

Effective Dates for Certain Amendments Made by the Economic Growth and Tax Relief Reconciliation Act of 2001

Notice 2001-56

I. Purpose

This notice provides guidance relating to the effective dates for §§ 611(c), 613, and 636(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. 107-16. Section 611(c) of EGTRRA increases the compensation limit of § 401(a)(17) of the Internal Revenue Code (Code) and related sections. Section 613 of EGTRRA modifies the rules in § 416 of the Code regarding determination of top-heavy status. Section 636(a) of EGTRRA directs the Secretary to revise the regulations relating to hardship distributions under § 401(k)(2)(B)(i)(IV) of the Code.

Notice 2001-42, 2001-30 I.R.B. 70, provides a remedial amendment period for EGTRRA, in which any needed retroactive remedial EGTRRA plan amendments may be adopted. The availability of the EGTRRA remedial amendment period is conditioned on the timely adoption of required good faith EGTRRA plan amendments. See Notice 2001-57, page **[insert page #]**, this bulletin, for sample good faith amendments. Although a good faith plan amendment need not reflect all guidance issued under EGTRRA, the plan's operation must be consistent with that guidance, beginning with the effective date of that guidance.

II. Compensation Limit under § 401(a)(17)

A. Background

Section 401(a)(17) of the Code limits the annual compensation that may be taken into account for purposes of determining a participant's benefit accruals under a defined benefit plan or a participant's allocations under a defined contribution plan. Section 401(a)(17) also limits the annual compensation that may be taken into account for purposes of certain nondiscrimination requirements, including those in §§ 401(a)(4), 401(a)(5), 401(l), 401(k), 401(m), 403(b)(12), 404(a)(2), and 410(b)(2), and for purposes of determining whether a definition of compensation is nondiscriminatory under § 414(s)(3). Under § 401(a)(17) as in effect prior to the effective date of the EGTRRA amendment, the compensation limit is \$150,000, indexed in \$10,000 increments for cost-of-living adjustments. For 2001, the compensation limit is \$170,000. A higher compensation limit applies to eligible participants in certain governmental plans. See Treas. Reg. § 1.401(a)(17)-1(d)(4)(ii).

Section 611(c) of EGTRRA amended § 401(a)(17) of the Code by increasing the \$150,000 limit (as adjusted) to \$200,000, and changing the method used for cost-of-living adjustments. Section 611(c) of EGTRRA made similar amendments to §§ 404(l), 408(k), and 505(b)(7) of the Code.

B. Effective Date

Section 611(i)(1) of EGTRRA provides that the increase in the compensation limit of § 401(a)(17) of the Code applies to years beginning after December 31, 2001. Thus, for purposes of determining benefit accruals or the amount of allocations for plan years beginning on or after January 1, 2002, compensation taken into account may not exceed the compensation limit under § 401(a)(17), as amended by § 611(c) of EGTRRA. In the case of a plan that uses annual compensation for periods prior to the first plan year beginning on or after January 1, 2002, to determine accruals or allocations for a plan year beginning on or after January 1, 2002, the plan is permitted to provide that the \$200,000 compensation limit applies to annual compensation for such prior periods in determining such accruals or allocations.

The compensation limit under § 401(a)(17) of the Code is adjusted for cost-of-living increases in accordance with § 401(a)(17)(B), as amended by EGTRRA, as of the beginning of a calendar year. As under pre-EGTRRA law, any such increases shall apply only with respect to annual compensation during the plan year or other 12-month period over which compensation is determined that begins with or within such calendar year (and any subsequent calendar year).

Example. B is a participant in a nongovernmental defined benefit plan, Plan A. Plan A has a calendar plan year, and a benefit formula that provides for an annual benefit at normal retirement age equal to the product of: (years of service) x (1 percent) x (high 3-year average compensation). For this purpose, high 3-year average compensation is the average of the compensation over the 3 consecutive plan years for which the average is the highest, and compensation for each year is limited to \$150,000, as adjusted for cost-of-living increases. As of December 31, 2001, B has 10 years of service and compensation of \$250,000 for each of the 3 years 1999, 2000, and 2001. B's high 3-year average compensation of \$166,667 is determined as the average of annual compensation (as limited by § 401(a)(17) of the Code) of \$160,000 for 1999, \$170,000 for 2000, and \$170,000 for 2001. B's annual benefit under the plan formula as of December 31, 2001, is \$16,667, calculated as $(10) \times (.01) \times (\$166,667)$.

In 2002, Plan A is amended (1) to use the \$200,000 compensation limit for compensation paid in years beginning after December 31, 2001, and (2) to use the \$200,000 compensation limit for compensation paid in years beginning prior to January 1, 2002, in determining benefit accruals in years beginning after December 31, 2001. B has annual compensation of \$250,000 for 2002. A high 3-year average compensation of \$200,000 is determined for B as of December 31, 2002, as the average of annual compensation (as limited by § 401(a)(17) of the Code, as amended by EGTRRA) of \$200,000 for 2000, \$200,000 for 2001, and \$200,000 for 2002. As of December 31, 2002, B's annual benefit under the plan formula is \$22,000, calculated as $(11) \times (.01) \times (\$200,000)$.

Plan A is not required to implement the EGTRRA increase in the compensation limit under § 401(a)(17) of the Code in its benefit formula. Plan A could retain the compensation limit in effect prior to EGTRRA, or provide for any other compensation limit that is less than the compensation limit as amended by EGTRRA. Accordingly, Plan A could be amended to provide that the increased compensation limit applies only to annual compensation paid in plan years beginning on or after January 1, 2002. In that case, a high 3-year average compensation of \$180,000 would be determined for B as of December 31, 2002, as the average of annual compensation of \$170,000 for 2000 and

\$170,000 for 2001 (both as limited by § 401(a)(17) of the Code, as in effect prior to amendment by EGTRRA), and \$200,000 for 2002 (as limited by § 401(a)(17) of the Code, as amended by EGTRRA). B's annual benefit as of December 31, 2002, would be \$19,800, calculated as $(11) \times (.01) \times (\$180,000)$.

III. Determination of Top-Heavy Status under § 416

A. Background

Section 416(a) of the Code provides that a plan that is a top-heavy plan for a plan year must satisfy the vesting and minimum benefit requirements of § 416(b) and (c) for the plan year. A defined benefit plan is a top-heavy plan for a plan year if, as of the determination date, the present value of the cumulative accrued benefits under the plan for key employees exceeds 60 percent of the present value of the cumulative accrued benefits under the plan for all employees. A defined contribution plan is a top-heavy plan for a plan year if, as of the determination date, the aggregate of the accounts of key employees under the plan exceeds 60 percent of the aggregate of the accounts of all employees under the plan. The determination date with respect to any plan year is the last day of the preceding plan year or, in the case of the first plan year of a plan, the last day of such plan year. The determination of whether a plan is top-heavy is made in accordance with the requirements of § 416(g) (including the aggregation requirements of § 416(g)(2)).

Section 613 of EGTRRA amended several provisions of § 416 of the Code, including provisions related to the requirements for determining whether a plan is a top-heavy plan for a plan year. Section 613(a) of EGTRRA modified the definition of "key employee" in § 416(i)(1) of the Code by increasing the compensation threshold for determining when officers are key employees to \$130,000 and by eliminating the ten employees owning the largest interests in the employer as a separate category of key employees. Section 613(c) of EGTRRA also provides that the determination of key employee status is made based on the plan year ending on the determination date, thereby eliminating the additional 4-year lookback period for determining key employee status. In general, § 613(c) of EGTRRA modified §§ 416(g)(3) and 416(g)(4)(E) of the Code to exclude from the determination of top-heavy status (1) distributions made prior to the 1-year period ending on the determination date (except that a 5-year period is retained for in-service distributions) and (2) the accrued benefits and account balances of employees who performed no service for the employer during the 1-year period ending on the determination date.

B. Effective Date

Section 613(f) of EGTRRA provides that the amendments made by § 613 apply to years beginning after December 31, 2001. Thus, the EGTRRA amendments to § 416 of the Code apply for purposes of determining whether a plan is top-heavy for the first plan year beginning after December 31, 2001, even though the determination date for that plan year is before the effective date of the EGTRRA amendment.

Thus, for example, for a plan with a calendar plan year (other than a plan in its first plan year), the determination of whether the plan is top-heavy for the plan year beginning January 1, 2002, is made as of December 31, 2001. This determination is made in accordance with the provisions of § 416 of the Code, as amended by EGTRRA. For example, for purposes of identifying key employees in accordance with § 416(i)(1)(A) of the Code as amended by EGTRRA, officers with annual compensation greater than \$130,000 for 2001 are key

employees, and the additional 4-year lookback period does not apply for purposes of that determination.

IV. Hardship Distributions

A. Background

Elective deferrals under a qualified cash or deferred arrangement subject to § 401(k) of the Code may not be distributable to participants prior to the occurrence of one of the events specified in § 401(k)(2). One of these events is a hardship of the employee. Treas. Reg. § 1.401(k)-1(d)(2)(i) provides that a distribution is treated as made on account of an employee's hardship if it is made on account of an immediate and heavy financial need and is necessary to satisfy the financial need. Treas. Reg. § 1.401(k)-1(d)(2)(iv)(B) provides a safe harbor pursuant to which a distribution is deemed necessary to satisfy an immediate and heavy financial need. One of the requirements of the safe harbor is that the employee is prohibited from making elective contributions and employee contributions under the plan and all other plans maintained by the employer for at least 12 months after receipt of the hardship distribution. See Treas. Reg. § 1.401(k)-1(d)(2)(iv)(B)(4).

Sections 401(k)(12) and 401(m)(11) of the Code provide design-based safe harbor methods for satisfying the actual deferral percentage (ADP) test contained in § 401(k)(3)(A)(ii) and the actual contribution percentage (ACP) test contained in § 401(m)(2) based on matching contributions that meet certain conditions and that satisfy certain notice requirements. Notice 98-52, 1998-2 C.B. 634, provides that a plan will not fail to satisfy the ADP matching contribution safe harbor merely because an eligible employee's ability to make elective deferrals is suspended for 12 months following a hardship distribution. Notice 98-52 also provides that a plan will not fail to satisfy the ACP matching contribution safe harbor merely because an eligible employee's ability to make elective deferrals and employee contributions is suspended for 12 months following a hardship distribution. See Treas. Reg. § 1.401(k)-1(d)(2)(iv)(B)(4) and sections V.B.1.c.iv and VI.B of Notice 98-52.

Section 636(a) of EGTRRA directs the Secretary of the Treasury to modify the regulations regarding hardship distributions to provide that the period during which an employee is prohibited from making elective deferrals in order for the distribution to be deemed necessary to satisfy a financial need shall be 6 months (instead of 12 months).

B. Effective Date

Section 636(a) of EGTRRA provides that the regulations as revised in accordance with § 636(a) shall apply to years beginning after December 31, 2001. Thus, the revised regulations will be effective for calendar years beginning after December 31, 2001, rather than effective only with respect to hardship distributions received after December 31, 2001. For example, a plan that provides for hardship distributions in accordance with the safe harbor in Treas. Reg. § 1.401(k)-1(d)(2)(iv)(B) may be amended to provide that an employee who receives a hardship distribution in 2001 is prohibited from making elective deferrals and employee contributions for 6 months after receipt of the distribution (or until January 1, 2002, if later). However, a plan sponsor generally could retain its existing suspension period for all hardship distributions (or for all hardship distributions prior to January 1, 2002).

However, in order to continue to rely on the matching contribution safe harbor in § 401(k)(12) or § 401(m)(11) of the Code to satisfy the ADP or ACP test, a plan must reduce the

period during which elective deferrals and employee contributions are suspended following a hardship distribution from 12 months to 6 months for calendar years beginning after December 31, 2001. A plan will not fail to satisfy this requirement merely because it provides that the reduction from 12 months to 6 months applies only to hardship distributions made after December 31, 2001.

V. Effect on Other Documents

Notice 98-52 is modified.

DRAFTING INFORMATION

The principal author of this notice is Ann Trichilo of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at (202) 283-9516 or (202) 283-9517, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday. Ms. Trichilo may be reached at (202) 283-9695. These telephone numbers are not toll-free.