

REPTECH

Customized Employee Benefits Administration

NEW OPPORTUNITIES TO IMPLEMENT A SAFE HARBOR 401(k) PLAN

Safe Harbor 401(k) Introduced in 1999.

As part of pension legislation passed in 1996 and 1997, a simplified 401(k) plan design known as a "safe harbor 401(k)" was created. IRS Notice 98-52 defines a safe harbor 401(k) plan. A plan is a safe harbor 401(k) plan if the employer: (1) commits (by amending the plan) to either a specific matching formula or a 3% floor nonelective contribution; **and** (2) gives a timely notice to the affected employees. Employee notification had to be given no later than March 1, 1999 for a safe harbor 401(k) plan to be effective for the 1999 plan year. The IRS notice also explained that the plan provisions did not actually need to be amended until the end of the current remedial amendment period. (See "AMENDMENTS

UPDATE" in this issue.) A 401(k) plan that meets one of the "safe harbor" designs will not have to perform the Actual Deferral Percentage ("ADP") test which compares the average elective deferrals of the group of highly compensated employees ("HCEs") to the average elective deferrals of the group of nonhighly compensated employees ("NHCEs"). Under the ADP test the average percentage of the HCE group is limited to the lesser of two times the average percentage of the NHCE group or two percentage points greater than the average percentage of the NHCE group. A similar test exists for employer matching contributions called the Actual Contribution Percentage ("ACP") test. If designed properly, a safe harbor 401(k) plan may be exempt from performing this test as well.

The initial guidance provided by the IRS was sufficient to get safe harbor 401(k) plans up and running. However, as with most new programs, issues arose in operation that either were not addressed or were not anticipated by the IRS. After all, the IRS can't think of everything! In order to address these additional issues, IRS Notice 2000-3 was released.

IRS Notice 2000-3

This notice responds to suggestions received by the IRS regarding ways to make it easier for employers to adopt and administer safe harbor 401(k) plans, such as:

Sponsors of existing 401(k) plans or employers considering adoption of a 401(k) plan in 2000 may still take advantage of the safe harbor 401(k) rules. Normally, safe harbor 401(k)

notices must be provided before the plan year begins. However, in an effort to encourage employers to take advantage of safe harbor 401(k) plans, IRS Notice 2000-3 allows employers adopting a safe harbor method for the first time in 2000 to still do so. For plan years beginning on or after January 1, 2000 and on or before June 1, 2000, an employer may adopt a safe harbor method for the first time if the appropriate employee notification is given on or before **May 1, 2000**. However, regardless of which safe harbor contribution method is adopted, it must be applied for the entire plan year as though it had been in effect at the beginning of the plan year. For example, assume the matching safe harbor method is chosen as of April 1, 2000. Safe harbor matching contributions must be made on any 401(k) deferrals made by eligible employees between January 1, 2000 and March 31, 2000, not just on 401(k) deferrals from April 1, 2000 forward.

Current sponsors of safe harbor 401(k) plans using a safe harbor matching contribution may prospectively suspend matching contributions during a plan year and then actually perform the ADP and, if applicable, the

ACP tests on a current year basis. Eligible employees must be given notice of this decision and must also be given the opportunity to change their 401(k) elections appropriately.

- For the 2001 plan year, sponsors of existing 401(k) plans may be able to wait as late as December 1 of the calendar year to decide to adopt the 3% floor nonelective safe harbor contribution method. Notice must be given to eligible employees before the plan year begins stating that the plan may be amended during the plan year to provide for the 3% floor nonelective safe harbor contribution. If the employer decides to exercise this option, a supplemental notice containing information regarding the safe harbor contribution must be provided to eligible employees no later than 30 days before the last day of the plan year.

These are just a few of the highlights of IRS Notice 2000-3. If you are interested in pursuing one of these new opportunities, please call. Remember, the window of availability for some of these options is very narrow for the 2000 plan year.

2000 PLAN LIMITS

The elective deferral limit of Code §402(g) increases to \$10,500; the compensation limit jumps to \$170,000; and the Social Security Wage Base increases to \$76,200. The highly compensated employee definition continues to be employees who earn more than \$80,000 in the previous plan year or 5% owners in either the current plan year or the previous plan year. For 2001, the highly compensated employee compensation amount for the previous plan year increases to \$85,000. The definition of “key” employees for purposes of top-heavy plans changes only slightly to officers who earn more than \$67,500, 5% owners, 1% owners who earn more than \$150,000, and one of the 10 largest owners (owning at least 1/2 %) who earn more than \$30,000. Why aren't the “key employee” and the “highly compensated employee” definitions the same? Go figure! And while you have your calculator out, call your Congressman.

New Comparability Plans Targeted

IRS Notice 2000-14, released jointly by the Treasury Department and the IRS on

February 24, 2000, targets new comparability plans for extensive governmental review. A new comparability plan (also known as a cross-tested plan) is one in which different contribution allocation formulas apply to different classifications of employees (e.g. HCEs and NHCEs). These agencies are concerned that because these types of plans contain built-in contribution disparities between HCEs and NHCEs, they cannot be reconciled with the spirit of the nondiscrimination rules. New comparability plan designs have been under scrutiny by governmental agencies beginning in 1994. Since that time, their position has changed from skepticism to acceptance and back again. This waffling causes uncertainty and doubt among new comparability plan sponsors and their consultants.

The American Society of Pension Actuaries (“ASPA”) has negotiated a compromise with the Treasury Department which should give both plan sponsors and benefit consultants some certainty regarding these plans. The Treasury Department has agreed that any new regulations issued as a result of their review will generally not be effective until the first plan year

beginning after December 31, 2001. This relief period applies to (1) new comparability plan designs in existence on February 24, 2000; (2) new plans using a new comparability design where the plan sponsor currently has no retirement in effect nor has had one in effect at any time since February 24, 2000; or (3) a new plan, or an amendment to an existing plan, that adopts a new comparability design, provided that the only previous plan in effect since February 24, 2000 has been a 401(k) plan (with deferrals and matching contributions only), a SEP or a SIMPLE plan. REPTECH will report any new developments regarding new comparability plans.

AMENDMENTS UPDATE

Amendments to plan documents to reflect the changes in qualification provisions of GATT, USERRA, SBJPA '96, and TRA '97 (collectively known as the GUST amendments) were originally required to be made before the last day of the 1999 plan year. During 1999, this deadline was extended to the last day of the 2000 plan year. If the plan was terminated, the

amendments had to be in effect on the date of termination. Plans must be operated in accordance with the new rules and then amended retroactively to cover the period affected by the change in the law. As previously reported, the changes in the law over the last four years will require a complete restatement of all qualified plans, with corresponding republishing of the SPD, and submission of the plan to the IRS for a new determination letter (unless the plan is allowed to rely on the opinion letter issued to REPTECH (e.g., standardized plans)).

IRS Rev. Proc. 2000-20

We have recently received additional guidance regarding the required document restatements in the form of IRS Rev. Proc. 2000-20. The IRS will open the approval program for GUST-amended plan documents beginning in April, 2000. This means that GUST-amended documents should be available for adoption by individual employer sponsors beginning in late 2000. The IRS realizes that the current deadline of the last day of the 2000 plan year (December 31, 2000 for calendar year plans) is unrealistic. Therefore, they are

extending the remedial amendment period deadline to the end of the twelfth month following the date your document provider's GUST-amended document is approved. For example, if REPTECH's GUST-amended document is approved on October 3, 2000, the deadline for most employer's using REPTECH's document would be October 31, 2001. Please note, however, this extended deadline does not apply to

employers whose plan years begin after January 1, 2000. Assume in the previous example that the 2000 plan year begins June 1, 2000. This plan must be restated on a GUST-amended document no later than May 31, 2001 (the last day of the 2000 plan year). The extension also does not apply to individually-designed documents, ESOPs, and multiple employer plan documents.

REPTTECH will keep clients updated regarding the entire restatement process as new information and dates become available.

QUESTIONS?**Contact:****Eileen A. Baldwin (ext. 16)****Ralph W. Shaw (ext. 15)****Nancy L. Walker (ext. 22)****Denver: 720-489-8700****Toll Free: 1-877-291-4015**