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TCRS 2009-03: Final Regulations on Automatic Contribution Arrangements

On February 24, 2009, the Internal Revenue Service (IRS) published final regulations relating to automatic contribution arrangements. An automatic contribution arrangement is an arrangement that provides for a cash or deferred election and which specifies that a covered employee who fails to affirmatively elect to defer (or not defer by making a 0% deferral election) is deemed to have made a default election to contribute the automatic deferral percentage set by the plan.

Background

In November 2007, proposed regulations relating to automatic contribution arrangements were issued. Public comments on the proposed regulations were received and a public hearing was held in May 2008. After consideration of the comments, the IRS published these final regulations based on the proposed regulations with certain modifications and clarifications. [Click here for TCRS 2007-08 to access our summary of the proposed regulations.](#)

The most significant modifications and clarifications to the proposed regulations are highlighted in the summary below.

Scope of Final Regulations

These final regulations apply to plan sponsors who maintain qualified 401(k) plans, 403(b), 457(b) governmental, 408(k)(6) Simplified Employee Pension and 408(p) SIMPLE plans that contain an automatic contribution arrangement.

Only Eligible Automatic Contribution Arrangements (EACAs) and Qualified Automatic Contribution Arrangements (QACAs) are covered by the final regulations. Plan sponsors of Automatic Contribution Arrangements (ACAs) that are not intended to be EACAs or QACAs must look to the final 401(k) regulations issued in 2004 for guidance.

The following changes made by the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) are reflected in these final regulations:

- For plan years beginning on and after January 1, 2008, the requirement that gap period income (the income from the last day of the employee's taxable year to the date of distribution) be distributed with distributions of excess deferrals was eliminated.
- For plan years beginning on and after January 1, 2008, income on distributed excess ADP/ACP contributions must be included in taxable income in the year of distribution.

Effective Date

The EACA modifications are effective for plan years beginning on and after January 1, 2010. For plan years that begin in 2008, EACAs must be operated in accordance with a good faith interpretation of Internal Revenue Code (IRC) section 414(w); which means in accordance with the proposed regulations or these final regulations. The final regulations do not address what happens in plan years that begin in 2009.

The QACA modifications are generally effective for plan years beginning on and after January 1, 2008, except where a later date is indicated (for example, the requirement to use compensation that meets the nondiscriminatory rules of Treasury Regulation section 1.414(s)-1 is effective for plan years beginning on or after January 1, 2010).

EACAs

- An EACA may be implemented for only a select group of employees, for example, new hires. Effective for plan years beginning on or after January 1, 2010, if the EACA does not automatically enroll all eligible

employees, the 6-month extended period for distributing excess ADP/ACP contributions will not be available to the EACA.

- Generally, an EACA may not be implemented mid-year. But, because an EACA may be implemented for only a select group of employees, such as new hires, a plan sponsor wishing to cover new hires only may implement the EACA mid-year.
- A plan may permit multiple EACAs for different groups of employees under a plan. The final regulations require such multiple EACAs to be aggregated and the default percentage to be uniform, unless the groups are mandatorily disaggregated for plan purposes, such as for the coverage rules of IRC section 410(b). Examples of groups that are mandatorily disaggregated are adopting employers under a multiple employer plan, union/non-union groups, groups tested separately under the early participation rules that apply to 401(k) plans and qualified separate lines of business.
- The final regulations require the plan document to specify which employees are covered under an EACA and whether an employee who made an affirmative election remains covered under the EACA. Further, the final regulations require the notice regarding an employee's rights and obligations to be provided only to those employees to be covered under the EACA.
- The final regulations provide that if it is not practicable (based on the plan sponsor's unique facts and circumstances) for the required employee notice to be provided on or before the eligibility date, the plan sponsor may provide the notice after the eligibility date but prior to the pay date for the payroll period that includes the date the employee becomes eligible, provided deferrals are permitted from compensation (as defined under the plan) starting from the eligibility date.

QACAs

- The final regulations clarify that a QACA must automatically enroll all eligible employees, except employees who had an affirmative election in place immediately before the effective date of the QACA.
- To address the issue of plans with immediate eligibility, the final regulations permit a plan sponsor to provide the QACA required employee notice after the eligibility date but prior to the pay date for the payroll period that includes the date the employee becomes eligible. Note that the final regulations extend this rule to the employee notice required for traditional 401(k) safe harbor plans.
- In determining when a rehired employee first had automatic deferrals made on his behalf for purposes of the QACA minimum automatic deferral percentage (see TCRS 2007-08 for the required minimum automatic deferral percentage under a QACA), the final regulations provide that such percentage is determined based on the number of years since the employee first had automatic deferrals made to the QACA. However, in order to address recordkeeping concerns, the final regulations permit a QACA to treat a rehired employee who did not have automatic deferrals made on his behalf for an entire plan year as though the year of rehire of the employee is his/her first year (initial period) under the QACA.
- For plan years beginning on or after January 1, 2010, the compensation that must be used in determining automatic deferrals is compensation that meets the nondiscriminatory rules of Treasury Regulation section 1.414(s)-1. This is the same rule that applies to traditional 401(k) safe harbor plans.
- To address the issue of whether a QACA may provide for an increase in the automatic deferral percentage mid-year (to coincide with salary increases or performance evaluations), the final regulations provide that such an increase is permitted as long as the increase is uniform for all employees and the QACA minimum automatic deferral percentage for the entire year is satisfied.
- The final regulations do not permit a plan to treat employees who did not affirmatively elect to make deferrals prior to the effective date of the QACA as though they had affirmatively elected zero (0) deferrals. Thus, only employees who had an affirmative election in effect immediately before the QACA became effective may be excluded from being automatically enrolled. This may cause undue burden for plan sponsors who do not have the records to determine if an employee made an affirmative election not to join the plan.
- The final regulations clarify that QACA safe harbor contributions are not available for hardship withdrawals.

- The final regulations further clarify that the QACA safe harbor contributions apply to all eligible employees, even those who are not automatically enrolled (because they had an affirmative deferral election in effect).

90-Day Opt-Out

- For plan sponsors concerned about inadvertently permitting an automatically enrolled employee to make a withdrawal election outside of the 90-day opt-out period, the final regulations permit the use of an earlier deadline for making this election, as long as it is at least 30 days.
- The latest effective date of a withdrawal election was modified from the proposed regulations. Under the proposed regulations, the effective date of the withdrawal election must be no later than the last day of the payroll period that begins after the date the election is made. In response to commentators' requests, the final regulations provide that the latest effective date of the withdrawal election cannot be after the earlier of: 1) the pay date for the second payroll period beginning after the election is made, and 2) the first pay date that occurs at least 30 days after the election is made. The final regulations permit a plan to use an earlier effective date for the withdrawal.
- The final regulations clarify when the withdrawal amount may be distributed. According to the final regulations, the distribution must be processed in accordance with the plan's ordinary timing procedures for other plan distributions. The final regulations also clarify that a plan may charge a fee for processing the withdrawal, but the plan cannot charge a higher fee than would apply to any other cash distribution from the plan.
- The final regulations provide clarification on the required forfeiture of matching contributions that relate to withdrawn automatic deferrals under the 90-day opt-out provision. According to the final regulations, the forfeiture applies to matching amounts that have been allocated to the employee's account, adjusted for gains/losses. The final regulations permit a plan to provide that matching contributions do not have to be made if the withdrawal of automatic deferrals has been made prior to the date the match would have been allocated to an employee's account.

This Summary is designed to provide an overview of the Final Regulations on Automatic Contribution Arrangements and is not intended to be comprehensive. The Transamerica Center for Retirement Studies® ("The Center") is a non-profit corporation and private operating foundation. The Center may be funded by contributions from Transamerica Life Insurance Company and its affiliates or other unaffiliated third-parties. For more information about The Center, please refer to www.transamericacenter.org. The Center and its representatives cannot give ERISA, tax or legal advice. This material is provided for informational purposes only and should not be construed as ERISA, tax or legal advice. Interested parties must consult and rely solely upon their own independent advisors regarding their particular situation and the concepts presented here. Although care has been taken in preparing this material and presenting it accurately, The Center disclaims any express or implied warranty as to the accuracy of any material contained herein and any liability with respect to it.