Comments on Notice 98-52

February 23, 1999

Roger Kuehnle
Employee Plans Division
CC:DOM:CORP:R (Notice 98-52)
Room 5228
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Notice 98-52

Dear Mr. Kuehnle:

The American Society of Pension Actuaries (ASPPA) is a national organization of approximately 3,000 members who provide actuarial, consulting, administrative, legal and other services for qualified plans and tax-sheltered annuities. ASPPA's members and their clients are committed to compliance with the legal requirements affecting these plans and arrangements.

Thank you for the timely issuance of Notice 98-52, guidance on safe harbor 401(k) plans, We are particularly appreciative of the extended time until March 1, 1999, to provide employees with notification of this arrangement. We expect that a significant number of plan sponsors will opt to use the safe harbor arrangement, resulting in greater retirement savings for both highly and non-highly compensated employees alike.

We note that a number of the requirements contained in Notice 98-52 goes beyond the provisions of Code section 401(k)(12), and we question their appropriateness as discussed below. We believe in order to make the safe harbor 401(k) plan more usable for plan sponsors, we suggest the following changes to the guidance:

- Flexibility to choose safe harbor option annually
- A more simplified notice to plan participants
- Removal of the 4% cap on discretionary matching contributions
- Expanded availability of safe harbor when the plan sponsor has a short plan year
- Limitation of deferral election percentages to integral amounts
- Removal of anti-abuse rule for non-calendar plan years
- Flexibility in timing of choice of non-elective safe harbor
- Availability of prior year testing for ACP test
- Clarification of the application of the multiple use test
- Ability to elect safe harbor mid-year
- Need for LRM language
- Need for guidance regarding funding of safe harbor contribution

Discussion

1. Safe Harbor Options Within the Plan Document: Most plan sponsors who choose to use the new safe harbor option will be content to commit to a fixed safe harbor choice on a long term basis. However, others will prefer to retain flexibility that allows them to respond to business changes without the need to amend the plan document. Notice 98-52 does not accommodate this

flexibility, despite the fact that the statute itself does not impose the requirement to state the plan's compliance method within the four corners of the plan document.

We suggest a more flexible approach, similar to SIMPLE IRAs, where the plan sponsor may choose the nonelective or matching contribution option on a year-by-year basis. The advance notice will adequately document the decision and prevent any potential abuse that the amendment requirement is presumably designed to meet.

2. Simplified Notice to Plan Participants: The notice requirement contained in Notice 98-52 provides for a significant amount of information to the plan participant, much of which is already required to be provided in the Summary Plan Description (SPD). We suggest a simpler notice that provides the following information to plan participants:

- The name of the plan
- ? The fact that the plan sponsor has chosen to make the safe harbor nonelective or the safe harbor match
- The matching or nonelective contribution formula
- The numerical impact on the plan participant if he or she chooses to defer at the maximum level of deferral to attract the maximum match (e.g., if you choose to defer 5% of your pay, the company will contribute a matching contribution of 4% of pay.)
- If the safe-harbor match or nonelective contribution will be made to a different plan than where elective contributions are deposited, then the name of the plan should be provided.

We propose that the information listed above should be sufficient (in conjunction with the Summary Plan Description) for a plan participant to make an informed decision.

We do not support the requirement in the notice (not contained in the statute) that the notice must describe other types of contributions to the plan that are not related to the safe harbor. These contributions would clearly not need to be mentioned where the employer maintains a separate plan. Employers should not be penalized for using a single document. Inclusion of irrelevant information in the notice can only lead to confusion for employees.

3. 4% Cap on the Discretionary Match: Section VI.B.4.b. under "ACP Test Safe Harbor" provides for a maximum discretionary match of 4% of the employee's compensation. We see no statutory basis for this limitation and suggest that it be removed. At the very least, if the limit is retained, final guidance should clarify that the cap only applies to HCEs.

4. Short Plan Years and the Safe Harbor: Section X only permits a plan year of less than 12 months for newly established plans. We can envision a number of non-abusive situations where the plan sponsor has legitimate reasons for using a short plan year. We believe that plan sponsors in the situations below should be able to use the safe harbor 401(k) plan:

- A plan sponsor changes its fiscal year and wishes to change its plan year to coincide with its fiscal year for ease of data collection;
- A plan sponsor does not change its fiscal year, but wishes to align its 401(k) plan year with its other plans to permit use of the nonelective safe harbor on an aggregated basis
- A plan sponsor does not change its fiscal year, but wishes to align its 401(k) plan year with its other plans to use consistent limitation years or to coordinate data collection
- A plan sponsor decides to terminate its 401(k) plan;
- A plan sponsor is involved in a merger or acquisition, where a short plan year is needed in conjunction with a plan merger (or merely to bring both plans to the same plan year) for ongoing compliance testing.

5. Integral Deferral Percentages: The requirements of the notice state that a safe harbor plan must permit the participants to defer “any lesser amount,” meaning that participants must be able to defer an amount smaller than the amount which provides them with the maximum employer matching contribution. For Administrative ease, we propose that plan sponsors be permitted to impose a minimum of 1% of pay (or a flat dollar amount per payroll period not to exceed 1% of pay). However, the plan sponsors may impose integral limits; i.e., a plan participant may choose to defer 1%, 2%, 3%, etc. of pay.

6. Anti-Abuse Rule for Non-Calendar Plan Years: Section VIII.E. contains an anti-abuse rule that applies in the case of a plan that is not maintained on a calendar year basis. It refers to the anti-abuse rule contained in Notice 98-1. We do not understand the reason for the concern with non-calendar year plans and urge that the anti-abuse role not be applied in this situation.

We also wish to reiterate our concerns about the anti-abuse rule contained in Notice 98-1. The quoted material below is taken from our April 2, 1998 letter to Mark Iwry:

“This type of provision is problematic for several reasons. First, Notice 98-1 prohibits changes from current year to prior year testing more often than once every five years. Therefore, the most that a taxpayer may do is change from prior year to current year, and then back again five years later. The 5-year rule, by itself, prevents the ‘repeated changes in the testing procedure’ to which the anti-abuse rule refers.

Second, this provision denies taxpayers the confidence that, if they follow the law and the IRS’s written guidance, they can be assured that they are operating their plans in a qualified fashion. This provision says to taxpayers: “No matter what you do, or how hard you try, there is always some possibility that this plan can be disqualified by an IRS reviewer”.

Third, we believe this type of provision provides field agents with improper discretion in reviewing plans. If an agent comes across a practice that he or she believes is abusive, his or her remedy should not be to single out this taxpayer for special unpredictable plan disqualification. The proper remedy should be to raise the problem to the IRS Headquarters and have new guidance issued disallowing the practice.

Taxpayers and their advisors must have the assurance that, if they act in certain ways, there is a predictable outcome. The Internal Revenue Code, regulations, and IRS guidance serve to provide that level of assurance. When the IRS attempts to reserve the right to penalize people outside that written guidance, it undermines the trust and comfort that taxpayers have in the system and in their behavior, and discourages the formation and maintenance of retirement plans. This has an emotional and financial cost that far exceeds any possible benefit that this type of catch-all provision provides to tax administration. We strongly urge that this provision be removed from Notice 98-1.”

7. Timing Flexibility for Nonelective Contribution Safe Harbor: Because the nonelective option should not have an impact on whether an employee chooses to participate, we suggested that the plan sponsor be permitted to choose the nonelective option (in lieu of testing) any time up to 12 months following the close of the plan year, as long as the nonelective contribution is made to the plan by this same deadline. Currently, a number of plan sponsors with top-heavy 401(k) plans will not permit their key employees to participate until late in the plan year, when they are certain that the company will have sufficient funds to satisfy the top-heavy minimum requirement. By allowing this flexibility, plan sponsors will be able to increase retirement savings for all employees without undermining employee decisions about contributing to the plan.

8. Availability of Prior Year Testing for ACP Test: Section VIII.F. of the Notice requires that a plan that uses the safe harbor methods to satisfy the ADP or ACP test for a plan year is treated as

using the current year testing method for that plan year and must use current year testing for all other tests needed for that plan. This appears to be a departure from prior guidance which did not, in any way, suggest that a plan could not use a prior year test for ADP purposes and a current year test for ACP purposes (or vice versa). Final guidance should make it clear that use of the ADP safe harbor does not limit the option to use prior year testing for ACP contributions, as long as the ACP safe harbor is not used. Clearly, this can be done by using separate plans and should not be barred, simply because components, which are required to be desegregated for testing purposes in any event, happen to be stated in a single plan document.

We suggest that, for plans with after-tax employee contributions, such plan sponsor be permitted to use prior year testing based on after-tax employee contributions only. To require such a plan sponsor to use current year testing will reduce the certainty in passing the ACP test for after-tax employee contributions.

Also, a plan sponsor who decides, in future years, to discontinue use of the safe harbor arrangement should not be precluded from using prior-year testing immediately. Requiring such a plan sponsor to wait up to five years to use prior-year testing is unreasonable.

9. Clarification of the Application of the Multiple Use Test: Section VIII.G. of the Notice contains rules concerning the multiple use test. We are requesting clarification with respect to the application of the multiple use test for a plan that provides the following elements:

- Elective contributions
- Matching employer contributions
- After-tax voluntary employee contributions

The Notice appears to say that a plan that uses an ADP and ACP safe harbor will, nonetheless, be required to perform a multiple use test. We are unclear on what elements would be used in the multiple use test. It would seem to us that the only contributions to be considered in the multiple use test would be after-tax voluntary contributions, for which no multiple use test would be required.

10. Mid-Year Election of Safe Harbor: A number of existing profit sharing plans may choose to implement a 401(k) feature. In some cases, due to timing, it may be difficult to implement the 401(k) feature as of the first day of the plan year. Such plans should not be precluded from using a safe harbor format from the date of implementation of the 401(k) feature until the end of the year, as long as the safe harbor match or contribution is made with respect to the entire plan year. If there is concern about the manipulation of the implementation of the 401(k) feature, a cutoff date (similar to SIMPLE plans) of 3 months before the close of the plan year could be implemented.

11. Need for LRM Language: We anticipate that a number of plan sponsors will be submitting their 401(k) plans for approval under GUST (GATT, USERRA, SBJPA ‘96, and TRA ‘97) sometime in 1999. To eliminate the need for multiple amendments, we would encourage the issuance of LRM language for safe harbor plans early in 1999.

12. Need for Guidance Regarding Funding of the Safe Harbor Contribution: After a plan sponsor commits in advance of the plan year to making the matching or nonelective contribution under the safe harbor, it may find itself unable to fulfill the contribution commitment. Please provide guidance for the plan sponsor’s alternatives in this circumstance.

We would also request guidance on the timing of the discontinuance of the safe harbor arrangement. We suggest that a plan sponsor be able to discontinue the arrangement mid-year by providing 15 day advance notice to plan participants. Such similar notice would also be

applicable in the event a sister plan (one providing the safe harbor contribution) to a 401(k) plan is terminated.

We appreciate the opportunity to discuss the views of ASPPA's membership. We welcome comments or questions. You may call Joan Gucciardi, Gucciardi Benefit Resources, Inc. (Milwaukee, Wisconsin) at (414) 302-9199, the chair of the 401(k) Subcommittee for ASPPA's Government Affairs Committee to open avenues of discussion. Other members of the Subcommittee are:

Ed Burrows (Boston, Massachusetts)
Kevin Donovan, Tucson Pension Consultations (Tucson, Arizona)
Ilene Ferenczy, Altman, Kritzer & Levick, P.C. (Atlanta, Georgia)
Kim Hedrick, Aon Consulting (Atlanta, Georgia)
Marge Martin, Sedgwick Noble Lowndes (Roseland, New Jersey)
David Pratt, Albany Law School (Albany, New York)
Mike Pruett, Cache Pension Services (Anchorage, Alaska)
Robert Richter, Corbel and Company (Jacksonville, Florida)
Janice Wegesin, JMW Consulting (Palatine, Illinois)

Sincerely,

Brian H. Graff, Esq. Executive Director

Bruce Ashton, Co-ChairGovernment Affairs Committee

Craig Hoffman, Co-Chair, Government Affairs Committee

George Taylor, Co-Chair, Government Affairs Committee

Cc: Mark Iwry, Carol Gold