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Treasury Finalizes Regulations on Automatic Contribution Arrangements

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The Pension Protection Act of 2006 (PPA) created the Qualified Automatic Contribution Arrangement (QACA) and the Eligible Automatic Contribution Arrangement (EACA) effective for plan years beginning in 2008 or later. Such plans should have been operating in good-faith compliance with the proposed regulations issued in November 2007. ASPPA's Government Affairs Committee (GAC) submitted written comments to the Treasury Department and testified at hearings before the IRS and Treasury on the proposed regulations.

On February 24, 2009, the Treasury Department published the much-anticipated final regulations which addressed several of GAC's recommendations.

▲ Effective Dates

The provisions applicable to QACAs are effective retroactively for plan years beginning on or after January 1, 2008. The EACA provisions are effective for plan years beginning in 2010 or later. The preamble to the regulations indicates they are not applicable to automatic enrollment arrangements established pursuant to guidance predating PPA. The full text of the regulations is available at <http://edocket.access.gpo.gov/2009/pdf/E9-3716.pdf>.

▲ Background

An EACA is a feature in a 401(k) plan that provides for the automatic enrollment at a uniform default percentage for all covered employees who do not have an affirmative deferral election in effect. Subject to certain limitations, participants covered by the EACA can request a permissible withdrawal of the amounts automatically withheld during the first 90 days, and sponsors of EACAs generally have an extended deadline of 6 months following the end of the plan year (instead of the regular 2 ½ months) to distribute excess contributions to avoid imposition of the 10% penalty.

A QACA is a new type of safe-harbor 401(k) plan that combines the automatic enrollment feature of the EACA with the automatic escalation of the default percentage each year. The employer is required to make a minimum contribution in the form of a match or non-elective contribution. See [ASPPA *asap* 2007-30](#) for additional background information.

▲ Uniformity Requirement

In the proposed regulations there was a requirement that, subject to certain limited exceptions, the default deferral percentage must be applied uniformly to all employees eligible to make a cash-or-deferred election in the plan, e.g. existing employees and new hires. In its comment letter, GAC requested the flexibility to apply the EACA default percentage only to new hires. The final regulations grant this flexibility by allowing the employer to specify in its plan document the employees that will and will not be covered by the EACA. This may include a provision that employees cease to be covered by the EACA upon making an affirmative deferral election. Plans that elect this limited application and do not cover all employees under the EACA provisions, however, are not permitted to take advantage of the extended 6-month timeframe for avoiding the excise tax on refunds of excess contributions.

The final regulations also permit a single plan to include multiple EACAs with different default deferral percentages for all groups of employees that can be disaggregated under IRC §410(b). For example, a single plan could include 2 EACAs – one covering collectively-bargained employees with a default rate of 3% and one covering non-collectively-bargained employees with a default rate of 4%. To avoid abuse in this area, the regulations require that all EACAs covering employees who cannot otherwise be disaggregated under §410(b) must be combined to determine whether the plan satisfies the uniformity requirement.

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The QACA uniformity rule is modified with regard to the timing of the automatic deferral increases. The final regulations clarify that the scheduled increases are based on the date on which deferrals for a given participant are first withheld pursuant to the QACA without regard to whether he or she may have had an affirmative election in effect in the interim. However, the plan can “reset” an employee to the beginning of the schedule, e.g. the Initial Period, if he or she does not have any default deferrals withheld during the immediately preceding plan year. This has practical application in determining the correct default percentage for rehired employees.

Example: Frank is automatically enrolled in a QACA in 2008 at a default rate of 3%. He terminates employment in December 2008 and is rehired in January 2010. Under the minimum required QACA escalation schedule, Frank would normally be increased to 4% in 2010; however, since he did not make any default deferrals during the entire 2009 plan year, he may be treated as a newly enrolled QACA participant at the 3% default rate. The plan is also permitted to uniformly apply automatic deferral increases based on portions of years instead of at year-end. This allows employers to coordinate the automatic increases with performance evaluations and/or salary increases.

Although there was nothing in previous guidance specifically precluding the practice, the final regulations note that a plan may provide that affirmative elections expire at a set time. Participants who do not make a subsequent affirmative election would be automatically enrolled at the default rate. This may also include situations in which a participant’s prior affirmative election is not re-started following deferral suspension due to hardship distribution.

▲ Permissible Withdrawals

The final regulations clarify that in order to be eligible for a permissible withdrawal, a participant in an EACA must request the withdrawal within 90 days of the first pay date on which default deferrals were withheld as opposed to the date of deposit. Plan sponsors may choose to further restrict the timeframe for requesting permissible withdrawals to a minimum of 30 days. All EACAs required to be aggregated for application of the uniformity rule (described above) must also be aggregated to determine whether a participant is within the specified window to request a permissible withdrawal.

Similar to the above-described treatment of rehires, the permissible withdrawal clock is reset for employees who do not have any default deferrals withheld during the plan year immediately preceding their rehire. Any withdrawal request

would be applicable only to newly withheld automatic deferrals and not to any deferrals that were contributed during the participant’s prior employment.

Several other ASPPA GAC questions related to EACA withdrawals are also confirmed or clarified.

- Permissible withdrawals are included in income in the year of distribution but are not subject to the early withdrawal penalty under IRC §72(t).
- Permissible withdrawals are disregarded for the ADP test and the IRC §402(g) limit.
- The timing of actual distribution must be consistent with the plan’s specified timing for other distributions.
- Processing fees may be charged directly to the participant’s account as long as the fees *do not exceed* fees charged for other plan distributions.
- As long as the plan sponsor is not otherwise required to allocate its matching contribution earlier, i.e. with each pay period, the plan document may provide that it is not necessary to allocate and immediately forfeit matching contributions related to automatic deferrals that are permissibly withdrawn.

▲ Notice Requirement

There are several clarifications on the timing of the QACA/EACA notice. Specifically, the notice is deemed timely if provided between 30 and 90 days prior to the start of a plan year. For a participant that becomes eligible during the year, the notice must be provided no earlier than 90 days prior to his or her eligibility date and no later than the eligibility date. If the notice cannot reasonably be provided in this timeframe, it may still be considered timely if provided prior to the pay date that includes the pay period in which the employee became eligible. Further, the employee must have sufficient time to make a deferral election after receiving the notice.

▲ Disappointments

The final regulations do not provide relief or clarification on two key issues raised by ASPPA and other commentators. First, the final regulations retain the prohibition on adding an QACA or a EACA to an existing 401(k) plan in the middle of a plan year. The second item relates to the requirement that employer matching and non-elective contributions intended to satisfy the ADP and ACP tests in a QACA must be vested after no more than 2 years. There has been some confusion on whether or how the sponsor of a traditional safe-harbor 401(k) plan requiring immediate vesting can transition to the 2-year vesting schedule if they implement a QACA. The final regulations do not provide any further guidance on this question.

As with most regulations, the final automatic contribution arrangement regulations include many small details that may pose traps for the unwary. Stay tuned for information on an upcoming ASPPA webcast that will delve into the details and practical implications of these new regulations.