, the guidance provides that:

- Earnings on dividends paid to the ESOP are not deductible.
- Investment losses on dividends paid to the ESOP reduce the amount that is available to be paid to the participant as cash or reinvested in stock and therefore reduces the amount that is deductible by the employer.
- A participant may be restricted from reinvesting the dividends if he is currently applying for a hardship withdrawal from any 401(k) plan sponsored by the employer.
- Any dividends that are reinvested into employer stock in accordance with a participant's election are treated as earnings and are subject to the same requirements as other earnings in the plan.
- Dividends that are reinvested must be fully vested.
- Reinvested dividends are not considered plan contributions and do not count toward a participant's annual additions limit or elective deferral limit and are not included in the ADP and ACP tests.

An employer that wishes to deduct reinvested dividends must adopt a good-faith plan amendment by the end of the plan year that includes the last day of the employer's first tax year in which the employer seeks the deduction.

## **California Privacy Law**

Last year, the California legislature passed Senate Bill 168. While the entire bill concerns identity theft, one part of it focuses on confidentiality of Social Security Numbers (SSNs). The law applies generally to persons or entities operating in California, and, in most cases, is effective July 1, 2002.

In general, this law prohibits five activities involving SSNs:

- Publicly posting or publicly displaying an individual's SSN.
- Printing SSNs on any card required for an individual to access products or services.
- Requiring an individual to transmit his or her SSN over the Internet, unless the connection is secure or the SSN is encrypted.
- Requiring an individual to use an SSN to access a Web site, unless a password, unique



PIN or other authentication device is also required to access the site.

- Printing an individual's SSN on materials (other than forms or applications) that are mailed to that individual, unless federal or state law requires that SSNs be included.

At Prudential, we have examined the new law and have decided to bring *all* of our operations into compliance with these standards, not just those involving California residents. While the impact on our business is relatively modest, there are a few existing practices that will be changed in accordance with the law.

For more details on Prudential's compliance efforts with the California privacy law, please contact your Prudential representative.

**Pension Analyst by Prudential Retirement**

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