Dedicated to the Private Pension System

Comments to the
Internal Revenue Service
CC:IT&A:RU

Catch-Up Contributions for Individuals Age 50 or Over

26 CFR Part 1
REG-142499-01
RIN 1545-BA24

Federal Register
Vol. 66, No. 205
October 23, 2001
pp. 53555-53564

January 30, 2002

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Catch-Up Contributions for Individuals Age 50 or Over

The American Society of Pension Actuaries (ASPA) offers these comments on the proposed regulations under §414(v) regarding Catch-Up Contributions for Individuals Age 50 or Over [REG-142499-01]. ASPA and its members welcome the promptness of this guidance. Nevertheless, we believe that clarification and further guidance is required with regard to certain aspects of the proposed rules.

ASPA is a national organization of 5,000 members who provide actuarial, consulting, administrative, legal and other services to qualified plans and tax-sheltered annuities.

SUMMARY OF ISSUES

This letter addresses a number of issues, which are described in greater detail below. We begin with general comments and proceed to our more specific issues, as follows:

1. Timing of Adoption of Catch-up Amendment and Related Amendment Issues;

2. Participant Notices and Requirement for Elections;

3. Application of Catch-up Rules to Non-Calendar Year Plans;

4. Application of "ADP Limit" to HCEs Only;

5. Other Amendment Issues;

6. Matching of Catch-Up Contributions;

7. Catch-Up Rules for §403(b) Plans;

8. Adoption of Catch-Up Provisions by Sponsor of SARSEP; and

9. Other Miscellaneous Issues.

DISCUSSION OF ISSUES

1. Timing of Adoption of Catch-Up Amendment and Related Amendment Issues

Plan sponsors and practitioners alike are unclear about when a plan amendment permitting catch-up provisions must be adopted, whether for 2002 or a subsequent year. Under Prop. Reg. §1.414(v)-1(b)(2)(i), catch-up contributions are determined as of the end of the plan year even though it is possible a participant may have exceeded one of the applicable limits—either statutory or employer-provided as defined in Prop. Reg. §§1.414(v)-1(b)(1)(i) and (ii)—prior to the end of the year.

Adoption for 2002. Notice 2001-57 seems to provide that a good faith EGTRRA amendment that reflects adoption of catch-up contributions is timely if it is adopted no later than the end of the plan year in which catch-ups are implemented, or the end of the GUST remedial amendment period. To avoid confusion, we suggest the Service confirm in its final regulations that catch-up eligible participants be permitted to make elective deferrals intended to be catch-up contributions during the 2002 plan year so long as the amendment is adopted by the last day of the plan year.

However, if this is not the Service's position, ASPA proposes that an employer be able to adopt a catch-up amendment in the 2002 plan year no later than October 1, 2002, (or, if later, 90 days prior to the plan's year end). This date would seem to be consistent with the universal availability requirement as clarified by Notice 2002-4 and also would allow participants sufficient time to adjust their deferral elections to take advantage of the newly enacted provision.

Adoption in Subsequent Year. Many plan sponsors are delaying the adoption of catch-up provisions due to uncertainties regarding the effect on plan administration, state conformity issues, or in some instances, because they currently have no employees who meet the definition of catch-up eligible participant in Prop. Reg. §1.414(v)-1(a)(4). Assuming these plans have passed the end of the GUST remedial amendment period and have timely adopted a good-faith EGTRRA amendment, Notice 2001-42 requires the adoption of an amendment "if the plan sponsor elects to implement a provision of EGTRRA for the year and the plan, prior to the amendment, is inconsistent with the operation of the plan in a manner consistent with EGTRRA."

Here again, Notice 2001-57 seems to give plan sponsors until the end of the plan year in which they implement catch-up contributions to amend their plans to include a good-faith catch-up provision. Assuming this is a correct reading of the Notice, ASPA suggests the final regulations clarify and confirm this point.

However, if it is the Service's position that such an amendment must be adopted earlier in the plan year, ASPA proposes that qualified plans be allowed to add a catch-up provision using the Notice 2001-57 sample amendment at any time during the plan year, up to 90 days prior to the end of a plan year in which participants have been permitted to make

catch-up contributions. This interpretation is consistent with the existing treatment of the addition of a safe-harbor provision to eliminate ADP/ACP testing. It also is consistent with the October 1, 2002, universal availability date as provided for in Notice 2002-4.

Non-Calendar Year Plans. These plans present special challenges to the timing of adoption of the catch-up provisions. The rules are so new that, for plan years ending in 2002, it may be nearly impossible for an employer to adopt catch-up provisions before the last month of the plan year (*e.g.,* January 31, 2002, year end).

In subsequent years, a plan sponsor may make a decision to permit catch-up contributions based upon the plan's testing results for the plan year that ends within a calendar year. However, the testing results may not be available until several months after the plan's year end.

As with calendar year plans, ASPA requests confirmation that the Notice 2001-57 plan year-end rule is also applicable. If an amendment is needed before the end of the plan year, ASPA proposes that a plan be able to add the provision no later than 90 days prior to the plan's year-end.

Related Amendment Issues

A. Employer-provided limits are often applied only to Highly Compensated Employees (HCE) and many plan sponsors have maintained administrative procedures (rather than strict plan provisions) to effect these limits operationally. The limits may change (increase or decrease) from year to year, and are generally set based upon nondiscrimination testing results from the prior plan year. Of course, these test results are generally not available until sometime during the subsequent plan year.

It appears the provisions of Prop. Reg. §1.414(v)-1(b)(1)(ii) will require plan sponsors that previously opted for administrative restrictions on deferrals to adopt specific plan provisions. If this interpretation is correct, guidance is needed on the timing to adopt such amendments, particularly with regard to increases or decreases that may be appropriate for plans with §401(k)/(m) nondiscrimination test failures. Further, clarification is needed as to whether or not a standard plan provision giving the administrator the right to limit or cease HCE deferrals qualifies as an employer-provided limit under the regulations. ASPA proposes that a plan be permitted to impose or adjust a plan-specified limit at any time during the plan year, so long as such amendment does not cause the plan to fail to satisfy §411(d)(6) anti-cutback rules, along with confirmation that a general plan provision giving the administrator the right to restrict HCE deferrals will qualify as an employer-provided limit.

A generous policy should be adopted with regard to amendment to, or adoption of, these employer-provided limits. Such limits generally give participants more certainty of the amount of elective deferrals that may remain in the plan and ease the administrative and testing burdens associated with maintaining cash or deferred arrangements, and therefore benefit both the employee and the plan sponsor.

B. Along these lines, if a sponsor of a newly-established cash or deferred arrangement elects the "deemed 3%" rule for its first plan year, please confirm that the resulting 5% ADP limit is not considered an employer-provided limit for purposes of catch-up contributions.

C. Employers that opt for current year testing in determining the ADP limit may conclude that using prior year testing enables catch-up eligible participants to be certain of their elective deferral limits for the plan year. However, the rules of Section VII of Notice 98-1 may preclude an employer from changing its testing election. Notice 98-1 was developed based upon the nondiscrimination testing rules in effect at the time the notice was issued. The Service should revise the rules of Section VII of Notice 98-1 regarding an employer's ability to change its testing elections, in light of catch-up contributions, by allowing a change in testing method for the plan year in which catch-up contribution provisions are first adopted.

2. Participant Notices and Requirement for Elections

The proposed regulations did not specify how to notify participants should the plan sponsor decide to adopt catch-up provisions. In conjunction with the universal availability rule cited in Prop. Reg. §1.414(v)-1(e), it is unclear what is considered "timely and proper" notice to an employee so that all catch-up eligible participants "are provided with the effective opportunity to make the same dollar amount of catch-up contributions."

Further, must the participant make any election, whether affirmative or negative, or other acknowledgment, regarding the application of catch-up rules to their deferrals? Most payroll systems, whether commercial or private, have determined that to monitor various deferral limits, catch-up contributions amounts in excess of statutory limits or employer-provided limits, will be captured in a field separate from the "regular" elective deferral. For this reason, many payroll providers want employees to make an affirmative election regarding elective deferrals that would exceed the above-mentioned limits.

ASPA recommends that employee notification rules take the form of a standardized notice, prepared by the Service, that must either (a) be provided at least 30 days before the first date on which catch-up contributions may be made, or (b) permit participants to change their current deferral election for at least 60 days after the notice is given. Further, plans should be permitted to implement whatever election procedures the plan sponsor deems appropriate to facilitate plan administration.

3. Application of Catch-Up Rules to Non-Calendar Year Plans

Presumably, catch-up eligible participants in a calendar year plan expect to be able to make deferrals to the plan up to the §402(g) limit (or a plan-specified limit, if less) plus the catch-up limit. The HCE's elective deferrals are limited only if the ADP limit is less than the plan-specified or §402(g) limit.

Examples 5 and 6 of the proposed regulations explain the results for a catch-up eligible employee participating in a non-calendar year plan that permits catch-up contributions. It appears the application of the proposed regulations should result in any catch-up eligible HCE being able to defer up to the §402(g) or plan-specified limit plus the catch-up limit, every calendar year, except to the extent the ADP limit is less.

Guidance is needed to clarify the results when:

A. There are no elective deferrals during the calendar year in which the plan year ends, or

B. Elective deferrals for the calendar year that are made within the plan year do not exceed the §402(g) limit, but do exceed an employer-provided limit or the ADP limit.

Each of these situations is discussed below.

A. No Elective Deferrals for Calendar Year Prior to Plan Year End

We request the Service issue guidance to clarify the results if there are no elective deferrals during the calendar year in which the plan year ends. This situation might occur if the participant has either been prevented from contributing because of a hardship withdrawal restriction or if the participant reached the plan maximum in the portion of the plan year prior to the new calendar year. In other words, can ADP failures create catch-up contributions for a year in which no contributions have been made?

Suppose an employer maintains a cash or deferred arrangement with a January 31 year end. The employer first adopts the catch-up rules effective January 1, 2003. The plan fails its ADP test for its year ending January 31, 2003. A catch-up eligible HCE has excess contributions of $500 as of January 31, 2003, without regard to §414(v).

Must the employee have deferred at least $500 in January 2003 in order for the plan to characterize the $500 as catch-up contributions? Based upon the proposed guidance, ASPA believes the answer should be no, but we request clarification of this result in the regulations.

How much can the participant contribute during the period February 1, 2003, through December 31, 2003? The proposed regulations leads one to conclude that the employee may contribute an amount up to the §402(g) limit, plus $1,500 (which is the balance of allowable catch-up contributions for the 2003 calendar year) assuming the plan has no employer-provided limit. However, the regulations should contain clear examples and guidance in this regard.

B. Elective Deferrals Not in Excess of §402(g) Prior to Plan Year End

Consider the following examples, which raise questions not answered in the Proposed Regulations:

A plan with a March 31 year-end limits elective deferrals for HCEs to 5% of pay. Catch-up eligible participants are permitted to contribute an amount in excess of 5% of pay, so long as it does not cause the employee to have elective deferrals in excess of the catch-up dollar amount for the calendar year. The §402(g) limit for 2003 is $12,000; the catch-up limit is $2,000.

Assume an HCE, who is also a catch-up eligible participant, made no contributions during 2002, but contributes $11,000 during the period January 1, 2003, to March 31, 2003, and has compensation of $180,000 for the plan year. Since the employer-provided limit is 5% of pay, $2,000 is treated as catch-up contributions for 2003 and $9,000 is included in the March 31, 2003, ADP test.

It is determined that the ADP limit for the year ending March 31, 2003, is $8,500. Since the employee has already contributed an amount equal to the catch-up limit for 2003, the excess contributions of $500 ($9,000 less $8,500) must be refunded to the employee.

However, the employee has not exceeded his §402(g) limit for the 2003 calendar year. May the employee make elective deferrals for the period April 1, 2003, through December 31, 2003, of $3,000? This would permit the employee's pre- and post-April 1 deferrals to total $12,000. We believe the final regulations should contain clear examples and guidance in this regard.

Consider a plan with a May 31 year-end that permits catch-up contributions. For the plan year ending May 31, 2003, a catch-up eligible HCE contributes the following amounts:

- $6,000 from June 1, 2002, to December 31, 2002 (a total of $11,000 for calendar year 2002); and

- $6,000 from January 1, 2003, to May 31, 2003.

Since the HCE did not exceed the §402(g) limit for 2002 or 2003, the entire $12,000 is included in the plan's ADP test for the year ending May 31, 2003. The ADP limit for the plan year is determined to be $9,500. The HCE has excess contributions of $2,500; therefore, $2,000 will be treated as catch-up contributions for 2003 and the remaining $500 will be refunded to the HCE under the terms of the plan.

Again, the employee has not exceeded his §402(g) limit for 2003; however, the employee already has catch-up contributions (by operation of the ADP limit) of $2,000. Assuming a catch-up eligible participant in a non-calendar year plan has the §402(g) limit plus the catch-up limit available, the HCE's total elective deferrals for calendar year 2003 are limited to the extent the ADP limit is less than the §402(g) limit. In our example, the

HCE's 2003 §402(g) limit is $12,000, the catch-up limit is $2,000, and the ADP limit adjustment is $500, or $13,500.

Are the elective deferrals of the HCE for the period June 1, 2003, through December 31, 2003, therefore limited to $7,500?

4. Application of "ADP Limit" to HCEs Only

Prop. Reg. §1.414(v)-1(b) identifies the applicable limits "for purposes of determining catch-up contributions for a catch-up eligible participant" without regard to whether or not the catch-up eligible participant is a HCE. It does not appear that the "ADP Limit" should apply to Non Highly Compensated Employees (NHCE); however, the regulations are not clear in this regard. The definition of applicable limits should be clarified so that the "Actual Deferral Percentage (ADP) limit" defined in Prop. Reg. §1.414(v)-1(b)(1)(iii) applies only to HCEs.

5. Other Amendment Issues

Plan sponsors need guidance regarding their ability to eliminate catch-up provisions on a prospective basis. We urge the Service to provide guidance permitting an employer to eliminate catch-up contributions at any time subject to the universal availability requirements of the regulations.

Further, the universal availability rules in Prop. Reg. §1.414(v)-1(e) appear to require an employer to adopt catch-up provisions for newly acquired plans. We believe the right to make catch-up contributions is not a protected benefit under §411(d)(6), and therefore guidance should permit an employer to eliminate catch-up provisions in plans the employer maintained prior to an acquisition. A broader interpretation will enable plan sponsors to manage their employee benefits in a way that makes sense for their specific businesses. Many employers may be hesitant to adopt catch-up provisions without the ability to eliminate the provisions if deemed necessary.

6. Matching of Catch-up Contributions

Prop. Reg. 1.414(v)-1(d) mentions certain aspects of matching contributions related to catch-up contributions; however, guidance is needed for the following situation:

An employer permits catch-up contributions, but also imposes a 6% deferral limit for HCEs. The plan further provides that catch-up contributions are not matched. Matching contributions are made throughout the plan year.

The employer requires all catch-up eligible employees, including those who are NHCEs, to specifically elect to make catch-up contributions on a pro-rata basis (such as pay-period to pay-period) throughout the plan year. The employer matches contributions on a payroll-to-payroll basis, and the employer intends to match only those employee deferrals that are not attributable to the specific catch-up election.

Under the proposed regulations, catch-up contributions are not determined until the end of the plan year and amounts deferred as catch-up under election rules such as those discussed above may, in fact, be subsequently determined not to be catch-up amounts. Since those amounts have not been matched throughout the year, must those amounts be matched at the time the elective deferrals are determined not to be catch-up contributions under §414(v)?

ASPA proposes that employers be permitted to allocate no matching contributions attributable to designated catch-up elective deferrals, even if those deferrals are subsequently determined not to be catch-up amounts, without violating the benefits, rights, and features rules of §401(a)(4).

7. Catch-up Rules for §403(b) Plans

Please confirm that if an employee qualifies to use §402(g)(7), then the applicable "statutory limit" is the §402(g) limit, as increased by §402(g)(7). For example, an employee who qualifies for the additional $3,000 elective deferral under §402(g)(7) in 2002 has a "statutory limit" of $14,000. If the employee's elective deferrals exceed $14,000, only then will there be a catch-up contribution under §414(v).

In addition, ASPA recommends that the rules applicable to qualified plans specifying the time for adopting catch-up contribution amendments and employee notices also be applied to these types of arrangements.

8. Adoption of Catch-Up Provisions by Sponsor of SARSEP

Many plan sponsors executed IRS-provided Form 5305A-SEP to implement a SARSEP. Sponsors of such plans need guidance regarding the manner in which to adopt EGTRRA provisions, including catch-up. Revenue Procedure 2002-10 addresses the issue of SARSEPs being updated for EGTRRA (both prototype and the governmental form); however, issues with respect to the timing of the adoption of the catch-up provisions and participant notification arise that are the same as qualified plans. We urge the Service to adopt a consistent set of rules.

9. Other Miscellaneous Issues

For a plan that corrects ADP test failures by using QNECs, the ADP limit under Prop. Reg. §1.414(v)-1(b)(iii) is determined by including such QNECs. In other words, is it the position of the Service that the ADP limit for purposes of catch-up contributions is determined after all other corrective measures that increase the ADP limit—such as QNECs, QMACs, or shifting under §1.401(k)-1(b)(4)(ii) and §1.401(m)-1(b)(4)(ii)—have been taken into account?

Reg. §1.415-6(b)(6)(iv) permits a plan to provide for the return of elective deferrals as a means to satisfy the rules of §415. Must the document be amended with regard to

provisions limiting annual additions to permit these elective deferrals to be treated as catch-up contributions?

ASPA recommends that the Service clarify that a plan amendment providing for catch-up contributions as a corrective mechanism for purposes of §415 need not be adopted at this time so long as the plan operates under the terms of the law and is amended by the end of the EGTRRA remedial amendment period (currently the last day of the 2005 plan year).

This letter was prepared by the ASPA's 401(k) Subcommittee of the Government Affairs Committee. Please contact us if you have any comments or questions regarding the matters discussed above.

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