Pension ANALYST

Important Information	Plan Administration and Operation	September 2004

IRS Provides Plan Administration Guidance

WHO'S AFFECTED This guidance applies to both qualified defined benefit and defined contribution plans, including 401(k) plans. With the exception of the extended amendment deadline, this guidance also applies to 403(b) plans.

BACKGROUND AND SUMMARY Earlier this year, the IRS issued assorted guidance relating to the operation of qualified plans and 403(b) plans. Specifically, the IRS has:

- Extended the amendment deadline for certain new plans and plan amendments adopted after December 31, 2001;
- Proposed revisions to the minimum coverage testing rules for 401(k) plans when some employees are eligible to make contributions to a 403(b) plan, rather than to the 401(k) plan; and
- Clarified that 401(k) and 403(b) automatic enrollment deferral contributions are subject to the same legal and plan limits as deferrals that are contributed through an affirmative election.

ACTION AND NEXT STEPS Plan sponsors should review the information in this publication to determine which items apply to their plans. If you have questions about the application of any of these provisions to your plan, please contact your Prudential Retirement representative for assistance.

IN THIS ISSUE

Prudential Financial

PRUDENTIAL RETIREMENT

Extension of Amendment Deadline

In general, a qualified plan may be amended after the end of a plan year to retroactively correct disqualifying provisions only if the corrective (or "remedial") amendment is adopted no later than the filing deadline for the sponsoring employer's federal income tax return, including extensions. A "disqualifying provision" is any provision in a new plan, the absence of a provision from a new plan, or any amendment to an existing plan, which could cause the plan to be disqualified.

For example, Employer X is a corporation with a calendar tax year. Employer X's standard tax filing deadline for 2004 is March 15, 2005, but Employer X requests a six-month extension to September 15, 2005. Employer X establishes Plan A, a money purchase pension plan with a calendar plan year, effective January 1, 2004. Employer X discovers in early 2005 that the Plan A plan document erroneously permits participants to take in-service withdrawals (although no such withdrawals have actually been taken). Employer X may adopt a corrective amendment eliminating this provision, retroactively effective as of January 1, 2004, as late as September 15, 2005.

In Revenue Procedure 2004-25, the IRS extended the deadline for correcting disqualifying provisions in new plans put into effect after December 31, 2001, and any amendments to existing plans adopted after December 31, 2001. This extended deadline is the deadline for amending plans to comply with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which is currently no earlier than the last day of the plan's 2005 plan year.

As a result of this extension, sponsors of new plans will be able to wait to file requests for initial determination letters until the IRS reviews plans for EGTRRA. If the IRS finds a disqualifying provision at that time, the plan sponsor will be allowed to retroactively amend the plan to correct the problem.

It is important to note that this amendment deadline *extension does not apply to* the adoption of:

- GUST amendments for existing plans;
- EGTRRA "good faith" model amendments;
- Amendments to reflect final minimum required distribution regulations;
- Amendments to defined benefit plans to comply with applicable mortality table requirements; or
- Amendments to comply with "deemed section 125 compensation" rules.

Proposed Revisions to Minimum Coverage Rules

The IRS has published proposed revisions to the qualified plan minimum coverage testing rules. These revisions affect controlled groups that include both a 501(c)(3) tax-exempt employer and a for-profit employer. A 501(c)(3) tax-exempt employer is eligible to sponsor both a 401(k) plan and a 403(b) plan, while a for-profit employer can sponsor a 401(k) plan, but not a 403(b) plan.

Prior to the enactment of the Small Business Job Protection Act of 1996 (SBJPA), nongovernmental tax-exempt organizations could only sponsor a 401(k) plan if the plan had been in existence before July 2, 1986. Between 1986 and 1996, a special rule allowed for-profit entities to treat the employees of related tax-exempt organizations that could not sponsor 401(k) plans as "excludable" for minimum coverage testing purposes. When SBJPA allowed nongovernmental tax-exempt organizations to again sponsor 401(k) plans, the special rule was eliminated due to the way it was worded. EGTRRA resurrected the rule retroactive to 1997 plan years, and these proposed revisions relate to the EGTRRA provision.

Under the proposed rules, employees who are eligible to make elective deferral contributions to an employer's 403(b) plan may be treated as "excludable employees" for minimum coverage testing purposes under a related employer's 401(k) and 401(m) arrangements. This rule helps the 401(k) and 401(m) arrangements pass the minimum coverage test. However, the exclusion does not apply to minimum coverage testing of other types of contributions (e.g., profit sharing or nonelective contributions) made to a 401(k) plan or a separate plan.

Employees of the tax-exempt organization are considered "excludable employees" for these purposes if they are eligible to make contributions to an ERISA 403(b) plan or non-ERISA 403(b) program and:

- No employee of the tax-exempt organization is eligible to participate in the section 401(k) or section 401(m) plan; and
- At least 95% of the for-profit employer's employees are eligible to participate in the 401(k) or 401(m) arrangement.

The IRS has proposed to make these rules effective retroactively, to plan years beginning on or after December 31, 1996. Plan sponsors may follow these proposed rules until the IRS publishes final rules. However, this provision is subject to the EGTRRA sunset rule. Unless Congress takes action to make it permanent, it will not be available for plan years beginning after December 31, 2010.

Automatic Enrollment Deferral Limits

A plan that uses "automatic enrollment" provides that eligible employees are automatically enrolled in the plan at a specified elective deferral rate, unless the employee elects to defer at a different rate, or elects not to participate. Past IRS guidance on automatic enrollment arrangements commonly included examples of a 3% elective deferral rate. Therefore, there was some question in the industry as to whether a 3% automatic enrollment arrangement was "safe harbor," and whether automatic enrollment arrangements with an elective deferral rate of greater than 3% were acceptable.

In an information letter issued earlier this year, the IRS clarified that there is no special deferral limit for amounts that are contributed by automatic enrollment to a 401(k) plan or 403(b) plan. Automatic enrollment deferrals are subject to the same statutory and plan limits as deferrals that are contributed through an affirmative election. Therefore, plans are not limited to an elective deferral rate of 3% of compensation under an automatic enrollment arrangement.

In addition, the automatic enrollment percentage under a plan may increase or otherwise change over time, according to a specified schedule. The automatic enrollment percentage may also increase with future increases or supplements to compensation (e.g., pay raises and bonus). However, the IRS cautions that the automatic enrollment notices provided to employees must describe the amounts and timing of any planned changes to the automatic enrollment or how the election would apply to any future compensation increases.

Pension Analyst by Prudential Retirement
The Pension Analyst is published by Prudential Retirement, a Prudential Financial business, to provide clients with up-to-date information on current legislation and regulatory developments affecting qualified retirement plans.

Editor: Mitzi Romano (860) 534-2768