Employee Plans CPE Technical Topics for 1999

SUMMARY OF PLAN REQUIREMENTS, NOTICES 97-2 AND 98-1, DISTRIBUTION OF EXCESS CONTRIBUTIONS AND ADP/ACP USING PRIOR YEAR METHOD

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CP:E

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I. INTRODUCTION

This section summarizes the determination letter requirements of Notice 97-2, 1997-1 C.B. 348, and Notice 98-1, 1998-3 I.R.B. 42. These notices provide guidance on amendments made by the Small Business Job Protection Act (SBJPA), including changes to the nondiscrimination rules under sections 401(k) and 401(m) of the Code.

The actual deferral percentage(ADP) test under section 401(k) tests for nondiscrimination in a qualified cash or deferred arrangement (CODA). This test compares the elective contributions contributed by the eligible highly compensated employees (HCEs) as a percentage of compensation with the elective contributions contributed by the eligible nonhighly compensated employees (NHCEs) as a percentage of compensation. The actual contribution percentage(ACP) test under section 401(m) is similar, except it applies to employee and matching contributions rather than elective contributions.

The SBJPA amended these sections to permit using prior plan year data in determining the ADP and ACP for NHCEs, unless the employer elects to use current plan year data. Current plan year data must be used for HCEs. Using prior year data simplifies plan administration for employers because the employer can determine ahead of time the maximum amount of of elective contributions and matching contributions that can be made on behalf of HCEs without violating the ADP and ACP tests. In addition, since the NHCE ADP/ACP can be determined as early as the beginning of the testing year, employers have more time to plan for correction and avoid all penalties. Other changes made by the SBJPA include changes in reallocating excess contributions and excess aggregate contributions to HCEs when correcting the plan=s failures to meet the ADP/ACP tests.

A plan must provide for the ADP or ACP tests by either:

specifically providing for these tests, or

incorporating these tests by reference.

A plan must also provide the correction methods to be implemented by the employer in the case of ADP or ACP test failures.

II. PLANS THAT INCORPORATE THE ADP/ACP TESTS BY REFERENCE

A plan that incorporates the ADP and ACP provisions by reference must:

specify the applicable Code sections and regulations,

specify that the plan is incorporating subsequent Internal Revenue Service guidance issued under the applicable Code provisions,

specify which of the two testing methods is being used (prior or current year), and

specify whether the ADP and ACP for NHCEs for the prior plan year is 3% or the current year's ADP and ACP if the first plan year rule applies.

If the plan provides for the distribution of excess contributions/excess aggregate contributions to correct ADP/ACP failures, the plan must be amended to provide that these distributions are reallocated on the basis of the HCE(s) with the highest dollar amount of elective deferrals (or employee and matching contributions), effective for plan years beginning after 12/31/96.

III. CURRENT OR PRIOR YEAR TESTING METHOD

A. Current or prior year testing method

For the 1997 plan year, section II of Notice 97-2 provides that no amendment is needed for an employer to use the current year testing method to determine the ADP/ACP for NHCEs when the current year testing methods (Pre-SBJPA rules) are spelled out in the plan. However, the plan must be amended if the prior year testing method is used for the 1997 plan year.

A plan must specify either the current or prior year testing method (see section III of Notice 98-1) and must be amended for any change in testing method.

B. Switching current and prior year methods

Notice 98-1, section VII, contains guidance on changing from the current year testing method to the prior year testing method. There is no restriction on switching from the prior to current year method.

There is also no restriction on switching from the current to the prior year testing method **during the plan's SBJPA remedial amendment period (which is the last day of the 1999 plan year for most plans).**

For plan years beginning after the end of the SBJPA remedial amendment period, the employer can switch from current to prior year in the following two situations:

Mergers and acquisition rule: As a result of an acquisition, merger or similar transaction, the employer maintains both a plan using the prior year testing method and a plan using the current year testing method. The change from current to prior year must occur **by the end of the first plan year beginning after the transaction.**

5 year rule: The plan (or if aggregated, each of the aggregated plans) has used the current year testing method for each of the 5 plan years preceding the plan year that changed to the prior year method (or if lesser, the number of plan years in which the plan has been in existence, including years in which the plan was a portion of another plan).

Although the plan must be amended for any change in testing method, notification or prior approval of the Service is not required for the change to be valid. However, the employer may apply for a determination letter on the plan amendment.

C. Remedial amendment period

Rev. Proc. 97-41, 1997-2 C.B. 489, extends the remedial amendment period for SBJPA generally to the last day of the first plan year beginning on or after January 1, 1999.

Any plan amendments to reflect a choice in testing method are not required to be adopted before the end of this remedial amendment period.

However, plans **must** be operated in accordance with the SBJPA changes as of the statutory effective date which, for the changes discussed in this section (such as the ADP/ACP testing method and distribution of excess contributions), is plan years beginning after 12/31/96 (i.e., plan years beginning after December 31, 1996).

In addition, any retroactive amendments must reflect:

the choices made in the operation of the plan for each testing year, including the choice of testing method, and
the date(s) on which the plan began to operate in accordance with those choices (and any changes).

IV. FIRST PLAN YEAR RULE

Under the prior year testing method, for the first year (current year) that the plan contains a cash or deferred arrangement (CODA), the plan must specify whether the prior year's NHCE ADP/ACP is to be 3% or the current year's actual ADP and ACP for NHCEs. (See section V and IX of Notice 98-1.)

If the first year's actual NHCE ADP and ACP is used, the plan is still considered to be using the prior year testing method. The first year's percentage becomes the prior year's percentage for the next plan year's ADP/ACP tests without any double counting limitation, as described in section VII of Notice 98-1.

A. Defining first plan year

The first plan year is the first year in which:

the plan provides for elective contributions, in the case of the ADP test, or

the plan provides for employee contributions, matching contributions or both, in the case of the ACP test.

There is no first plan year for the ADP or ACP test if a plan is aggregated under section 1.401(k)-1(g)(11) or section 1.401(m)-1(f)(14) with any other plan that included a section 401(k) plan or included a section 401(m) plan in the prior year.

The first plan year rule does not apply if the plan is a successor plan (that is 50% or more of the eligible employees for the first plan year were eligible employees under another section 401(k) plan (or section 401(m) plan if applicable maintained by the employer in the prior year).

V. DISTRIBUTION OF EXCESS CONTRIBUTIONS AND EXCESS AGGREGATE CONTRIBUTIONS

Under the SBJPA, a plan that provides for distributions of excess contributions must be amended to provide that excess contributions are distributed to the HCEs with the highest dollar amount of elective contributions (rather than the highest percentages) using the leveling method. Thus, the SBJPA did not

change how the dollar amount of the total reduction is calculated, but did change how these amounts are allocated to HCEs. Returning excess contributions to correct the ADP failure (or excess aggregate contributions to correct the ACP failure) is based on each HCE's elective contributions as a straight dollar amount, rather than on an HCE's elective contributions as a percentage of compensation (the pre-SBJPA rule). This method often results in more highly paid HCEs receiving distributions than under the pre-SBJPA rule.

Section III of Notice 97-2 provides the method to calculate the distributions:

> Determine the dollar amount of excess contributions under the leveling method based on percentages of compensation.
>
> Allocate and distribute the excess contributions to the HCE (or HCEs) with the highest dollar amount of elective contributions until the elective contributions left in the HCE's (or HCEs') account is equal to the HCE (or HCEs') with the next highest dollar amount of elective contributions. Repeat this allocation and distribution until every dollar of the excess contributions have been allocated and distributed. Notice 97-2 and Chapter 1 of CPE97 provide an example of the leveling method.

After using this method, the plan may still fail the ADP/ACP tests because they are based on elective contribution percentages rather than actual dollar amounts. However, the plan is treated as satisfying the ADP/ACP tests.

VI. ADJUSTMENTS TO THE PRIOR YEAR-S NHCE ADP/ACP-PLAN COVERAGE CHANGE

In general, under the prior year testing method, the ADP and ACP for NHCEs for the prior plan year is determined without regard to changes in the group of NHCEs for the testing year. Thus, even though some NHCEs are no longer employed or some NHCEs become HCEs in the testing year, these changes do not affect the ADP and ACP for these employees for the prior year.

Notice 98-1 provides for modifications to the prior year's NHCE ADP and ACP if a plan undergoes a "plan coverage change" (mergers, etc.) that takes place during the testing year. With respect to required plan language for a plan coverage change, a plan can incorporate section 401(k)(3) and section 401(m)(2) by reference that satisfies the requirements of section IX of Notice 98-1. Otherwise, the plan **must provide** for the adjustment of the ADP/ACP for

NHCEs in the event of a plan coverage change under section VI of Notice 98-1, including the following definitions provided by Notice 98-1:

Plan coverage change,

prior year subgroup,

weighted average of the ADPs/ACPs for the prior year subgroups, and

adjusted ADP/ACP.

Also, if the employer chooses to use the optional rule for minor plan coverage changes, the plan must provide for this rule. This rule permits the use of the ADP/ACP from one subgroup (instead of the weighted average of all subgroups) if the NHCEs of such subgroup constitute 90% or more of the total number of NHCEs from all prior year subgroups.

VII. MISCELLANEOUS

While this outline focuses on the determination letter requirements, other guidance in Notice 98-1 (mainly operational) includes:

(1) When qualified nonelective contributions (QNCs) and qualified matching contributions (QMACs) may be taken into account in calculating the ADP and ACP test,

(2) nondiscrimination testing of QNCs under the prior year testing method, and

(3) limits on double counting for testing years beginning on or after January 1, 1999. (Note that when a plan changes from current to prior year testing, the ADP and ACP for NHCEs could be used twice.)

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This section contains Notices 97-2, 98-1, as well as Rev. Proc. 97-9 with respect to Simple 401(k) plans

Notices 97-2 and 98-1 are reproduced below.

Part III. Administrative, Procedural and Miscellaneous

Cash or Deferred Arrangements; Nondiscrimination

Notice 97-2

This notice provides guidance and transition relief relating to the revised nondiscrimination rules under ' 401(k) and ' 401(m) of the Internal Revenue Code. The rules applicable to qualified cash or deferred arrangements under ' 401(k) and matching and employee contributions under ' 401(m) were changed by the Small Business Job Protection Act of 1996 (SBJPA), Pub. L. 104-188.

Under ' 401(k) and ' 401(m) of the Code, the actual deferral percentage (ADP) and the actual contribution percentage (ACP) of highly compensated employees (HCEs) are compared with those of nonhighly compensated employees (NHCEs).

Section 1433(c) of the SBJPA amends ' 401(k)(3)(A) and ' 401(m)(2)(A), effective for plan years beginning after December 31, 1996, to provide for the use of prior year data in determining the ADP and ACP of NHCEs, while current year data is used for HCEs. Alternatively, an employer may elect to use current year data for determining the ADP and ACP for both HCEs and NHCEs, but this election may only be changed as provided by the Secretary.

> Prior to the effective date of these amendments, plans must use current year data in determining the ADP and ACP for both HCEs and NHCEs.

Section 1433(e) of the SBJPA amends ' 401(k)(8)(C) and ' 401(m)(6)(C), effective for plan years beginning after December 31, 1996, to provide that the distribution of excess contributions and excess aggregate contributions will be made on the basis of the amount of contributions by, or on behalf of, each HCE.

Prior to the effective date of these amendments, plans must distribute excess contributions and excess aggregate contributions using a method based on the actual deferral ratio or actual contribution ratio of each HCE.

This notice provides guidance regarding:

the determination of the ADP and ACP for NHCEs under ' 401(k)(3)(A)(ii) and ' 401(m)(2)(A) for plan years beginning after December 31, 1996;

transition relief for plans that elect to use current year ADP or ACP data for the 1997 plan year; and

the distribution of excess contributions and excess aggregate contributions under ' 401(k)(8)(C) and ' 401(m)(6)(C) for plan years beginning after December 31, 1996.

I. DETERMINATION OF ADP AND ACP FOR NHCEs USING PRIOR YEAR DATA

Section 401(k)(3)(A)(ii), as amended, provides that a cash or deferred arrangement will not be treated as a qualified cash or deferred arrangement unless the actual deferral percentage for eligible HCEs for the plan year meets a nondiscrimination test when compared to the actual deferral percentage for all other eligible employees for the preceding plan year. Thus, as amended, ' 401(k)(3)(A)(ii) generally requires the comparison of the current year's ADP for HCEs to the prior year's ADP for NHCEs.

For purposes of ' 401(k)(3)(A)(ii), the actual deferral percentage for all other eligible employees for the preceding plan year is the ADP for the preceding plan year for the group of employees who were NHCEs in the preceding plan year, using the definition of HCE in effect for the preceding plan year.

Thus, for purposes of ' 401(k)(3)(A)(ii), the individuals taken into account in determining the prior year=s ADP for NHCEs are those individuals who were NHCEs during the preceding year, without regard to the individuals' status in the current year. For example, an individual who was an NHCE for the preceding plan year is included in this calculation even if the individual is no longer employed by the employer or has become an HCE in the current plan year.

As a result, the prior year=s ADP for NHCEs can be calculated as soon as the necessary data on prior year status, contributions and compensation become available.

For example, for the 1997 plan year, if a plan does not provide for matching contributions described in ' 401(m)(4)(A) or qualified nonelective contributions described in ' 401(m)(4)(C), the ADP for the 1997 plan year of HCEs will be compared with the ADP for the 1996 plan year of NHCEs in 1996, i.e., with the same ADP used in nondiscrimination testing for the 1996 plan year under prior law.

Future guidance will address the conditions under which and the extent to which matching contributions described in ' 401(m)(4)(A) and qualified nonelective contributions described in ' 401(m)(4)(C) may be taken into account in determining the current or prior year=s ADP or ACP for NHCEs in nondiscrimination testing for the 1997 plan year and future plan years.

For purposes of determining the prior year=s ACP for NHCEs under ' 401(m)(2)(A), as amended, rules similar to those used in determining the prior year's ADP for NHCEs under ' 401(k)(3)(A)(ii) will apply.

II. TRANSITION RELIEF FOR PLANS USING CURRENT YEAR ADP OR ACP DATA FOR THE 1997 PLAN YEAR

Under ' 401(k)(3)(A)(ii) and ' 401(m)(2)(A), as amended, an employer that elects to use current year data in determining the ADP or ACP of NHCEs for the 1997 plan year or for later plan years must continue to use current year data for all future plan years, unless the election is changed in a manner provided by the Secretary.

Under the transition relief provided by this notice, a plan that uses current year data in determining the ADP or ACP of NHCEs for the 1997 plan year will be permitted to use prior year data for the 1998 plan year without receiving approval from the Service.
For the 1997 plan year, no plan amendment or formal election is required to be made in 1996 or 1997 in order to continue to use current year data in determining the ADP of NHCEs. The Treasury and the Service intend to issue guidance regarding the conditions under which employers that elect to use current year data for the 1998 or a later plan year may switch to using prior year data for subsequent plan years.

III. DISTRIBUTION OF EXCESS CONTRIBUTIONS AND EXCESS AGGREGATE CONTRIBUTIONS

Section 401(k)(8), as amended, provides a new procedure for correcting a plan's failure to meet the nondiscrimination test of ' 401(k)(3). Under ' 401(k)(8)(B), which was not amended by the SBJPA, an excess contribution is determined for each HCE. Section 401(k)(8)(C), prior to amendment, and ' 1.401(k)-1(f)(2) of the Income Tax Regulations provided for the distribution of this amount to each HCE. Parallel rules applied to correction of failure to satisfy the nondiscrimination test of ' 401(m).

The SBJPA amended ' 401(k)(8)(C) to provide that distributions of excess contributions for any plan year are made to HCEs on the basis of the amount of contributions by, or on behalf of, each HCE.

> This amendment does not affect the total amount of the excess contributions to be distributed, but merely reallocates the distributions among the HCEs.

Accordingly, in order to distribute excess contributions under ' 401(k)(8), as amended, the following procedure is used:

1. Calculate the dollar amount of excess contributions for each affected HCE in a manner described in ' 401(k)(8)(B) and ' 1.401(k)-1(f)(2). However, in applying these rules, rather than distributing the amount necessary to reduce the actual deferral ratio (ADR) of each affected HCE in order of these employees= ADRs, beginning with the highest ADR, the plan uses these amounts in step 2.

2. Determine the total of the dollar amounts calculated in step 1.

This total amount in step 2 (total excess contributions) should be distributed in accordance with steps 3 and 4 below:

3. The elective contributions of the HCE with the highest dollar amount of elective contributions are reduced by the amount required to cause that HCE=s elective contributions to equal the dollar amount of the elective contributions of the HCE with the next highest dollar amount of elective contributions. This amount is then distributed to the HCE with the highest dollar amount.

However, if a lesser reduction, when added to the total dollar amount already distributed under this step, would equal the total excess contributions, the lesser reduction amount is distributed.

4. If the total amount distributed is less than the total excess contributions, step 3 is repeated.

If these distributions are made, the cash or deferred arrangement is treated as meeting the nondiscrimination test of ' 401(k)(3) regardless of whether the ADP, if recalculated after distributions, would satisfy ' 401(k)(3).

A parallel method is used for the purpose of recharacterizing excess contributions under ' 401(k)(8)(A)(ii) and for distributing excess aggregate contributions under ' 401(m)(6)(C), as amended.

After excess and excess aggregate contributions, if any, have been distributed using the method described above, the multiple use test of ' 401(m)(9) is applied. For purposes of ' 401(m)(9), if a corrective distribution of excess contributions has been made, or a recharacterization has occurred, the ADP for HCEs is deemed to be the largest amount permitted under ' 401(k)(3). Similarly, if a corrective distribution of excess aggregate contributions has been made, the ACP for HCEs is deemed to be the largest amount permitted under ' 401(m)(2).

The method described above for distributing excess contributions is illustrated by the following example:

For the 1997 plan year, HCE 1 has elective contributions of $8,500 and $85,000 in compensation, for an ADR of 10%, and HCE 2 has elective contributions of $9,500 and compensation of $158,333, for an ADR of 6%. As a result, the ADP for the 2 HCEs under the plan (HCE 1 and HCE 2) is 8%. The ADP for the NHCEs is 3%. Under the ADP test of ' 401(k)(3)(A)(ii), the ADP of the two HCEs under the plan may not exceed 5% (i.e., 2 percentage points more than the ADP of the NHCEs under the plan).

Pursuant to ' 401(k)(8)(B), ' 1.401(k)-1(f)(2), and this notice, the total excess contributions for the HCEs is determined as follows:

Step 1. The elective contributions of HCE 1 (the HCE with the highest ADR) are reduced by $3,400 in order to reduce the ADR of HCE 1 to 6% ($5,100/$85,000), which is the ADR of HCE 2. Because the ADP of the HCEs still exceeds 5%, the ADP test of

' 401(k)(3)(A)(ii) is not satisfied and further reductions in elective contributions are necessary. The elective contributions of HCE 1 and HCE 2 are each reduced by one percent of compensation ($850 and $1,583 respectively). Because the ADP of the HCEs now equals 5%, the ADP test of ' 401(k)(3)(A)(ii) is satisfied, and no further reductions in elective contributions are necessary.

Step 2. The total excess contributions for the HCEs that must be distributed equal $5,833, the total reductions in elective contributions under step 1 ($3,400 + $850 + $1,583).

Pursuant to ' 401(k)(8)(C), the $5,833 in total excess contributions for the 1997 plan year would then be distributed as follows:

Step 3. The plan distributes $1,000 in elective contributions to HCE 2 (the HCE with the highest dollar amount of elective contributions) in order to reduce the dollar amount of the elective contributions of HCE 2 to $8,500, which is the dollar amount of the elective contributions of HCE 1.

Step 4. Because the total amount distributed ($1,000) is less than the total excess contributions ($5,833), step 3 must be repeated. As the dollar amounts of remaining elective contributions for both HCE 1 and HCE 2 are equal, the remaining $4,833 of excess contributions is then distributed equally to HCE 1 and HCE 2 in the amount of $2,416.50 each.

Under this example, HCE 1 must receive a total distribution of $2,416.50 of excess contributions, and HCE 2 must receive a total distribution of $3,416.50 of excess contributions. This is true even though the ADR of HCE 1 exceeded the ADR of HCE 2. The plan is now treated as satisfying the nondiscrimination test of ' 401(k)(3) even though the ADP would fail to satisfy ' 401(k)(3), if recalculated after distributions.

COMMENTS REQUESTED

The Treasury and the Service invite comments and suggestions regarding the matters discussed in this notice. Comments are specifically requested concerning:

- The use of qualified matching and qualified nonelective contributions in computing the prior year's ADP for NHCEs, including methods of preventing inappropriate double counting.

- The appropriate determination of the prior year's ADP for NHCEs when the group of employees tested is significantly different in the current year than in the prior year.

Comments can be addressed to CC:DOM:CORP:R (Notice 97-2), 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 97-2), 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.

DRAFTING INFORMATION

The principal authors of this notice are Kenneth Conn of the Employee Plans Division and Catherine Fernandez of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). For further information regarding this notice, contact the Employee Plans Division's telephone assistance service between 1:30 and 4:00 p.m., Eastern Time, Monday through Thursday at (202) 622-6074/75 or Kenneth Conn at (202) 622-6214. (These telephone numbers are not toll-free numbers.)

Employee Plans CPE Technical Topics for 1999

PART III - Administrative, Procedural and Miscellaneous

Cash or Deferred Arrangements; Nondiscrimination

Notice 98-1

1. PURPOSE

This notice provides guidance and transition relief relating to recent statutory amendments to the nondiscrimination rules under ' 401(k) and ' 401(m) of the Internal Revenue Code. The rules applicable to qualified cash or deferred arrangements under ' 401(k) and matching and employee contributions under ' 401(m) were amended by the Small Business Job Protection Act of 1996 (SBJPA), Pub. L. 104-188.

Specifically, this notice provides guidance on

- ! The election to use the current year testing method.
- ! The use of qualified nonelective contributions (QNCs) and qualified matching contributions (QMACs) under the prior year testing method.
- ! The application of the first plan year rule under the prior year testing method.
- ! The impact of certain plan population changes under the prior year testing method.
- ! A change from the current year testing method to the prior year testing method, including related transition relief.
- ! Plan amendments needed to reflect the testing method of a plan, including the application of the remedial amendment period under ' 401(b).

2. BACKGROUND

1. SBJPA Amendments to ' 401(k) and ' 401(m)

Under ' 401(k) and ' 401(m), the actual deferral percentage (ADP) and the actual contribution percentage (ACP) of highly compensated employees (HCEs) are compared with those of nonhighly compensated employees (NHCEs).

Section 1433(c) of SBJPA amended ' 401(k)(3)(A) and ' 401(m)(2)(A), effective for plan years beginning after December 31, 1996, to provide for the use of prior year data in determining the ADP and ACP for NHCEs, while continuing to provide for the use of current year data for HCEs.

Alternatively, an employer may elect to use current year data for determining the ADP and ACP for both HCEs and NHCEs, but the statute provides that this election may be changed only as provided by the Secretary.

Section 1433(d) of SBJPA amended ' 401(k)(3) and ' 401(m)(3) to provide a special rule for determining the ADP and ACP for NHCEs for the first plan year of a plan (other than a successor plan) where the prior year testing method is used.

2. Previous Guidance on the SBJPA Amendments

Notice 97-2, 1997-2 I.R.B. 22, provides guidance on determining the individuals who are taken into account in computing the ADP or ACP for NHCEs for the prior year under the prior year testing method.

The guidance provides transition relief to allow plans using the current year testing method for the 1997 testing year to change to the prior year testing method for the 1998 testing year without obtaining approval from the Internal Revenue Service.

The notice also provides rules for distributions of excess contributions and excess aggregate contributions.

Notice 97-2 states that Treasury and the Service will issue guidance regarding the conditions under which employers that elect to use current year data for the 1998 or a later plan year may change that election and use prior year testing for subsequent plan years.

Notice 97-2 also requested comments concerning

(i) the use of QNCs and QMACs in computing the prior year's ADP for NHCEs, including methods of preventing inappropriate double counting; and

(ii) the appropriate determination of the prior year's ADP for NHCEs when the group of employees tested is significantly different in the current year than in the prior year. After consideration of the comments received, this notice provides guidance on these issues.

Rev. Proc. 97-41, 1997-33 I.R.B. 51, provides guidance to sponsors of plans that are qualified under ' 401(a) with respect to the date by which they must adopt amendments to comply with changes in the law, including a remedial amendment period for amendments to reflect changes to the qualification requirements made by SBJPA.

3. Definitions

If a term that is used in this notice is defined in the regulations under ' 401(k) or ' 401(m), then the definition under these regulations applies for purposes of this notice.

For example, "plan" as used in this notice means plan as defined in ' 1.401(k)-1(g)(11) of the Income Tax Regulations. In addition, for purposes of this notice,

the "testing year" is the plan year for which the ADP or ACP for HCEs is being tested;

the "prior year" is the plan year immediately preceding the testing year. If the plan uses data from the testing year in determining the ADP or ACP for NHCEs, it is using the "current year testing method;"

if the plan uses data from the prior year in determining the ADP or ACP for NHCEs, it is using the "prior year testing method."

Sections V and VI of this notice provide additional definitions used in applying the first plan year rule and definitions used in the rules relating to changes in the group of eligible employees when a plan uses the prior year testing method.

4. Effect of Statutory Changes on Regulations

Because of the amendments made to ' 401(k) and ' 401(m), certain portions of ' 1.401(k)-1 and '' 1.401(m)-1 and 1.401(m)-2 no longer reflect current law. This notice provides guidance on a limited number of issues relating to the use of the prior year testing method and relating to a change in testing method. The regulations shall continue in force to the extent that they are not inconsistent with the Code, as amended, and subsequent guidance, including Notice 97-2 and this notice.

3. USE OF CURRENT YEAR TESTING METHOD

As provided under ' 401(k)(3)(A) and ' 401(m)(2)(A), an employer may elect to use the current year testing method for a plan in lieu of the prior year testing method. A plan using the prior year testing method may adopt the current year testing method for any subsequent testing year.

Notification to or filing with the Service of an election to use the current year testing method is not required in order for the election to be valid. However, as provided in section IX of this notice, the plan document governing the plan must reflect whether the plan uses the current year testing method or the prior year testing method for a testing year.

A plan that uses the current year testing method for a testing year may not be permissively aggregated under ' 1.410(b)-7(d) with a plan that uses the prior year testing method for that testing year.

4. USE OF QNCs AND QMACs UNDER PRIOR YEAR TESTING METHOD

Section 401(k)(3)(D) and ' 401(m)(3) provide that an employer may take into account QNCs and QMACs in calculating the ADP, and QNCs in calculating the ACP, as provided by the Secretary. A plan may continue to take QNCs and QMACs into account under the prior year testing method, subject to the limitations set forth in section VII.B. of this notice.

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1. Timing of Contribution of QNCs and QMACs

In order to be taken into account in the calculation of the ADP or ACP for a year under the prior year testing method, a QNC or QMAC must be allocated as of a date within the year and must actually be paid to the trust no later than the end of the 12-month period following the end of the year to which the contribution relates. See '' 1.401(k)-1(b)(4)(i)(A) and (b)(5)(v) and '' 1.401(m)-1(b)(4)(ii) and (b)(5)(iv).

Consequently, under the prior year testing method, in order to be taken into account in calculating the ADP or ACP for NHCEs for the prior year, a QNC or QMAC must be contributed by the end of the testing year. Thus, for example, if the prior year testing method is used for the 1998 testing year, QNCs that are allocated to the accounts of NHCEs for the 1997 plan year (i.e., the prior year) must be contributed to the plan by the end of the 1998 plan year in order to be treated as elective contributions for purposes of the ADP test for the 1998 testing year.

> By contrast, in order to be taken into account in calculating the ADP or ACP for HCEs for the 1998 testing year, a QNC or QMAC must be contributed by the end of the 1999 plan year.

It should be noted that ' 1.415-6(b)(7)(ii) provides that, for purposes of satisfying ' 415, employer contributions shall not be deemed credited to a participant's account for a particular limitation year unless the contributions are actually made to the plan no later than 30 days after the end of the period described in ' 404(a)(6) applicable to the taxable year with or within which the particular limitation year ends.

> Thus, contributions made after the date described in ' 1.415-6(b)(7)(ii) are treated as annual additions for the next ' 415 limitation year. Accordingly, under either the prior year testing method or the current year testing method, a violation of ' 415(c) might occur if QNCs or QMACs are contributed after the date described in ' 1.415-6(b)(7)(ii).

2. Nondiscrimination Testing of QNCs under the Prior Year Testing Method

Section 1.401(k)-1(b)(5) provides that

(i) the amount of nonelective contributions, including those QNCs treated as elective contributions for purposes of the ADP test, and

(ii) the amount of nonelective contributions, excluding those QNCs treated as elective contributions for purposes of the ADP test,

must each satisfy the requirements of ' 401(a)(4).

Under ' 1.401(m)-1(b)(5), a similar rule applies to QNCs treated as matching contributions for purposes of the ACP test.

These nondiscrimination requirements continue to apply to plans that use the prior year testing method. This is true even though the QNCs allocated to the HCEs and NHCEs in a single plan year are taken into account for ADP and ACP testing in different testing years.

Accordingly, QNCs allocated to the accounts of NHCEs and HCEs for the same plan year will be subject to the requirements of ' 401(a)(4) for that plan year; however, QNCs allocated to the accounts of HCEs will be taken into account for ADP or ACP testing in the plan year for which they are allocated, while QNCs allocated to the accounts of NHCEs will not be taken into account in determining the permitted ADP or ACP for HCEs until the following plan year.

5. FIRST PLAN YEAR RULE UNDER PRIOR YEAR TESTING METHOD

Section 401(k)(3)(E) provides that, for the first plan year of any plan (other than a successor plan) that uses the prior year testing method, the ADP for NHCEs for the prior year is 3%, or, if the employer elects, is the ADP for NHCEs for that first plan year.

For this purpose, the "first plan year" of any plan is the first year in which the plan, within the meaning of ' 414(l), is or includes a section 401(k) plan (i.e., the first year a plan provides for elective contributions described in ' 1.401(k)-1(g)(3)). However, a plan does not have a first plan year if for such plan year the plan is aggregated under ' 1.401(k)-1(g)(11) with any other plan that was or that included a section 401(k) plan in the prior year.

Section 401(m)(3) provides that rules similar to the rules of ' 401(k)(3)(E) shall apply for purposes of the ACP test. For purposes of the ACP test, the "first plan year" of any plan is the first year in which a plan, within the meaning of ' 414(l), is or includes a section

401(m) plan (i.e., the first year a plan provides for employee contributions described in ' 1.401(m)-1(f)(6) or matching contributions described in ' 1.401(m)-1(f)(12), or both). However, a plan does not have a first plan year if for such plan year the plan is aggregated for purposes of ' 1.401(m)-1(g)(14) with any other plan that was or that included a section 401(m) plan in the prior year.

For purposes of this notice, a plan is a "successor plan" if 50% or more of the eligible employees for the first plan year were eligible employees under another section 401(k) plan (or section 401(m) plan, as applicable) maintained by the employer in the prior year.

For example, in 1998, Employer H sponsors Plan T, a section 401(k) plan. In 1999, Employer H establishes Plan U, also a section 401(k) plan, which had 200 eligible employees, including 100 employees who were eligible employees under Plan T in 1998. Plan U is a successor plan.

If a plan (other than a successor plan) uses the prior year testing method and for its first plan year the plan determines the ADP or ACP for NHCEs for the prior plan year using the ADP or ACP for NHCEs for that first plan year (in lieu of 3%), then the use of the prior year testing method in the next testing year is not treated as a change in testing method.

Such a plan would not be subject to the limitations on double counting described in section VII.B. for that next testing year.

If a successor plan uses the prior year testing method for its first plan year, the ADP and ACP for NHCEs for the prior year are determined under the rules in section VI of this notice.

6. CHANGES IN THE GROUP OF ELIGIBLE NHCEs WHERE PLAN USES PRIOR YEAR TESTING METHOD

1. General Rule: Disregard Changes in the Group of NHCEs

Except as provided in section VI.B. and C., below, under the prior year testing method, the ADP or ACP for NHCEs for the prior year under a plan is determined without regard to changes in the group of NHCEs who are eligible employees under the plan in the testing year.

Thus, under the prior year testing method, the prior year ADP or ACP for NHCEs is used

even though some NHCEs may have first become eligible employees under the plan in the testing year because they meet existing plan eligibility requirements, and

even though individuals who were eligible employees under the plan and NHCEs in the prior year are no longer employed by the employer or have become HCEs in the testing year.

2. Exception for Plan Coverage Changes

If a plan results from, or is otherwise affected by, a plan coverage change that becomes effective during the testing year, then the ADP and ACP for NHCEs for the prior year under the plan is the weighted average of the ADPs for the prior year subgroups and the weighted average of the ACPs for the prior year subgroups, respectively.

3. Optional Rule for Minor Plan Coverage Changes

If:

a plan results from, or is otherwise affected by, a plan coverage change, and

90% or more of the total number of NHCEs from all prior year subgroups are from a single prior year subgroup,

then in determining the ADP or ACP for NHCEs for the prior year under the plan, an employer may elect to use the ADP and ACP for NHCEs for the prior year of the plan under which that single prior year subgroup was eligible, in lieu of using the weighted averages described in section VI.B., above.

4. Definitions

For purposes of this notice:

1. "Plan coverage change" means a change in the group or groups of eligible employees under a plan on account of:

(a) the establishment or amendment of a plan,

(b) a plan merger, consolidation, or spinoff under ' 414(l),

(c) a change in the way plans within the meaning of ' 414(l) are combined or separated for purposes of ' 1.401(k)-1(g)(11) (e.g., permissively aggregating plans not previously aggregated under ' 1.410(b)-7(d), or ceasing to permissively aggregate plans under ' 1.410(b)-7(d)), or

(d) a combination of any of the foregoing.

2. "Prior year subgroup" means:

all NHCEs for the prior year who, in the prior year, were eligible employees under a specific section 401(k) plan (or, in the case of the ACP test, a specific section 401(m) plan) maintained by the employer and

who would have been eligible employees in the prior year under the plan being tested if the plan coverage change had first been effective as of the first day of the prior year instead of first being effective during the testing year.

3. "Weighted average of the ADPs for the prior year subgroups" and "weighted average of the ACPs for the prior year subgroups" mean the sum, for all prior year subgroups, of the adjusted ADPs and adjusted ACPs, respectively.

4. "Adjusted ADP" and "adjusted ACP" with respect to a prior year subgroup mean the respective ADP and ACP for NHCEs for the prior year of the specific plan under which the members of the prior year subgroup were eligible employees, multiplied by a fraction:

the numerator of which is the number of NHCEs in the prior year subgroup and

the denominator of which is the total number of NHCEs in all prior year subgroups.

E. Examples

The requirements of this section VI are illustrated by the following examples:

Example 1:

(i) Employer B maintains two plans, Plan N and Plan P, each of which includes a section 401(k) plan. The plans were not permissively aggregated under ' 1.410(b)-7(d) for the 1998 testing year. Both plans use the prior year testing method. Plan N had 300 eligible employees who were NHCEs for 1998, and their ADP for that year was 6%. Plan P had 100 eligible employees who were NHCEs for 1998, and the ADP for those NHCEs for that plan was 4%.

Plan N and Plan P are permissively aggregated under ' 1.410(b)-7(d) for the 1999 plan year.

(ii) The permissive aggregation of Plan N and Plan P for the 1999 testing year under ' 1.410(b)-7(d) is a plan coverage change that results in treating the plans as one plan (Plan NP) for purposes of ' 1.401(k)-1(g)(11).

Therefore, the prior year ADP for NHCEs under Plan NP for the 1999 testing year is the weighted average of the ADPs for the prior year subgroups.

(iii) The first step in determining the weighted average of the ADPs for the prior year subgroups is to identify the prior year subgroups.

With respect to the 1999 testing year, an employee is a member of a prior year subgroup if the employee:

(A) was an NHCE of Employer B for the 1998 plan year,

(B) was an eligible employee for the 1998 plan year under any section 401(k) plan maintained by Employer B, and

(C) would have been an eligible employee in the 1998 plan year under Plan NP if Plan N and Plan P had been permissively aggregated under ' 1.410(b)-7(d) for that plan year.

The NHCEs who were eligible employees under separate section 401(k) plans for the 1998 plan year comprise separate prior year subgroups. Thus, there are two prior year subgroups under Plan NP for the 1999 testing year:

the 300 NHCEs who were eligible employees under Plan N for the 1998 plan year and

the 100 NHCEs who were eligible employees under Plan P for the 1998 plan year.

(iv) The weighted average of the ADPs for the prior year subgroups is the sum of:

(A) the adjusted ADP with respect to the prior year subgroup that consists of the NHCEs who were eligible employees under Plan N, and

(B) the adjusted ADP with respect to the prior year subgroup that consists of the NHCEs who were eligible employees under Plan P.

The adjusted ADP for the prior year subgroup that consists of the NHCEs who were eligible employees under Plan N is 4.5%, calculated as follows:

6% (the ADP for the NHCEs under Plan N for the prior year) x 300/400 (the number of NHCEs in that prior year subgroup divided by the total number of NHCEs in all prior year subgroups), which equals 4.5%.

The adjusted ADP for the prior year subgroup that consists of the NHCEs who were eligible employees under Plan P is 1%, calculated as follows:

4% (the ADP for the NHCEs under Plan P for the prior year) x 100/400 (the number of NHCEs in that prior year subgroup divided by the total number of NHCEs in all prior year subgroups), which equals 1%.

Thus, the prior year ADP for NHCEs under Plan NP for the 1999 testing year is 5.5% (the sum of adjusted ADPs for the prior year subgroups, 4.5% plus 1%).

Example 2:

(i) Employer C maintains a plan, Plan Q, which includes a section 401(k) plan and which uses the prior year testing method. Plan Q covers employees of Division A and Division B. In 1998, Plan Q had 500 eligible employees who were NHCEs, and the ADP for those NHCEs for 1998 was 5%. Effective January 1, 1999, Employer C spins off a portion of Plan Q under ' 414(l), creating a new Plan R which includes a section 401(k) plan in which the 100 employees of Division B are eligible employees.

(ii) The spin-off of Plan R is a plan coverage change that affects Plan Q. Accordingly, for purposes of the 1999 testing year under Plan Q, the prior year ADP for NHCEs under Plan Q is the weighted average of the ADPs for the prior year subgroups.

Plan Q has only one prior year subgroup (because the only NHCEs who would have been eligible employees under Plan Q for the 1998 plan year if the spin-off had occurred as of the first day of that plan year were eligible employees under Plan Q).

Therefore, for purposes of the 1999 testing year under Plan Q, the ADP for NHCEs for the prior year is the weighted average of the ADPs for the prior year subgroups, or 5%, the same as if the plan spin-off had not occurred.

Example 3:

(i) The facts are the same as in Example 2, except that instead of spinning off Plan R from Plan Q, Employer C amends the eligibility provisions under Plan Q to exclude employees of Division B effective January 1, 1999. In addition, effective on that same date, Employer C establishes a new plan, Plan R, which includes a section 401(k) plan that uses the prior year testing method. The only eligible employees under Plan R are the 100 employees of Division B who were eligible employees under Plan Q.

(ii) Plan R is a successor plan, within the meaning of section V of this notice (because all of the employees were eligible employees under Plan Q in the prior year), and, therefore, the first plan year rule of that section does not apply.

(iii) The amendment to the eligibility provisions of Plan Q and the establishment of Plan R are plan coverage changes that affect Plan Q and result in Plan R. Accordingly, the prior year ADP for NHCEs under Plan Q is the weighted average of the ADPs for the prior year subgroups.
Plan Q has only one prior year subgroup (because the only NHCEs who would have been eligible employees under Plan Q for the 1998 plan year if the amendment to the Plan Q eligibility provisions had occurred as of the first day of that plan year were eligible employees under Plan Q).

Therefore, for purposes of the 1999 testing year under Plan Q, the ADP for NHCEs for the prior year is the weighted average of the ADPs for the prior

year subgroups, or 5%, the same as if the plan amendment had not occurred.

(iv) Similarly, Plan R has only one prior year subgroup (because the only NHCEs who would have been eligible employees under Plan R for the 1998 plan year if the plan were established as of the first day of that plan year were eligible employees under Plan Q).

Therefore, for purposes of the 1999 testing year under Plan R, the ADP for NHCEs for the prior year is the weighted average of the ADPs for the prior year subgroups, or 5%, the same as that of Plan Q.

Example 4:

(i) The facts are the same as in Example 3, except that the provisions of Plan R extend eligibility to 50 hourly employees who previously were not eligible employees under any section 401(k) plan maintained by Employer C.

(ii) Plan R is a successor plan, within the meaning of section V of this notice (because 100 of Plan R's 150 eligible employees were eligible employees under another section 401(k) plan maintained by Employer C in the prior year), and, therefore, the first plan year rule of that section does not apply.

(iii) The establishment of Plan R is a plan coverage change that affects Plan R. Because the 50 hourly employees were not eligible employees under any section 401(k) plan of Employer C for the prior year, they do not comprise a prior year subgroup. Accordingly, Plan R still has only one prior year subgroup.

Therefore, for purposes of the 1999 testing year under Plan R, the ADP for NHCEs for the prior year is the weighted average of the ADPs for the prior year subgroups, or 5%, the same as that of Plan Q.

7. CHANGE FROM CURRENT YEAR TO PRIOR YEAR TESTING METHOD

1. General Rule

Section 401(k)(3)(A) provides that if an employer elects to use the current year testing method for purposes of the ADP test, that method may not be changed except as provided by the Secretary. A similar rule applies under ' 401(m)(2)(A) in the case of the ACP test.

Thus, the statute indicates that once an employer elects to use the current year testing method, the ability to change that election will be limited.

In general, it is expected that plans will select a testing method and retain it. Treasury and the Service recognize, however, that there may be legitimate reasons for occasionally reevaluating and changing the testing method under a plan. In addition, certain business transactions may result in a diversity of testing methods among plans of an employer, and the employer may wish to use consistent testing methods. Finally, Treasury and the Service believe that employers with existing plans should be given a period of time to decide whether to change from the current year testing method (which was the required testing method prior to the SBJPA changes) to the prior year testing method.

Accordingly, a plan is permitted to change from the current year testing method to the prior year testing method in any of the following situations:

1. The plan is not the result of the aggregation of two or more plans, and the current year testing method was used under the plan for each of the 5 plan years preceding the plan year of the change (or if lesser, the number of plan years the plan has been in existence, including years in which the plan was a portion of another plan).

2. The plan is the result of the aggregation of two or more plans, and for each of the plans that are being aggregated (the aggregating plans), the current year testing method was used for each of the 5 plan years preceding the plan year of the change (or if lesser, the number of plan years since that aggregating plan has been in existence, including years in which the aggregating plan was a portion of another plan).

3. A transaction occurs that is described in ' 410(b)(6)(C)(i) and ' 1.410(b)-2(f);

   as a result of the transaction, the employer maintains both a plan using the prior year testing method and a plan using the current year testing method; and

   the change from the current year testing method to the prior year testing year method occurs within the transition period described in ' 410(b)(6)(C)(ii).

4. The change occurs during the plan's remedial amendment period for the SBJPA changes (see Rev. Proc. 97-41).

Notification to or filing with the Service of a change from the current year to the prior year testing method is not required in order for the change to be valid. However, as provided in section IX of this notice, the plan document governing the plan must reflect such a change.

2. Limitations on Double Counting of Certain Contributions

If a plan changes from the current year testing method to the prior year testing method, then, for purposes of the first testing year for which the change is effective, the ADP and ACP for NHCEs for the prior year is determined in the following manner:

1. The ADP for NHCEs for the prior year is determined taking into account only:

(a) elective contributions for those NHCEs that were taken into account for purposes of the ADP test (and not the ACP test) under the current year testing method for the prior year and

(b) QNCs that were allocated to the accounts of those NHCEs for the prior year but that were not used to satisfy the ADP test or the ACP test under the current year testing method for the prior year.

2. The ACP for NHCEs for the prior year is determined taking into account only

(a) employee contributions for those NHCEs for the prior year,

(b) matching contributions for those NHCEs that were taken into account for purposes of the ACP test (and not the ADP test) under the current year testing method for the prior year, and

(c) QNCs that were allocated to the accounts of those NHCEs for the prior year but that were not used to satisfy the ACP test or the ADP test under the current year testing method for the prior year.

Thus, in determining the ADP for NHCEs for the prior year, the following contributions made for the prior testing year are disregarded:

QNCs used to satisfy either the ADP or ACP test under the current year testing method for the prior testing year,

elective contributions taken into account for purposes of the ACP test, and

all QMACs.

Similarly, in determining the ACP for NHCEs for the prior year, the following contributions made for the prior testing year are disregarded:

QNCs used to satisfy either the ADP or ACP test under the current year testing method for the prior testing year,

QMACs taken into account for purposes of the ADP test, and
all elective contributions.

The limitations on double counting under this section VII.B. do not apply for testing years beginning before January 1, 1999. Accordingly, in the case of a plan that changes from the current year to the prior year testing method for the first time for either the 1997 or 1998 testing year, the ADP and ACP for NHCEs used for that testing year are the same as the ADP and ACP, respectively, for NHCEs used for the prior testing year.

3. Examples

The limitations on double counting are illustrated by the following examples:

Example 1:

(i) Employer A established Plan M, a calendar year section 401(k) plan, in 1993 and, through the 2000 testing year, has always used the current year testing method under Plan M. The ADP for the HCEs under Plan M is 7% for the 2000 testing year. Based solely on elective contributions by NHCEs under Plan M for the 2000 testing year, the ADP for NHCEs for the 2000 testing year is 4%. In order to satisfy the ADP test, Employer A provides a QNC to each NHCE for the 2000 testing year equal to 1% of compensation. No other contributions under Plan M are taken into account in determining the ADP for NHCEs. Thus, the ADP for NHCEs for the 2000 testing year is 5%.

Plan M is amended to use the prior year testing method instead of the current year testing method for purposes of the ADP test for the 2001 testing year.

(ii) In determining the ADP for NHCEs under Plan M for the 2001 testing year in accordance with the prior year testing method, the elective contributions made by NHCEs under Plan M for the 2000 plan year are taken into account.

However, the QNCs equal to 1% of compensation made under Plan M on behalf of NHCEs for the 2000 plan year are disregarded because they were used to satisfy the ADP test for the 2000 testing year.

Thus, for purposes of the 2001 testing year, the ADP for NHCEs for the prior year is 4% (unless additional QNCs for NHCEs are timely contributed and allocated for the 2000 plan year).

Example 2:

(i) The facts are the same as in Example 1, except that the testing years are 1997 and 1998, instead of 2000 and 2001.

(ii) For purposes of the 1998 testing year, the ADP for NHCEs for the prior year is 5%. The QNCs equal to 1% of compensation made under Plan M on behalf of NHCEs that were used to satisfy the ADP test for the 1997 testing year are not disregarded because the limitation on double counting applies only for testing years beginning on or after January 1, 1999.

8. ANTI-ABUSE PROVISION

This guidance is designed to provide simple, practical rules that accommodate legitimate plan changes. At the same time, the rules are intended to be applied by employers in a manner that does not make use of changes in plan testing procedures or other plan provisions to inflate inappropriately the prior year ADP and ACP for NHCEs (which are used as benchmarks for testing the ADP and ACP for HCEs). Further, the ADP and ACP tests are part of the overall requirement that benefits or contributions not discriminate in favor of HCEs.

Therefore, a plan will not be treated as satisfying the ADP or ACP test:

if there are repeated changes in plan testing procedures or plan provisions that have the effect of distorting the ADP or ACP test so as to increase significantly the permitted ADP or ACP for HCEs and

if a principal purpose of the changes was to achieve such a result.

9. PLAN PROVISIONS REGARDING TESTING METHOD

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 must provide that the ADP or ACP test will be met. Because a plan may now use either the current year testing method or the prior year testing method, a plan must specify which of these two testing methods it is using.

If the employer changes the testing method under a plan, the plan must be amended to reflect the change.

Further, for purposes of the first plan year rule described in ' 401(k)(3)(E) and ' 401(m)(3) and section V of this notice, the plan must specify whether the ADP and ACP for NHCEs for the prior plan year is 3% or the current year's ADP and ACP for the NHCEs.

The regulations under ' 401(k) and ' 401(m) permit a plan to incorporate by reference ' 401(k)(3) and ' 401(m)(2) (and, if applicable, ' 401(m)(9)) and the specific underlying regulations. A plan that incorporates these provisions by reference:

> must continue to refer to the applicable Code sections and the specific underlying regulations,
>
> must specify which of the two testing methods (prior year or current year) it is using, and
>
> must now provide that it is incorporating by reference subsequent Internal Revenue Service guidance issued under the applicable Code provisions.
>
> Further, for purpose of the first plan year rule described in ' 401(k)(3)(E) and ' 401(m)(3) and section V of this notice, a plan that incorporates these provisions by reference must specify whether the ADP and ACP for NHCEs for the prior plan year is 3% or the current year's ADP and ACP for the NHCEs.

Rev. Proc. 97-41 provides that qualified retirement plans have a remedial amendment period under ' 401(b) so that certain plan amendments for SBJPA generally are not required to be adopted before the last day of the first plan year beginning on or after January 1, 1999.

Pursuant to Rev. Proc. 97-41, a plan provision reflecting the ADP or ACP testing method is a disqualifying provision, and thus any plan amendments to reflect a choice in testing method are not required to be adopted until the end of this remedial amendment period. However, plans

must be operated in accordance with the SBJPA changes to ' 401(k)(3)(A) and ' 401(m)(2)(A) as of the statutory effective date.

In addition, under Rev. Proc. 97-41, any retroactive amendments must reflect the choices made in the operation of the plan for each testing year, including the choice of testing method (and any changes to that election), and must reflect the date on which the plan began to operate in accordance with those choices (and any such changes).

10. 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 1545-1579.

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 IX. This requirement to amend plan documents is necessary to reflect the new nondiscrimination test under ' 401(k)(3) and ' 401(m)(2) as amended by SBJPA. The pre-SBJPA method of nondiscrimination testing is still available under these Code sections and a plan amendment may not be required to reflect the choice of the pre-SBJPA testing method. The information will be used to determine whether the ADP and ACP of HCEs exceeds the ADP and ACP of NHCEs by more than the statutory limits. The collection of information is required to obtain a benefit. The likely respondents are businesses or other for-profit institutions, and nonprofit institutions.

The estimated total annual recordkeeping burden is 49,000 hours. The estimated annual burden per recordkeeper is 20 minutes. The estimate number of recordkeepers is 147,000.

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.

11. COMMENTS

Treasury and the Service invite comments regarding the matters discussed in this notice. Comments may be submitted to the Service at CC:DOM:CORP:R (Notice 98-1), Room 5226, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. Alternatively, taxpayers may hand-deliver comments between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 97-XX), Courier's Desk, Internal Revenue Service, 1111

Constitution Avenue, N.W., Washington, D.C., or may submit comments electronically via the Service's Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

Drafting Information

The principal authors of this notice are Susan Lennon of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations) and Roger Kuehnle of the Employee Plans Division. For further information regarding this notice, contact the Employee Plans Division's telephone assistance service between 1:30 and 4:00 p.m., Eastern Time, Monday through Thursday at (202) 622-6074/75. (These telephone numbers are not toll-free.)

Employee Plans CPE Technical Topics for 1999

Rev. Rul. 98-30

Section 401.--Pension, Profit-Sharing, Stock Bonus Plans, etc.

26 CFR 1.401(k)-1: Certain Cash or Deferred Arrangements.

1998-25 I.R.B. 8; REV. RUL. 98-30

June 22, 1998

ISSUE

Will employer contributions to a profit-sharing plan fail to be considered elective contributions, within the meaning of ' 1.401(k)-1(g)(3) of the Income Tax Regulations, made under a qualified cash or deferred arrangement, within the meaning of ' 401(k) of the Internal Revenue Code, merely because they are made pursuant to an arrangement under which, in any case in which an employee does not affirmatively elect to receive cash, the employee's compensation is reduced by a fixed percentage and that amount is contributed on the employee's behalf to the plan?

FACTS

Employer X maintains Plan A, a profit-sharing plan intended to satisfy the requirements of ' 401(a), including '' 401(k) and 401(m). Under Plan A, any employee of Employer X, including an employee with less than one year of service, may elect to have Employer X make contributions on the employee's behalf to Plan A in lieu of receiving that amount as cash compensation that would otherwise be payable to the employee. The employee may designate the amount of these compensation reduction contributions as a percentage of the employee's compensation, subject to certain limitations set forth in the plan.

Under Plan A, a newly hired employee is immediately eligible to participate in Plan A. If the employee does not affirmatively elect to receive cash or have a specified amount contributed to Plan A, his or her compensation is automatically reduced by 3 percent and this amount is contributed to Plan A. An election not to make compensation reduction contributions or to contribute a different percentage of compensation can be made at any time. The election is effective for the first pay period and subsequent pay periods (until superseded by a subsequent election) if filed when the employee is hired or if filed within a reasonable period thereafter ending before the compensation for the first pay period is currently available. Thus, if an employee files an election to receive cash in lieu of compensation reduction contributions and the election is filed when the employee is hired or within a reasonable period thereafter ending before the compensation is currently available (and if the employee does not later elect to have

compensation reduction contributions made), then no compensation reduction contributions for the first pay period are made on the employee's behalf to Plan A. Elections filed at a later date are effective for payroll periods beginning in the month next following the date the election is filed.

At the time an employee is hired, the employee receives a notice that explains the automatic compensation reduction election and the employee's right to elect to have no such compensation reduction contributions made to the plan or to alter the amount of those contributions, including the procedure for exercising that right and the timing for implementation of any such election. The employee is subsequently notified annually of his or her compensation reduction percentage and the employee's right to change the percentage.

Plan A provides that compensation reduction contributions are immediately nonforfeitable and, if the employee has not attained age 59 1/2, cannot be distributed prior to the employee's retirement, death, or separation from service except in the case of hardship (as defined in the plan). Plan A also provides that, for each employee who has at least 1 year of service, Employer X will make matching contributions to Plan A on account of the employee's compensation reduction contributions up to a specified percentage of the employee's compensation. Plan A does not permit after-tax employee contributions.

Plan A provides that both matching contributions and compensation reduction contributions will be invested in accordance with the participant's election among a broad range of investment funds held by the trustee or, if no investment election is made by the participant, in the trust's balanced fund which includes both diversified equity and fixed income investments. n1

- - - - - - - - - - - - - - - - - -Footnotes- -

n1 The Department of Labor has advised Treasury and the Service that, under Title I of the Employee Retirement Income Security Act of 1974 (ERISA), fiduciaries of a plan must ensure that the plan is administered prudently and solely in the interest of plan participants and beneficiaries. While ERISA ' 404(c) may serve to relieve certain fiduciaries from liability when participants or beneficiaries exercise control over the assets in their individual accounts, the Department of Labor has taken the position that a participant or beneficiary will not be considered to have exercised control when the participant or beneficiary is merely apprised of investments that will be made on his or her behalf in the absence of instructions to the contrary. See 29 CFR ' 2550.404c-1 and 57 FR 46924.

LAW AND ANALYSIS

Section 401(k) provides that a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan can meet the requirements of ' 401(a) even if it includes a

qualified cash or deferred arrangement. Section 401(k) also sets forth the requirements that a cash or deferred arrangement must satisfy in order to be a qualified cash or deferred arrangement.

Section 1.401(k)-1(a)(2)(i) defines a cash or deferred arrangement as an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of ' 401(a). Section 1.401(k)-1(a)(2)(ii) provides that a cash or deferred arrangement does not include an arrangement under which amounts contributed under a plan at an employee's election are designated or treated at the time of contribution as after-tax employee contributions.

Section 1.401(k)-1(a)(3)(i) defines a cash or deferred election as any election (or modification of an earlier election) by an employee to have the employer either provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available or contribute an amount to a trust (or provide an accrual or other benefit) under a plan deferring the receipt of compensation. Section 1.401(k)-1(a)(3)(iv) provides that a cash or deferred election does not include a one-time irrevocable election, made at the time an employee commences employment with the employer or upon the employee's first becoming eligible under any plan of the employer, to have contributions made by the employer on the employee's behalf to the plan (or to any other plan of the employer) equal to a specified amount or percentage of the employee's compensation.

Section 1.401(k)-1(e)(2) provides generally that a qualified cash or deferred arrangement must provide that the amount that each eligible employee may defer as an elective contribution is available to the employee in cash.

Section 1.401(k)-1(g)(3) defines elective contributions as employer contributions made to a plan that were subject to a cash or deferred election under a cash or deferred arrangement. Such contributions are elective contributions without regard to whether the cash or deferred arrangement is a qualified cash or deferred arrangement.

The definition of a cash or deferred election in ' 1.401(k)-1(a)(3)(i) requires that the employee have an election between the employer paying cash (or some other taxable benefit) to the employee or making a contribution to a trust on behalf of the employee. The regulation does not require that the employee receive an amount in cash in any case in which the employee does not make an affirmative election to have that amount contributed to the trust. Thus, a cash or deferred election will not fail to be made under a qualified cash or deferred arrangement merely because, when an employee fails to make an affirmative election with respect to an amount of compensation, that amount is contributed on the employee's behalf to a trust, provided that the employee had an effective opportunity to elect to receive that amount in cash. The employee has an effective opportunity to elect to receive an amount in cash as required under '

1.401(k)-1(a)(3)(i) if the employee receives notice of the availability of the election and the employee has a reasonable period to make the election before the date on which the cash is currently available.

If Plan A were to permit after-tax employee contributions, then the amounts contributed to the plan would have to be designated or treated, at the time of the contribution, as pre-tax compensation reduction contributions or after-tax employee contributions.

Compensation reduction contributions made by Employer X to Plan A (including those made if the employee has not filed an election to the contrary) are amounts contributed pursuant to a procedure under which the employee receives a notice explaining his or her rights to have no compensation reduction contribution and, after receiving the notice, the employee has a reasonable period before the cash is currently available in which to elect to receive the cash in lieu of having an employer contribution made to the plan in that amount. Thus, an eligible employee has an effective opportunity to elect to receive cash or have a contribution made to the plan on the employee's behalf. In addition, compensation reduction contributions made under the plan are not contributions made pursuant to a one-time irrevocable election because the employee can change the election in the future. Consequently, the compensation reduction contributions under Plan A are made pursuant to a cash or deferred election and satisfy the requirement in ' 1.401(k)-1(a)(3)(i) that the amount that each eligible employee may defer as an elective contribution be available to the employee in cash. The result would be the same if the plan required a period of service (permitted under ' 401(k)(2)(D)) before an employee became eligible for elective contributions.

HOLDING

Where, as in this case, an eligible employee has an effective opportunity to elect to receive cash or have that amount contributed by the employer to a profit-sharing plan, those employer contributions made on the employee's behalf to the plan in lieu of receipt of cash compensation will not fail to be considered elective contributions within the meaning of ' 1.401(k)-1(g)(3) made under a qualified cash or deferred arrangement within the meaning of ' 401(k) merely because they are made pursuant to an arrangement under which, in any case in which an employee does not affirmatively elect to receive cash, the employee's compensation is reduced by a fixed percentage and that amount is contributed on the employee's behalf to the plan.

PAPERWORK REDUCTION ACT

The collection of information contained in this revenue ruling 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 1545-1605.

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 revenue ruling is in the sixth paragraph in the section headed "LAW AND ANALYSIS." This information is required in order for certain employee elections to meet the requirements of ' 401(k). 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 burden is 1,000 hours. The estimated annual burden per respondent is 1 hour. The estimated number of respondents is 1,000.

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

Rev. Proc. 97-9

1997-1 C.B. 624; 1997-2 I.R.B. 56; REV. PROC. 97-9

January 13, 1997

SECTION 1. PURPOSE

.01 This revenue procedure provides a model amendment that may be used to assist employers in adopting a plan that contains 401(k) SIMPLE provisions. The model amendment gives plan sponsors a way to incorporate 401(k) SIMPLE provisions in plans containing cash or deferred arrangements ("CODAs") and matching contributions. The model amendment incorporates the alternative method of satisfying the nondiscrimination tests applicable to these plans as contained in ' 401(k)(11) and 401(m)(10) of the Internal Revenue Code. Sections 401(k)(11) and 401(m)(10) were added to the Code by ' 1422 of the Small Business Job Protection Act of 1996, Pub. L. No. 104--188 ("SBJPA"). This revenue procedure does not apply to ' 408(p) SIMPLE plans, as described in ' 1421 of the SBJPA, under which contributions are made to employees' SIMPLE IRAs.

.02 The model amendment may be used by organizations or practitioners with approved master and prototype ("M&P") plans, regional prototype plans, or volume submitter specimen plans to modify the existing plans they sponsor so that employers can establish new plans containing 401(k) SIMPLE provisions. Employers that currently maintain an M&P plan, a regional prototype plan or a volume submitter specimen plan may modify existing 401(k) plans to incorporate 401(k) SIMPLE provisions. The model amendment may also be used by sponsors of individually designed plans to modify existing 401(k) plans to incorporate 401(k) SIMPLE provisions. The model amendment is available only for sponsors of plans containing provisions required to satisfy '' 401(k), 401(m) and 401(a)(30) that have received favorable opinion, notification, advisory, or determination letters that take into account the requirements of the Tax Reform Act of 1986, Pub. L. No. 99--514 ("TRA '86").

SECTION 2. BACKGROUND AND GENERAL INFORMATION

.01 New sections 401(k)(11) and 401(m)(10) of the Code ("401(k) SIMPLE provisions"), provide an alternative method of satisfying the nondiscrimination tests contained in '' 401(k)(3)(A)(ii) and 401(m)(2), applicable to CODAs. These 401(k) SIMPLE provisions may only be adopted by employers that employed 100 or fewer employees earning at least $ 5,000 in compensation for the preceding year. The 401(k) SIMPLE provisions may not be adopted by an employer who maintains another employer-sponsored plan covering employees who are eligible to participate in the cash or deferred arrangement using the 401(k) SIMPLE provisions.

Generally, no contributions may be made during a year to a plan using the 401(k) SIMPLE provisions, other than those contributions described in section 2.03 below.

.02 A 401(k) plan that includes 401(k) SIMPLE provisions does not have to satisfy the actual deferral percentage and actual contribution percentage tests otherwise applicable to plans containing CODAs and matching contributions and is not treated as top-heavy under ' 416 of the Code.

.03 Under a plan containing the 401(k) SIMPLE provisions, each employee may elect to make salary reduction contributions for a year of up to $ 6,000. The employer must make either a matching contribution equal to the employee's salary reduction contributions, limited to 3% of the employee's compensation for the year, or a nonelective contribution for all eligible employees equal to 2% of the employee's compensation for the year. All amounts contributed under 401(k) SIMPLE provisions must be nonforfeitable at all times.

.04 The plan year of a plan containing the 401(k) SIMPLE provisions must be the calendar year. An employer maintaining a 401(k) plan on a fiscal year basis must convert the plan to a calendar year in order to adopt the 401(k) SIMPLE provisions.

.05 Several additional requirements apply to plans adopting the model amendment and include the following:

(1) a special definition of compensation for purposes of the 3% matching and 2% nonelective contributions described in section 2.03;

(2) notification and election period requirements; and

(3) transitional rules for growing employers.

.06 Except as provided in section 2.02, all other qualification requirements of the Code continue to apply to a plan that contains 401(k) SIMPLE provisions including the contribution limitations of ' 415; the compensation limitations of ' 401(a)(17); and the requirement that the plan as amended continue to be operated in accordance with its terms. In addition, all other requirements applicable to 401(k) plans continue to apply, including, the distribution restrictions of ' 401(k)(2)(B) and the general prohibition set forth in ' 401(k)(4)(B) on State and local governments maintaining a 401(k) plan. Contributions under a plan containing 401(k) SIMPLE provisions are deductible subject to the limits of ' 404(a).

.07 The model amendment supersedes any plan provision that is inconsistent with the provisions of the model amendment. For example, if the plan contains a provision that limits any

employee's salary reduction contributions for a year to a percentage that results in an amount less than $ 6,000, the salary reduction contribution provision of the model amendment permitting yearly contributions of up to $ 6,000 will govern.

.08 Employers adopting a new 401(k) plan containing the model amendment may make it effective as of any date on or after January 1, 1997, but in no event later than October 1 of the year in which adopted. Employers amending an existing 401(k) plan to incorporate the model amendment must make the model amendment effective as of the following January 1 unless they are using the 1997 Transition Rule described in section 3.

SECTION 3. 1997 TRANSITION RULE

.01 Employers that have maintained a 401(k) plan in 1997 may adopt the model amendment for 1997 if the following conditions are satisfied:

(1) the employer adopts the 401(k) SIMPLE provisions by July 1, 1997, effective as of January 1, 1997;

(2) the salary reduction contributions for the year made prior to adoption of the model amendment do not total more than $ 6,000 for each employee;

(3) the matching or nonelective contributions described in section 2.03 are of inherently equal or greater value than the contributions required under the plan prior to the amendment; and

(4) all eligible employees are provided with an election period described in section 3.3(b)(iv) of the model amendment.

.02 If an employer adopts 401(k) SIMPLE provisions under this transition rule, the model amendment applies to the plan for the 1997 year. For example, the cumulative salary reduction contributions for the year, including those made prior to and those made following the adoption of the model amendment, must not total more than $ 6,000 for any employee.

SECTION 4. USE OF THE MODEL AMENDMENT

.01 Sponsors described in section 4.02 may amend their plans by adopting, word-for-word, the model amendment in the appendix in accordance with the instructions in this revenue procedure. If a sponsor to whom the model amendment is available pursuant to section 4.02 adopts the model amendment, neither application to the Service nor a user fee is required. The Service will

not issue new opinion, notification, advisory, or determination letters for plans that are amended solely to add the model amendment.

.02 The only sponsors to whom the model amendment is available are sponsors of M&P, regional prototype, volume submitter specimen, and individually designed plans that contain CODA provisions and that have received favorable opinion, notification, advisory, or determination letters that take into account the requirements of TRA '86 under Rev. Proc. 89--9, 1989--1 C.B. 780, as modified; Rev. Proc. 89--13, 1989--1 C.B. 801, as modified; Rev. Proc. 90--20, 1990--1 C.B. 495; Rev. Proc. 91--41, 1991--2 C.B. 697; Rev. Proc. 91--66, 1991--2 C.B. 870; Rev. Proc. 93--39, 1993--2 C.B. 513; or Rev. Proc. 96--6, 1996--1 I.R.B. 151.

.03 Organizations and practitioners that have approved M&P and regional prototype plans and volume submitter specimen plan sponsors that use the model language must file Form 8837, Notice of Adoption of Revenue Procedure Model Amendments.

SECTION 5. REVOCATION OF MODEL AMENDMENT

The model amendment contains a model revocation clause which permits employers to revoke the 401(k) SIMPLE provisions without terminating the plan. The revocation clause should be executed only if the employer wants to revert to the plan provisions that apply in the absence of 401(k) SIMPLE provisions. The revocation may be adopted on any date, but may only become effective on the first day of the calendar year following the date of adoption.

SECTION 6. RELIANCE

Plans that are amended in accordance with sections 4 and 5 will not lose their otherwise applicable extended reliance period under Rev. Procs. 89--9 and 89--13, as modified by Rev. Proc. 93--9, 1993--1 C.B. 474, or section 13 of Rev. Proc. 93--39. Employers entitled to rely on an opinion, notification, advisory, or determination letter will not lose reliance on the letter merely because of these amendments.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Maxine Terry and Roger Kuehnle of the Employee Plans Division. For further information regarding this revenue procedure, contact the Employee Plans Division's taxpayer assistance telephone service between 1:30 and 4:00 p.m., Eastern Time, Monday through Thursday at (202) 622--6074/6075. (These telephone numbers are not toll-free numbers.)

APPENDIX

MODEL AMENDMENT UNDER SECTIONS 401(k)(11) AND 401(m)(10)

MODEL AMENDMENT TO ADOPT SIMPLE 401(k) PROVISIONS

SECTION I. SIMPLE 401(K) PROVISIONS

1.1 This amendment adds to the plan SIMPLE 401(k) provisions that are intended to satisfy the requirements of '' 401(k)(11) and 401(m)(10) of the Internal Revenue Code.

1.2 The provisions of sections 3.3, IV, VI, and VII of this amendment apply for a year only if the following conditions are met:

(a) The employer adopting this amendment is an eligible employer. An eligible employer means, with respect to any year, an employer that had no more than 100 employees who received at least $ 5,000 of compensation from the employer for the preceding year. In applying the preceding sentence, all employees of controlled groups of corporations under ' 414(b), all employees of trades or businesses (whether incorporated or not) under common control under ' 414(c), all employees of affiliated service groups under ' 414(m), and leased employees required to be treated as the employer's employees under ' 414(n), are taken into account.

An eligible employer that adopts this amendment and that fails to be an eligible employer for any subsequent year, is treated as an eligible employer for the 2 years following the last year the employer was an eligible employer. If the failure is due to any acquisition, disposition, or similar transaction involving an eligible employer, the preceding sentence applies only if the provisions of ' 410(b)(6)(C)(i) are satisfied.

(b) No contributions are made, or benefits accrued for services during the year, on behalf of any eligible employee under any other plan, contract, pension, or trust described in ' 219(g)(5)(A) or (B), maintained by the employer.

1.3 To the extent that any other provision of the plan is inconsistent with the provisions of this amendment, the provisions of this amendment govern.

SECTION II. DEFINITIONS

2.1 "Compensation" means, for purposes of sections 1.2(a), 3.1 and 3.2, the sum of the wages, tips, and other compensation from the employer subject to federal income tax withholding (as described in ' 6051(a)(3)) and the employee's salary reduction contributions made under this or any other 401(k) plan, and, if applicable, elective deferrals under a ' 408(p) SIMPLE plan, a SARSEP, or a ' 403(b) annuity contract and compensation deferred under a ' 457 plan, required

to be reported by the employer on Form W-2 (as described in ' 6051(a)(8)). For self-employed individuals, compensation means net earnings from self-employment determined under ' 1402(a) prior to subtracting any contributions made under this plan on behalf of the individual. The provisions of the plan implementing the limit on compensation under ' 401(a)(17) apply to the compensation under Section III.

2.2 "Eligible employee" means, for purposes of this amendment, any employee who is entitled to make elective deferrals described in ' 402(g) under the terms of the plan.

2.3 "Year" means the calendar year.

SECTION III. CONTRIBUTIONS

3.1 Salary Reduction Contributions

(a) Each eligible employee may make a salary reduction election to have his or her compensation reduced for the year in any amount selected by the employee subject to the limitation in section 3.1(b). The employer will make a salary reduction contribution to the plan, as an elective deferral, in the amount by which the employee's compensation has been reduced.

(b) The total salary reduction contribution for the year cannot exceed $ 6,000 for any employee. To the extent permitted by law, this amount will be adjusted to reflect any annual cost-of-living increases announced by the IRS.

3.2 Other Contributions

(a) Matching Contributions--Each year, the employer will contribute a matching contribution to the plan on behalf of each employee who makes a salary reduction election under section 3.1. The amount of the matching contribution will be equal to the employee's salary reduction contribution up to a limit of 3% of the employee's compensation for the full calendar year.

(b) Nonelective Contribution--For any year, instead of a matching contribution, the employer may elect to contribute a nonelective contribution of 2% of compensation for the full calendar year for each eligible employee who received at least $ 5,000 of compensation from the employer for the year. By inserting a number less than $ 5,000 here, the employer agrees to substitute this lesser amount for the $ 5,000 amount in the preceding sentence.

3.3 Limitation on Other Contributions

(a) General rule--No employer or employee contributions may be made to this plan for the year other than salary reduction contributions described in section 3.1, matching or nonelective contributions described in section 3.2 and rollover contributions described in ' 1.402(c)--2, Q&A--1(a) of the Income Tax Regulations.

(b) 1997 Transition Rule--If the employer has maintained this plan during 1997 prior to adopting this amendment, then contributions made prior to the amendment are treated as made under sections 3.1 and 3.2 provided that: (i) the employer adopts the 401(k) SIMPLE provisions by July 1, 1997, effective as of January 1, 1997; (ii) the salary reduction contributions for the year made prior to adoption of the amendment do not total more than $ 6,000 for any employee; (iii) the other contributions set forth in section 3.2 are of inherently equal or greater value than the contributions required under the plan prior to the amendment; and (iv) for 1997, the 60-day election period requirement described in sections 4.1(a) and (b) is deemed satisfied if the employee may make or modify a salary reduction election during a 60-day election period that begins no later than 30 days after the amendment is adopted but in no event later than July 1, 1997.

3.4 The provisions of the plan implementing the limitations of ' 415 apply to contributions made pursuant to sections 3.1 and 3.2.

SECTION IV. ELECTION AND NOTICE REQUIREMENTS

4.1 Election Period

(a) In addition to any other election periods provided under the plan, each eligible employee may make or modify a salary reduction election during the 60-day period immediately preceding each January 1.

(b) For the year an employee becomes eligible to make salary reduction contributions under this amendment, the 60-day election period requirement of section 4.1(a) is deemed satisfied if the employee may make or modify a salary reduction election during a 60-day period that includes either the date the employee becomes eligible or the day before.

(c) Each employee may terminate a salary reduction election at any time during the year.

4.2 Notice Requirements

(a) The employer will notify each eligible employee prior to the 60-day election period described in section 4.1 or 3.3(b)(iv) that he or she can make a salary reduction election or to modify a prior election during that period.

(b) The notification described in section 4.2(a) will indicate whether the employer will provide a 3% matching contribution described in section 3.2(a) or a 2% nonelective contribution described in section 3.2(b).

SECTION V. VESTING REQUIREMENTS

All benefits attributable to contributions made pursuant to this amendment are nonforfeitable at all times.

SECTION VI. TOP--HEAVY RULES

The plan is not treated as a top-heavy plan under ' 416 for any year for which the provisions of this amendment are effective and satisfied.

SECTION VII. NONDISCRIMINATION TESTS

The plan is treated as meeting the requirements of '' 401(k)(3)(A)(ii) and 401(m)(2) for any year for which the provisions of this amendment are effective and satisfied.

SECTION VIII. EFFECTIVE DATE

This amendment is effective on .

Employer Name

By: Signature

Name and Title

Date

MODEL REVOCATION CLAUSE

This amendment is revoked effective as of the first day of the calendar year following (enter the date the revocation is adopted).

Employee Plans CPE Technical Topics for 1999

Employer Name By: Signature

Name and Title

Date