Part III. Administrative, Procedural, and Miscellaneous

Guidance on Certain Provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001

Notice 2002-4

I. PURPOSE

This notice provides guidance with respect to the effect on distributions from a section 401(k) plan of §§ 636(a) and 646 of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), Pub. L. 107-16. Section 636(a) of EGTRRA provides that the Secretary shall revise the regulations relating to hardship distributions under § 401(k)(2)(B)(i)(IV) of the Internal Revenue Code. Section 646 of EGTRRA amends the provisions of Code § 401(k)(2) and (10) to permit a plan to provide for distributions on severance from employment. This notice also provides guidance under Code § 414(v), added by § 631 of EGTRRA, on the application of the universal availability requirement under Code § 414(v)(4) in the case of an applicable employer plan (within the meaning of § 414(v)(6)(A)) that is also qualified under Puerto Rico law and provides a transition rule for satisfying the universal availability requirement for 2002.

Specifically this notice provides that:

- A plan may be amended to provide for distributions on severance from employment under § 401(k)(2)(B)(i)(I), as amended by EGTRRA, on or after January 1, 2002, regardless of whether the severance from employment occurred before, on, or after January 1, 2002.

- Beginning in 2002, for a plan that uses the safe harbor hardship provisions of § 1.401(k)-1(d)(2)(iv)(B) of the Income Tax Regulations, the amount of elective contributions that a participant is permitted to make in the year following a hardship distribution is no longer required to be limited to the amount of elective contributions permitted under Code § 402(g) for that year minus the amount of the elective contributions made in the year of the hardship.

- A plan will not be treated as failing to satisfy the requirements of § 414(v)(4) for 2002 solely because different plans maintained by the same employer (as defined in Regulations § 1.410(b)-9) adopt catch-up contributions beginning on different dates during 2002, provided that all such plans begin offering catch-up contributions no later than October 1, 2002.

- Until the issuance of further guidance, an applicable employer plan that permits catch-up contributions will not fail to satisfy the requirements of Code § 414(v)(4) or § 1.414(v)-1(e) of the Proposed Income Tax Regulations solely because another applicable employer plan maintained by the employer that is qualified under Puerto Rico law does not provide for catch-up contributions.

II. BACKGROUND

A. Distributions from a Section 401(k) Plan

Code § 401(k)(2) as in effect prior to EGTRRA provides that elective contributions under a qualified cash or deferred arrangement subject to § 401(k) may not be distributed prior to the occurrence of certain events, including the employee's separation from service, the occurrence of an event described in § 401(k)(10), and in the event of a hardship. The events listed in § 401(k)(10) are the termination of the plan without establishment or maintenance of another defined contribution plan (other than an employee stock ownership plan as defined in § 4975(e)(7)), the disposition by a corporation of substantially all of the assets used by the corporation in a trade or business of such corporation, and the disposition by a corporation of such corporation's interest in a subsidiary. Distributions may be made in connection with a sale of assets or interest in a subsidiary only with respect to an employee who continues employment with the corporation acquiring the assets or with the subsidiary, as applicable, and only if the seller continues to maintain the plan.

Section 646 of EGTRRA amended Code § 401(k)(2)(B)(i)(I) by replacing "separation from service" with "severance from employment." In addition, § 646 of EGTRRA amended Code § 401(k)(10) by deleting disposition by a corporation of substantially all of the assets of a trade or business and disposition of a corporation's interest in a subsidiary, leaving termination of a plan as the only distributable event described in § 401(k)(10). The amendments made by § 646 apply to distributions made after December 31, 2001.

Under Regulations § 1.401(k)-1(d)(2)(iv), a distribution is treated as made on account of hardship if it is made on account of an immediate and heavy financial need and is necessary to satisfy the financial need. Section 1.401(k)-1(d)(2)(iv)(B) provides that a distribution is deemed necessary to satisfy an immediate and heavy financial need if certain requirements are met. One such requirement is that, after receipt of the hardship distribution, a participant is prohibited from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for a period of at least 12 months (the "elective contribution prohibition period"). Another requirement is that the plan, and all other plans maintained by the employer, limit the employee's elective contributions for the next taxable year to the applicable limit under Code § 402(g) for that year minus the employee's elective contributions for the year of the hardship distribution (the "post-hardship contribution limit").

Section 636(a) of EGTRRA directs the Secretary of the Treasury to revise the regulations relating to distributions under Code § 401(k)(2)(B)(i)(IV) to provide that the period during which an employee is prohibited from making elective and employee contributions following a hardship distribution is 6 months, instead of 12 months, as required under Regulations § 1.401(k)-1(d)(2)(iv)(B)(*4*). Section 636(a) is effective for years beginning after December 31, 2001. Notice 2001-56, 2001-38 I.R.B. 277, provides guidance on § 636(a) of EGTRRA.

Code §§ 401(k)(12) and 401(m)(11) provide design-based safe harbor methods for satisfying the actual deferral percentage ("ADP") test contained in § 401(k)(3)(A)(ii) and the actual contribution percentage ("ACP") test contained in § 401(m)(2) based on matching contributions that meet certain conditions and that satisfy certain notice requirements. Section V.B.1.c.iv of Notice 98-52, 1998-2 C.B. 634, provides that a plan will not fail to satisfy the ADP matching contribution safe harbor merely because an eligible employee's ability to make elective contributions is suspended for 12 months following a hardship distribution. Section VI.B.3 of Notice 98-52 provides that a plan will not fail to satisfy the ACP matching contribution safe harbor merely because an eligible employee's ability to make employee contributions is suspended for 12 months following a hardship distribution. Notice 2001-56 provides that, in order to continue to rely on the matching contribution safe harbors, a plan must reduce the period during which elective contributions and employee contributions are suspended following a hardship distribution from 12 months to 6 months for calendar years beginning after December 31, 2001.

B. Universal Availability of Catch-up Contributions under § 414(v)

Section 631 of EGTRRA added § 414(v) to the Code. Under § 414(v), an individual age 50 or over is permitted to make catch-up contributions (up to a dollar limit provided in § 414(v)(2)) under an applicable employer plan if certain requirements provided in § 414(v) are satisfied. Section 414(v) also provides that a plan generally will not violate any provision of the Code by permitting these catch-up contributions to be made. Proposed regulations under § 414(v) were published in the Federal Register on October 23, 2001 (66 FR 53555). Section 414(v) is effective for contributions in taxable years beginning after December 31, 2001. The regulations are proposed to apply as of this effective date.

Section 414(v)(4)(A) provides that an applicable employer plan shall be treated as failing to meet the nondiscrimination requirements under § 401(a)(4) with respect to benefits, rights, and features unless the plan allows all eligible participants to make the same election with respect to catch-up contributions. Section 414(v)(4)(B) provides that, for this purpose, all plans maintained by employers who are treated as a single employer under subsection (b), (c), (m), or (o) of § 414 shall be treated as one plan.

Proposed Regulations § 1.414(v)-1(e) provides that an applicable employer plan that offers catch-up contributions will not satisfy the requirements of Code § 401(a)(4) unless all catch-up eligible participants who participate under any applicable employer plan maintained by the employer are provided with the effective opportunity to make the same dollar amount of catch-up contributions. Proposed Regulations § 1.414(v)-1(a)(4) provides that a catch-up eligible participant is an employee who is eligible to make elective deferrals during the plan year under an applicable employer plan (without regard to Code § 414(v) or the proposed regulations) and is age 50 or over (or is treated as age 50 as of January 1 of a year in accordance with Proposed Regulations § 1.414(v)-1(a)(4)(ii)). An applicable employer plan is a section 401(k) plan, a SIMPLE

IRA plan, a simplified employee pension, a plan or contract that satisfies the requirements of Code § 403(b), or a § 457 eligible governmental plan. The term "employer" under the proposed regulations has the same meaning as this term under Regulations § 1.410(b)-9. Under § 1.410(b)-9, the definition of employer includes the employer maintaining the plan and those employers required to be aggregated with the employer under Code § 414(b), (c), (m), or (o).

C. Remedial Amendment Period for EGTRRA

Notice 2001-42, 2001-30 I.R.B. 7, provides a remedial amendment period under Code § 401(b) ending not prior to the last day of the first plan year beginning on or after January 1, 2005, in which any needed retroactive remedial amendment with regard to EGTRRA may be adopted. The availability of this remedial amendment period is conditioned on the adoption of a good faith EGTRRA plan amendment no later than the later of: (i) the end of the plan year in which the EGTRRA change in the qualification requirement is required to be, or is optionally, put into effect under the plan; or (ii) the end of the GUST remedial amendment period for the plan. Notice 2001-57, 2001-38 I.R.B. 279, provides sample good faith amendments with respect to several provisions of EGTRRA, including §§ 631, 636(a), and 646.

III. DISTRIBUTIONS ON SEVERANCE FROM EMPLOYMENT

Under Code § 401(k)(2)(B)(i)(I), as amended by § 646 of EGTRRA, amounts attributable to elective contributions may be distributed upon the employee’s severance from employment with the employer maintaining the plan. For this purpose, the employer includes all corporations and other entities treated as the same employer under Code § 414(b), (c), (m), or (o). An employee does not have a severance from employment if, in connection with a change of employment, the employee’s new employer maintains the section 401(k) plan with respect to the employee (for example, by assuming sponsorship of the plan or by accepting a transfer of plan assets and liabilities (within the meaning of Code § 414(l)) with respect to the employee). Thus, for example, if all employees of a controlled group of corporations (within the meaning of § 414(b)) are covered by a section 401(k) plan and a transaction occurs such that one subsidiary corporation in the group is no longer aggregated with other members in the group under § 414(b), (c), (m), or (o), and in connection with the transaction no assets are transferred from the section 401(k) plan to a plan maintained by the former subsidiary corporation, then, participants in the section 401(k) plan who continue employment with the subsidiary corporation will have a severance from employment with the employer maintaining the section 401(k) plan and may receive a distribution of amounts attributable to elective contributions from that plan. However, if the subsidiary corporation maintained a section 401(k) plan for its employees before the transaction and continues to maintain the section 401(k) plan following the transaction, the employees who continue employment with the subsidiary do not have a severance from employment with the employer maintaining the plan.

The amendments to Code §§ 401(k)(2) and 401(k)(10) made by § 646 of EGTRRA are effective for distributions made after December 31, 2001. A plan sponsor of a section 401(k) plan that intends to permit distributions following an employee’s severance from employment must amend the plan to substitute severance from employment for separation from service. A plan may provide for distributions on severance from employment under Code § 401(k)(2)(B)(i)(I), as amended, on or after January 1, 2002, regardless of whether the severance from employment occurred before, on, or after January 1, 2002, and regardless of whether the distribution would satisfy the requirements of pre-EGTRRA § 401(k)(2)(B) and the regulations thereunder (including the 2-year rule in Regulations § 1.401(k)-1(d)(4)(iii)). Alternatively, the plan could provide for distributions on or after January 1, 2002, to participants who have a severance from employment on or after January 1, 2002 (or on or after another date specified in the plan). For the rules regarding the timing of the adoption of such an amendment, see Notices 2001-42 and 2001-57.

A section 401(k) plan will not fail to comply with Code § 401(k)(2)(B), as amended by § 646 of EGTRRA, merely because it does not permit distributions in all situations in which a participant has a severance from employment. Thus, for example, a plan could limit distributions to situations in which a participant has a separation from service or following a disposition of assets or disposition of a subsidiary under circumstances under which a distribution is permitted under Code § 401(k)(2)(B)(i)(II) and § 401(k)(10)(A)(ii) and (iii) as in effect prior to the EGTRRA amendments (see Rev. Rul. 2000-27, 2000-1 C.B. 1016). Accordingly, a section 401(k) plan need not be amended to provide for distributions upon severance from employment. However, if the plan is not amended to provide for distributions following a severance from employment, elective contributions can be distributed only to the extent permitted by the plan.

IV. DISTRIBUTIONS ON HARDSHIP

In response to the direction in § 636(a) of EGTRRA, the safe harbor provisions of Regulations § 1.401(k)-1(d)(2)(iv)(B) will be revised. The requirement in § 1.401(k)-1(d)(2)(iv)(B)(*4*) will be revised to reduce the elective contribution prohibition period from a period of at least 12 months to a period of at least 6 months. In addition, the post-hardship contribution limit in § 1.401(k)-1(d)(2)(iv)(B)(*3*) will be eliminated. Until the issuance of further guidance, taxpayers can rely on the rules in this section IV.

This revised safe harbor will be effective for calendar years beginning after December 31, 2001. Accordingly, the requirement that a participant's elective contributions under a plan (and all other plans maintained by the employer) be limited to the post-hardship contribution limit is permitted to be eliminated effective for calendar years beginning after December 31, 2001, for participants who received hardship distributions during 2001. A section 401(k) plan will not fail to comply with the hardship distribution safe harbor provisions under Regulations § 1.401(k)-1(d)(2)(iv)(B) solely because it retains its existing post-hardship contribution limit. However, in order to continue to rely on the matching contribution safe harbor under Code § 401(k)(12) or § 401(m)(11), a plan must eliminate the post-hardship contribution limit, effective for calendar years beginning after December 31, 2001, for participants who receive a hardship distribution after December 31, 2000.

Amendments related to the changes in the safe harbor for hardship distributions addressed in this notice are integral to a qualification requirement that has been changed by EGTRRA. For purposes of determining whether a plan provision is a disqualifying provision under Notice 2001-42, a plan sponsor will not fail to have adopted a timely good faith amendment with respect to the hardship distribution safe harbor even though the amendment does not specifically eliminate the post-hardship contribution limit. However, if the plan sponsor does not adopt a good faith amendment changing the elective contribution prohibition period (or adopts such a change effective for a year different from the year in which the post-hardship contribution limit is eliminated under the plan), the plan sponsor must adopt a timely good faith amendment eliminating the post-hardship contribution limit in order for the provision to be a disqualifying provision for purposes of the remedial amendment period under Notice 2001-42.

For example, a plan (other than a plan that relies on the matching contribution safe harbor under Code § 401(k)(12) or § 401(m)(11)) will not fail to comply with the revised safe harbor if it continues to prohibit elective and employee contributions for 12 months following a hardship distribution and, therefore, there is no requirement that a good faith amendment be adopted changing this period from 12 months to 6 months. However, in such case, a timely good faith amendment eliminating the post-hardship contribution limit is required for there to be a remedial amendment period with respect to the elimination of the limit.

V. CATCH-UP CONTRIBUTIONS UNDER § 414(v)

Under Code § 414(v)(4), a plan will not satisfy § 401(a)(4) unless all the catch-up eligible participants in any applicable employer plan maintained by the employer are provided with the effective opportunity to make the same dollar amount of catch-up contributions. Under the proposed regulations, an applicable employer plan would fail to comply with this provision unless all other applicable employer plans maintained by the same employer begin offering catch-up contributions as of the same effective date. Otherwise, there will be a period during which catch-up contributions are offered to some catch-up eligible participants but not to all. In contrast, a plan does not fail to satisfy the requirements of § 414(v)(4) and the proposed regulations solely because catch-up contributions are administered differently under different plans, provided that the administrative method under each plan satisfies the basic requirement that it provide the catch-up eligible participants in that plan with the effective opportunity to make the same dollar amount of catch-up contributions as the catch-up eligible participants in other plans maintained by the same employer.

The Service has received comments since the issuance of the proposed regulations indicating that it will be difficult for employers to comply with the universal availability requirement as of the beginning of 2002. These comments point out that this is a new section of the Code, so that plan administrative systems must be modified to allow for catch-up contributions. In addition, employers have expressed concern that there may be some plans that have difficulty with these new provisions, and that, as a result, plans maintained by the same employer may adopt and implement catch-up contributions as of different dates.

The Service has also received comments regarding compliance with Code

§ 414(v)(4) by an employer that maintains a plan that is qualified under Puerto Rico tax law as well as under the Code (pursuant to § 1022(i)(2) of ERISA). Puerto Rico law does not provide for catch-up contributions. If an employer maintains a plan qualified both under Puerto Rico law and under the Code, the employer could be effectively prohibited from offering catch-up contributions to catch-up eligible participants in other applicable employer plans maintained by the employer.

In response to these concerns and to ease the administrative burden of the initial implementation of Code § 414(v), this notice provides that a plan will not be treated as failing to satisfy the requirements of § 414(v)(4) for 2002 solely because different plans maintained by the same employer (as defined in Regulations § 1.410(b)-9) adopt catch-up contributions beginning on different dates during 2002, provided that all such plans begin offering catch-up contributions no later than October 1, 2002.

In addition, until the issuance of further guidance, an applicable employer plan (within the meaning of Code § 414(v)(6)(A)) that permits catch-up contributions will not fail to satisfy the requirements of Code § 414(v)(4) or Proposed Regulations § 1.414(v)-1(e) solely because another applicable employer plan maintained by the employer that is qualified under Puerto Rico law does not provide for catch-up contributions.

DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 9:30 p.m. Eastern Time, Monday through Friday. Mr. Kuehnle can be reached at 1-202-283-9888 (not a toll-free number).