Cash or Deferred Arrangements; Nondiscrimination

Notice 2000–3

I. PURPOSE

This notice provides additional guidance regarding 401(k) plans that are intended to satisfy the 401(k) safe harbors. This guidance responds to comments and suggestions regarding ways to make it easier for employers both to adopt and to administer 401(k) safe harbor plans. The notice:

- Encourages adoption of 401(k) safe harbor plans by giving sponsors of existing 401(k) plans the flexibility to wait as late as December 1 of a calendar year to decide to adopt the 401(k) safe harbor 3-percent employer nonelective contribution method for that calendar year;
- Permits 401(k) safe harbor plans to match elective or employee contributions on the basis of compensation for a payroll period, month, or quarter;
- Provides an extended period of time — until May 1, 2000 — for 401(k) plan sponsors adopting the 401(k) safe harbor methods for the first time in 2000 to provide the required safe harbor notice to employees;
- Provides explicitly that 401(k) safe harbor plans are permitted to require salary reduction elections to be made using whole percentages of pay or whole dollar amounts;
- Permits plan sponsors to provide the 401(k) safe harbor notice electronically and otherwise simplifies the notice requirement;
- Permits 401(k) safe harbor plans to provide matching contributions on an employee's aggregate employee and elective contributions;
- Makes clear that 401(k) safe harbor plans are permitted to apply to employee after-tax contributions a suspension similar to the 12-month suspension that may be applied to employee elective contributions after an in-service withdrawal of those contributions;
- Permits plan sponsors using the 401(k) safe harbor matching contribution method to exit the safe harbor prospectively during a plan year (and switch to ADP and ACP nondiscrimination testing) if employees are notified beforehand;
- Clarifies the interaction between the 401(k) safe harbors and the election to separately test otherwise excludable employees for purposes of the § 410(b) minimum coverage requirements; and
- Makes clear how the 401(k) safe harbor rules apply in the case of a profit sharing plan to which a 401(k) feature is added for the first time during a plan year.

In addition to modifying the guidance provided in Notice 98–52, 1998–46 I.R.B. 16, relating to 401(k) safe harbor plans, this notice requests comments regarding two significant areas that relate to 401(k) plans in general. The two areas are (1) potential approaches for simplifying the multiple use test applicable to § 401(k) plans, and (2) potential approaches for applying the highly compensated employee definition under § 414(q), the nondiscrimination requirements under § 401(k) and 401(m), and possibly other applicable qualification requirements, when a plan sponsor is involved in a merger, acquisition, disposition, or similar transaction.

II. BACKGROUND

A. SBJPA Amendments to §§ 401(k), 401(m), and 414(q)

Under § 401(k)(3) and § 401(m)(2) of the Code, the actual deferral percentage ("ADP") and the actual contribution percentage ("ACP") of highly compensated employees ("HCEs") are compared with those of nonhighly compensated employees ("NHCEs"). Section 414(q) defines a highly compensated employee for purposes of §§ 401(k) and 401(m), and for other purposes under the Code.

Section 1433(a) and (b) of the Small Business Job Protection Act of 1996 ("SBJPA") added new §§ 401(k)(12) and 401(m)(11) to the Code, effective for plan years beginning after December 31, 1998, to provide design-based safe harbor methods for satisfying the ADP test contained in § 401(k)(3)(A)(ii) and the ACP test contained in § 401(m)(2). Section 401(k)(12) provides that a cash or deferred arrangement ("CODA") is treated as satisfying the ADP test if the CODA meets certain contribution and notice requirements. Section 401(m)(11) provides that a defined contribution plan is treated as satisfying the ACP test with respect to matching contributions if the plan meets the contribution and notice requirements contained in § 401(k)(12) and in addition meets certain limitations on the amount and rate of matching contributions available under the plan.

Section 1433(c) of SBJPA amended § 401(k)(3)(A) and § 401(m)(2)(A), effective for plan years beginning after December 31, 1996, to provide for the use of prior year data in determining the ADP and ACP of NHCEs, while current year data is used for HCEs. Alternatively, an employer may elect to use current year data for determining the ADP and ACP for both HCEs and NHCEs, but this election may be changed only as provided by the Secretary. Prior to the effective date of these amendments, plans were required to use current year data in determining the ADP and ACP for both HCEs and NHCEs. Section 1433(d) of SBJPA amended § 401(k)(3) and § 401(m)(3) to provide a special rule for determining the ADP and ACP for NHCEs for the first plan year of a plan (other than a successor plan) where the prior year testing method is used.

Section 1433(e) of SBJPA amended § 401(k)(8)(C) and § 401(m)(6)(C), effective for plan years beginning after December 31, 1996, to provide that the distribution of excess contributions and excess aggregate contributions will be made on the basis of the amount of contributions by, or on behalf of, each HCE. Prior to the effective date of these amendments, plans were required to distribute excess contributions and excess aggregate contributions using a method based on the actual deferral ratio or actual contribution ratio of each HCE.

Section 1431 of SBJPA amended § 414(q)(1) to provide that the term "highly compensated employee" means any employee who (1) was a 5-percent owner at any time during the year or the preceding year, or (2) for the preceding year had compensation from the employer in excess of $80,000 (as adjusted) and, if the employer so elects, was in the top-paid group for the preceding year. The amendments made by § 1431 generally apply to years beginning after December 31, 1996.

B. Previous Guidance on the SBJPA Amendments to §§ 401(k), 401(m), and 414(q)

Notice 972, 1997–1 C.B. 348, provides guidance on determining the individuals who are taken into account in computing the ADP or ACP for NHCEs for the prior year under the prior year testing method. The notice also prescribes rules for distributions of excess contributions and excess aggregate contributions.

Notice 97–45, 1997–2 C.B. 296, provides guidance relating to the definition of highly compensated employee under § 414(q), as amended by § 1431 of SBJPA.

Notice 98–1, 1998–3 I.R.B. 42, provides guidance relating to the current and prior year ADP and ACP testing methods.

Notice 98–52 provides guidance on the safe harbor methods under § 401(k)(12) for satisfying the ADP test contained in § 401(k)(3)(A)(ii) and safe harbor methods under § 401(m)(11) for satisfying the ACP test contained in § 401(m)(2).

C. Definitions

Any term used in this notice that is defined in Notice 97–45, 98–1, or 98–52, or in the regulations under § 401(k), 401(m), or 414(q) has the same meaning as in those notices and regulations. For example, the term "employee contribution" means any mandatory or voluntary contribution to the plan that is treated at the time of contribution as an after-tax employee contribution (e.g., by reporting the contribution as taxable income subject to applicable withholding requirements) and is allocated to a separate account to which the attributable earnings and losses are allocated.

In addition, for purposes of this notice, (1) a "401(k) safe harbor plan" means a CODA that is intended to satisfy the ADP test safe harbor under section V of Notice 98–52, and, if applicable, a defined contribution plan (including a § 403(b) plan) that is intended to satisfy the ACP test safe harbor under section VI of Notice 98–52, (2) the "401(k) safe harbor nonelective contribution method" means the alternative for satisfying the safe harbor contribution requirement of the ADP test safe harbor under section V.B. of Notice 98–52 that includes satisfying the nonelective contribution requirement under section V.B.2. of Notice 98–52, (3) the "401(k) safe harbor matching contribution method" means the alternative for satisfying the safe harbor contribution requirement of the ADP test safe harbor under section V.B. of Notice 98–52 that includes satisfying the matching contribution requirement under section V.B.1. of Notice 98–52, and (4) a "401(k) safe harbor method" means the 401(k) safe harbor nonelective contribution method or the 401(k) safe harbor matching contribution method.

D. Effect on Regulations

Because of the amendments made to §§ 401(k), 401(m), and 414(q) by SBJPA, as well as by other recent legislation, certain portions of §§ 1.401(k)–1, 1.401(m)–1, 1.401(m)–2, and 1.414(q)–1T of the Income Tax Regulations no longer reflect current law. However, these regulations continue to apply to the extent they are not inconsistent with the Code, Notices 97–2, 97–45, 98–1, and 98–52, this notice, and any subsequent guidance.

III. Questions and Answers Relating to the 401(k) and (m) Safe Harbor Methods

Flexibility in Adoption of 401(k) Safe Harbor Nonelective Contribution Method

Q-1. By what date must the sponsor of a 401(k) plan adopt the 401(k) safe harbor nonelective contribution method for a plan year?

A-1. Generally, a plan that is intended to satisfy the 401(k) safe harbor requirements for a plan year must, prior to the beginning of the plan year, contain language to that effect and must specify the 401(k) safe harbor method that will be used. (However, see section XI.B. of Notice 98–52 and Rev. Proc. 99–23, 1999–16 I.R.B. 5, for the remedial amendment period applicable to plan changes incorporating the 401(k) safe harbor provisions.)

Notwithstanding section XI.A. of Notice 98–52, a plan that provides that it will satisfy the current year ADP (and, if applicable, ACP) testing method for a plan year may be amended not later than 30 days before the last day of the plan year to specify that the 401(k) safe harbor nonelective contribution method will be used for the plan year (including that the safe harbor nonelective contribution will be made), provided that the plan otherwise satisfies the ADP (and, if applicable, ACP) test safe harbor for the plan year (including the notice requirement under section V.C. of Notice 98–52, as modified by this notice). For purposes of the preceding sentence, in applying the content requirement of section V.C.1 of Notice 98–52:

(1) Instead of stating the amount of the safe harbor nonelective contribution to be made under the plan, the notice

given to eligible employees before the beginning of the plan year must provide that (a) the plan may be amended during the plan year to provide that the employer will make a safe harbor nonelective contribution of at least 3 percent to the plan for the plan year, and (b) if the plan is so amended, a supplemental notice will be given to eligible employees 30 days prior to the last day of the plan year informing them of such an amendment, and

(2) A supplemental notice must be provided to all eligible employees no later than 30 days prior to the last day of the plan year stating that a 3 percent safe harbor nonelective contribution will be made for the plan year. For administrative convenience, the supplemental notice may be provided separately or as part of the safe harbor notice for the following plan year.

Similar rules apply if, pursuant to section IX.A.1. of Notice 98–52, the safe harbor nonelective contribution is made to another plan of the employer.

Thus, for example, a plan sponsor that maintains a calendar-year 401(k) plan using the current year ADP testing method and that wishes to have the flexibility to decide toward the end of a plan year whether or not to adopt the 401(k) safe harbor nonelective contribution method with respect to its 401(k) plan could achieve that flexibility by providing the initial notice described in section V.C. of Notice 98–52 (as modified by this Q&A-1, and Q&A-7 and Q&A-8 of this notice) before the beginning of the plan year, as provided under section V.C.2. of Notice 98–52 (as modified by Q&A-9 of this notice). If the plan sponsor then decides to adopt the 401(k) safe harbor nonelective contribution method for the plan year, the plan sponsor must, by December 1 of the plan year, (1) amend the 401(k) plan accordingly and (2) provide a supplemental notice to all eligible employees stating that a 3-percent safe harbor nonelective contribution will be made for the plan year.

A plan sponsor that takes advantage of the flexibility provided under this Q&A-1 is not required to continue using the 401(k) safe harbor nonelective contribution method for the following plan year and is not limited in the number of years that it takes advantage of this flexibility.

In order to further facilitate the adoption of the 401(k) safe harbor nonelective contribution method under this Q&A-1, the Service intends to provide a simplified, pre-approved means of adopting the 401(k) safe harbor nonelective contribution method under the Service's master and prototype plan program.

Safe Harbor Matching Contribution Requirements

Q-2. Can a 401(k) safe harbor plan match elective and employee contributions on a payroll-by-payroll basis (instead of on an annual basis) without making additional contributions at the end of the year to take into account the total amount of an employee's compensation for the plan year?

A-2. Notwithstanding section VII.A. (or any other provision) of Notice 98–52, the requirements of sections V.B.1. and VI.B. of Notice 98–52 that relate to matching contributions may be met for a plan year by meeting such requirements either (1) with respect to the plan year as a whole, or (2) if the plan so provides, separately with respect to each payroll period (or with respect to all payroll periods ending with or within each month or plan-year quarter) taken into account under the arrangement for the plan year (the "payroll period method"). If the payroll period method is used, however, matching contributions with respect to elective or employee contributions made during a plan year quarter beginning after May 1, 2000 must be contributed to the plan by the last day of the following plan year quarter. Accordingly, in the case of a calendar year plan that uses the payroll period method, matching contributions with respect to elective or employee contributions made during the calendar quarter beginning July 1, 2000, must be contributed to the plan by December 31, 2000. The payroll period method applies only for purposes of satisfying the ADP safe harbor matching contribution requirements of § 401(k)(12) (section V.B.1. of Notice 98–52) and the ACP safe harbor matching contribution requirements of § 401(m)(11) (section VI.B. of Notice 98–52).

Q-3. Can a 401(k) safe harbor plan require that employees make elective contributions in whole percentages of pay or whole dollar amounts?

A-3. Notwithstanding section V.B.1.c.ii. of Notice 98–52, a plan will not fail to satisfy the requirements of sections V.B.1. and VI.B. of Notice 98–52 that relate to matching contributions merely because the plan requires employees to make cash or deferred or employee contribution elections in whole percentages of compensation or whole dollar amounts.

Q-4. Can a 401(k) safe harbor plan suspend additional employee contributions for up to 12 months after the in-service withdrawal of employee contributions?

A-4. Notwithstanding section V.B.1.c. and section VI.B.3. of Notice 98–52, a plan will not fail to satisfy the ACP test safe harbor of section VI of Notice 98–52 merely because, after a withdrawal of employee contributions from the plan, the plan suspends additional employee contributions for a period that does not exceed 12 months. See section V.B.1.c.iv. of Notice 98–52 for a similar exception that applies for purposes of hardship distributions of elective contributions.

Q-5. How do the rules of sections V.B.1. and VI.B.3. of Notice 98–52 apply to a plan that provides matching contributions on both elective contributions and employee contributions?

A-5. A plan will not fail to satisfy the requirements of section V.B.1.a., V.B.1.b., or VI.B.3.(iii) of Notice 98–52 merely because the plan provides matching contributions on both elective contributions and employee contributions if, under the terms of the plan, either (1) the matching contributions provided on an employee's elective contributions are not affected by the amount of the employee's employee contributions or (2) matching contributions are made with respect to the sum of an employee's elective and employee contributions under the same terms as matching contributions are made with respect to elective contributions.

For example, a plan will not fail to satisfy the matching contribution requirement of section V.B.1. or the ACP test safe harbor of section VI of Notice 98–52 merely because the plan provides a required matching contribution equal to 100 percent of the sum of each eligible employee's elective and employee contributions up to 4 percent of compensation. This is the case even if, during a plan year, an eligible employee first makes employee contributions of 4 percent of compensation that are matched by the employer and subsequently makes elective contributions that go unmatched, provided that the same match would have been available if the employee had instead made only elective contributions.

Q-6. May a plan that uses the 401(k) safe harbor matching contribution method suspend matching contributions on future elective and employee contributions during a plan year and instead use the current year ADP (and, if applicable, ACP) testing method for the plan year?

A-6. A plan that uses the 401(k) safe harbor matching contribution method will not fail to satisfy § 401(k) (or § 401(m)) for a plan year merely because the plan is amended during the plan year to reduce or eliminate matching contributions, provided:

(1) A supplemental notice is given to all eligible employees explaining the consequences of the amendment and informing them of the effective date of the reduction or elimination of matching contributions and that they have a reasonable opportunity (including a reasonable period) to change their cash or deferred elections and, if applicable, their employee contribution elections;

(2) The reduction or elimination of matching contributions is effective no earlier than the later of (i) 30 days after eligible employees are given the supplemental notice and (ii) the date the amendment is adopted;

(3) Eligible employees are given a reasonable opportunity (including a reasonable period) prior to the reduction or elimination of matching contributions to change their cash or deferred elections and, if applicable, their employee contribution elections;

(4) The plan is amended to provide that the ADP test and, if applicable, the ACP test will be performed and satisfied for the entire plan year using the current year testing method; and

(5) All other safe harbor requirements are satisfied through the effective date of the amendment.

Notice Requirement

Q-7. Can a plan use electronic media to satisfy the 401(k) safe harbor notice requirement?

A-7. The Service and Treasury are currently reviewing the legal and policy issues relating to the satisfaction of the safe harbor notice requirement through the use of electronic media. Prior to the issuance of additional guidance on this matter, however, a plan will not fail to satisfy the notice requirement of section V.C. of Notice 98–52 (as modified by this notice) with respect to an employee merely because, instead of receiving the notice on a written paper document, the employee receives the notice through an electronic medium reasonably accessible to the employee, provided that (1) the system under which the electronic notice is provided is reasonably designed to provide the notice in a manner no less understandable to the employee than a written paper document and (2) under such system, at the time the notice is provided, the employee is advised that the employee may request and receive the notice on a written paper document at no charge, and, upon request, that document is provided to the employee at no charge. This Q&A-7 also applies for purposes of providing the supplemental notices under Q&A-1 and Q&A-6 of this notice.

Q-8. Can a safe harbor notice cross-reference the plan's summary plan description for a portion of the information required in the notice?

A-8. Section V.C. of Notice 98–52 provides that the notice requirement of that section is satisfied if each eligible employee for the plan year is given written notice of the employee's rights and obligations under the plan and the notice satisfies the content requirement of paragraph 1 of that section and the timing requirement of paragraph 2 of that section.

Notwithstanding paragraph 1.a. of section V.C. of Notice 98–52, a plan will not fail to satisfy the content requirement merely because, in the case of the information described in items (ii) (relating to any other contributions under the plan), (iii) (relating to the plan to which safe harbor contributions will be made), (iv) (relating to the type and amount of compensation that may be deferred), and (vii) (relating to withdrawal and vesting provisions) of paragraph 1.a., the notice instead cross-references the relevant portions of an up-to-date summary plan description that has been provided (or concurrently is provided) to the employee. However, the notice must still accurately describe (1) the safe harbor matching or nonelective contribution formula used under the plan (including a description of the levels of matching contributions, if any, available under the plan) and state that these contributions (as well as elective contributions) are fully vested when made and (2) how to make cash or deferred elections (including any administrative requirements that apply to such elections) and the periods available under the plan for making such elections. In addition, the notice must also provide information that makes it easy for eligible employees to obtain additional information about the plan (including an additional copy of the summary plan description) such as telephone numbers, addresses and, if applicable, electronic addresses, of the individuals or offices from whom employees can obtain such plan information.

Q-9. By what date must the safe harbor notice be provided to employees in the case of a plan that adopts a 401(k) safe harbor method for the first time in the year 2000?

A-9. Generally, the notice required under section V.C. of Notice 98–52 must be provided in accordance with the timing requirements of section V.C.2. (i.e., the notice must be provided within a reasonable period before the beginning of the plan year (or, in the year an employee becomes eligible, within a reasonable period before the employee becomes eligible)). However, in an effort to allow plan sponsors that are considering the adoption of a 401(k) safe harbor method to fully utilize the guidance provided in this notice for plan years beginning in the year 2000, the Service and Treasury have determined that transition relief is appropriate. Accordingly, in the case of a plan sponsor that adopts a 401(k) safe harbor method for the first time with respect to a plan for a plan year that begins on or after January 1, 2000 and on or before June 1, 2000, the notice described in section V.C. of Notice 98–52 satisfies the timing requirement for that plan year if the notice is given on or before May 1, 2000. This transition relief applies whether the 401(k) safe harbor method is adopted under a newly established 401(k) plan or under a preexisting 401(k) plan.

In order to satisfy the 401(k) safe harbor requirements for the plan year, however, a plan that uses the transition relief provided under this Q&A-9 still must satisfy the otherwise applicable requirements of Notice 98–52 (as modified by this notice) with respect to the entire plan year. Thus, for example, in the case of a 401(k) plan that uses the 401(k) safe harbor matching contribution method, matching contributions still must be made with respect to elective contributions made prior to the date the safe harbor notice is provided to employees in the same amount as if the 401(k) safe harbor matching contribution method had been in place since the beginning of the plan year.

Interaction Between Safe Harbor Methods and § 410(b)(4) Election

Q-10. Is a plan required to provide safe harbor matching or nonelective contributions to participants who have not yet attained age 21 and completed a year of service if the plan uses one of the 401(k) safe harbor methods?

A-10. As provided in section IX.B.1. of Notice 98–52, if, pursuant to § 410(b)(4)(B), an employer applies § 410(b) separately to the portion of a plan (within the meaning of § 414(l)) that benefits only employees who satisfy age and service conditions under the plan that are lower than the greatest minimum age and service conditions permitted under § 410(a), the plan is treated as two separate plans for purposes of § 401(k), and the ADP test safe harbor need not be satisfied with respect to both plans in order for one of the plans to take advantage of the ADP test safe harbor. Accordingly, a plan that uses one of the 401(k) safe harbor methods is not required to provide safe harbor matching or nonelective contributions to participants who have not yet attained age 21 and completed a year of service. Those employees do not have to be treated as eligible employees for purposes of the 401(k) safe harbors, so long as the employer has elected to treat them separately for coverage purposes pursuant to § 410(b)(4). However, in such a case, the plan must specifically provide that elective contributions (and, if applicable, matching contributions) on behalf of those employees will satisfy the ADP test (and, if applicable, the ACP test).

Addition of 401(k) Safe Harbor Provisions to Existing Profit-Sharing Plans

Q-11. Can a CODA that is added to an existing profit-sharing plan for the first time during a plan year use a 401(k) safe harbor method for that plan year?

A-11. Generally, the safe harbor requirements must be satisfied for the entire plan year (see sections V.A. and VI.A. of Notice 98–52). In addition, except in the case of a newly established plan, the plan year must be 12 months long (see section X of Notice 98–52). Notwithstanding these requirements, however, in the case of a CODA that is added to an existing profit-sharing, stock bonus, or pre-ERISA money purchase pension plan for the first time during a plan year, the requirements of section V of Notice 98–52 will be treated as being satisfied for the entire plan year and the CODA will not be treated as failing to satisfy the requirements of section X of Notice 98–52, provided (1) the plan is not a successor plan (within the meaning of Notice 98–1), (2) the CODA is made effective no later than 3 months prior to the end of the plan year, and (3) the requirements of Notice 98–52 are otherwise satisfied for the entire period from the effective date of the CODA to the end of the plan year. Thus, an existing calendar-year profit-sharing plan that does not contain a CODA may be amended as late as October 1 to add a CODA that uses a 401(k) safe harbor method for that plan year.

A similar rule applies for purposes of section VI of Notice 98–52 in the case of the addition of matching contributions for the first time to an existing defined contribution plan at the same time as the adoption of the CODA.

IV SIMPLIFYING THE LIMITATION ON MULTIPLE USE

The limitation on multiple use applies to the current and prior year ADP and ACP testing methods (i.e., the nondiscrimination testing methods that § 401(k) plans must satisfy if they do not satisfy the 401(k) safe harbors or the SIMPLE 401(k) requirements). The limitation on multiple use is a nondiscrimination provision intended to limit the extent to which highly compensated employees receive greater benefits (as a percentage of pay) than nonhighly compensated employees, primarily under § 401(k) plans that provide for matching contributions. The Service and Treasury are considering approaches that would substantially simplify the limitation on multiple use administratively, while retaining most of the value of this limitation in ensuring a fairer distribution of benefits under § 401(k) plans and, in many cases, encouraging employers to make fully-vested nonelective contributions on behalf of nonhighly compensated employees.

Generally, the average rate of elective contributions under a § 401(k) plan on behalf of highly compensated employees may not exceed 125 percent of the average rate of elective contributions on behalf of nonhighly compensated employees. However, the Code provides an "alternative limitation" that permits the average rate of elective contributions under a § 401(k) plan on behalf of highly compensated employees to exceed 125 percent of the average rate on behalf of nonhighly compensated employees, provided that average rate for highly compensated employees is not greater than 2 percentage points more than the average rate for nonhighly compensated employees and is not greater than 200 percent of that of nonhighly compensated employees. The alternative limitation is particularly relevant where the average rate of elective contributions on behalf of nonhighly compensated employees is relatively low. For example, if the average rate of elective contributions on behalf of nonhighly compensated employees is 4 percent of pay, then the average rate of elective contributions on behalf of highly compensated employees may not exceed 6 percent of pay. Absent the alternative limitation, the average rate of elective contributions on behalf of highly compensated employees could not exceed 5 percent in such a case. Similar rules apply separately to the average rate of matching and employee after-tax contributions of highly compensated employees under a § 401(m) plan.

Section 401(m)(9) requires the Secretary of the Treasury to "prescribe such regulations as may be necessary to carry out the purposes of this subsection and subsection (k) including . . . such regulations as may be necessary to prevent the multiple use of the alternative limitation with respect to any highly compensated employee." Accordingly, while the alternative limitation may be used to satisfy either the nondiscrimination test for elective contributions or the nondiscrimination test for matching and employee after-tax contributions, the alternative limitation is not available to satisfy both tests. Absent the statutorily contemplated limitation on multiple use, the combined rates of elective and matching contributions on behalf of highly compensated employees under a § 401(k) plan that provides for matching contributions could, for example, be as much as 8 percent (i.e., an ADP of 4 percent and an ACP of 4 percent) while the combined rates for nonhighly compensated employees could be as little as 4 percent (i.e., an ADP of 2 percent and an ACP of 2 percent). In this case, the limitation on multiple use would reduce this 4-percentage-point disparity to 2_ percentage points.

While many employers choose to comply with the limitation on multiple use by reducing or limiting the elective and/or matching contributions on behalf of highly compensated employees, other employers instead increase the employer contributions made on behalf of nonhighly compensated employees. Accordingly, because of the limitation on multiple use, some moderate-income employees covered under 401(k) plans that provide matching contributions receive employer-provided benefits that amount to hundreds of dollars a year.

However, the approach taken under existing regulations in implementing the limitation on multiple use may be unnecessarily complicated. As a result, the Service and Treasury are reviewing potential changes to these regulations that would substantially simplify the application of the limitation on multiple use.

Under one possible approach, the multi-step mathematical test used in determining the aggregate limit on the rates of contributions for highly compensated employees would be replaced by a simple "look-up" table that is based on ranges of aggregate contribution rates for nonhighly compensated employees. For example, such a table could provide that if the combined ADP and ACP on behalf of nonhighly compensated employees is between 5 percent and 6 percent, then the combined ADP and ACP on behalf of highly compensated employees could be as much as 3 percentage points higher.

Alternatively, or in addition, the scope of the limitation's application might be narrowed slightly in order to give relief in cases where the value of the limitation would be inconsequential in comparison to the administrative expense of compliance. For example, where the combined ADP and ACP on behalf of nonhighly compensated employees exceeds a certain level (e.g., 9 percent or 10 percent), the limitation on multiple use might be deemed satisfied.

The Service and Treasury welcome comments on these and other potential approaches for simplifying the limitation on multiple use. Comments on the effect of the SBJPA changes to the methods for correcting excess contributions and excess aggregate contributions and the relation of those changes to corrections of multiple use limitation failures are also welcome. In addition, comments are welcome regarding whether it is more appropriate (as a matter of authority or otherwise) for simplification of the limitation on multiple use to be effected administratively or legislatively.

V POTENTIAL APPROACHES FOR APPLYING VARIOUS QUALIFICATION REQUIREMENTS IN MERGERS, ACQUISITIONS, DISPOSITIONS, AND SIMILAR TRANSACTIONS

The Service and Treasury are in the process of developing guidance regarding the application of the nondiscrimination requirements under § 401(k) and § 401(m), and the highly compensated employee definition under § 414(q), in situations where the entities sponsoring the plans are involved in mergers, acquisitions, dispositions, or similar transactions. Uncertainty among plan sponsors regarding the appropriate application of various qualification requirements in the context of business transactions and reorganizations may be leading to reduced employee protections, increased transaction costs for employers, and the inconsistent application of these requirements among different employers.

The guidance developed by the Service and Treasury will be designed to balance the need to protect employees' pension rights and benefits and provide for the fair distribution of tax-favored pension benefits with the potential burdens on employers of data collection and compliance in the context of business transactions and reorganizations. Simplified alternatives may be provided to address those types of transactions in which the information flow between the selling and purchasing entities or other entities involved in the transactions traditionally has been minimal.

As part of this process, the Service and Treasury are seeking comments from plan participants, plan sponsors, and other interested parties regarding the following:

(1) The types of business transactions and reorganizations (e.g., stock acquisitions, acquisitions of substantially all the assets of a trade or business, or other economically similar transactions) that reasonably would warrant continuity of treatment for purposes of the nondiscrimination requirements under § 401(k) and § 401(m) and the highly compensated employee definition under § 414(q), as well as the degree of specificity that is desirable or appropriate in describing these transactions.

(2) The application of the nondiscrimination requirements under § 401(k) and § 401(m) and the highly compensated employee definition under § 414(q) in cases where plans are combined or divided during (instead of at the beginning of) a plan year as a result of a business transaction or reorganization that occurs during a plan year.

(3) Whether more than one testing alternative may be appropriate when applying the nondiscrimination requirements under § 401(k) and § 401(m) in the case of mid-year transactions. For example, under certain circumstances, one approach to mid-year business transactions that also involve combining plans might be to give plan sponsors the option of applying the § 401(k) and § 401(m) nondiscrimination requirements on a pre-transaction and post-transaction basis as if there were separate short plan years for the uncombined and combined plans, or applying these requirements once on the basis of the entire plan year for the combined plan. A similar approach might apply in cases where plans are divided as a result of mid-year business transactions.

(4) The application of other plan qualification provisions (in addition to the

nondiscrimination requirements for § 401(k) and § 401(m) plans and the highly compensated employee definition under § 414(q)) in the context of business transactions and reorganizations, whether or not such transactions occur in the middle of a plan year. For example, § 414(a)(2) grants the Secretary of the Treasury the authority to prescribe regulations regarding the treatment of service with a predecessor employer as service with a successor employer. Comments are invited on whether regulations should be proposed to address situations in which participants experience an interruption of their vesting service under § 411(a) and eligibility service under § 410(a) by reason of certain business transactions or reorganizations.

VI REQUEST FOR COMMENTS

In addition to inviting comments on the potential approaches for simplifying the limitation on multiple use and for applying various qualification requirements in cases where plan sponsors are involved in mergers, acquisitions, and similar transactions, the Service and Treasury invite comments on the 401(k) safe harbor guidance provided in this notice. It is anticipated that further guidance in these areas would take the form of proposed regulations.

Comments should be submitted by March 24, 2000, in writing, and should reference Notice 2000–3. Comments can be addressed to CC:DOM:CORP:R (Notice 2000–3), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 2000–3), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may transmit comments electronically via the following Internet site: Cynthia.Grigsby@m1.irscounsel.treas.gov.

VII. EFFECT ON OTHER DOCUMENTS

Notice 98–52 is modified.

PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1669.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this notice are in section III, Q&As 1 and 2. The collections of information are required to enable personnel in the Tax Exempt and Government Entities Division of the Internal Revenue Service to determine if an employer's retirement plan satisfies the requirements to obtain favorable tax treatment and to inform plan participants of their rights and obligations under the plan. The likely respondents are businesses or other for-profit institutions, and not-for-profit institutions.

The estimated total annual reporting burden is 8,000 hours.

The estimated annual burden per respondent is 1 hour and 20 minutes. The estimated number of respondents is 6,000. The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers) between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.

Section 1504(d) Elections — Deferral of Termination

Notice 2000–7

PURPOSE

The purpose of this Notice is to provide guidance regarding the effect of the repeal of certain Canadian banking legislation on elections under section 1504(d) of the Internal Revenue Code.

BACKGROUND

Section 1504(d) of the Code allows, in certain circumstances, a domestic corporation owning or controlling, directly or indirectly, 100 percent of the capital stock of a Mexican or Canadian corporation, to elect to treat such corporation as a domestic corporation for all purposes of subtitle A of the Code. Among other requirements, such an election may be made only if the sole purpose for maintaining such corporation is to comply with Canadian or Mexican law regulating the title and operation of property.

If an election under section 1504(d) is in effect with respect to a Canadian or Mexican corporation, and the relevant provision in Canadian or Mexican law regulating the title and operation of property is repealed, it is the view of Treasury and the IRS that the election under section 1504(d) generally is terminated as of the effective date of the repeal. However, a foreign corporation may continue to be viewed as maintained solely for the purpose of complying with Canadian or Mexican law for a short period of time following the repeal of that foreign law if the taxpayer takes reasonable and expeditious measures to respond to the change in foreign law and for good reason is unable to complete such measures by the effective date of the repeal, as would be the case if the taxpayer is required to obtain regulatory approval in order to convert the foreign corporation to a branch of the U.S. parent and cannot obtain such approval by the effective date of the repeal. In such a case, the foreign corporation will continue to be viewed as maintained solely for the purpose of complying with Canadian or Mexican law only for so long as is reasonably necessary to convert to branch form and only for so long as the taxpayer persists in its efforts to convert to branch form during that period. The IRS may issue guidance identifying whether and the extent to which this short period of time exists in appropriate circumstances not specifically addressed by