

a year other than a plan year (such as the calendar year limit on elective deferrals under section 401(a)(30)), the determination of whether elective deferrals are in excess of the applicable limit is made on the basis of such other year.

As under the proposed regulations, this annual method for determining whether amounts are in excess of an applicable limit also applies to an employer-provided limit that is applied on a payroll-by-payroll basis during the plan year. A number of commentators suggested that plans that provide for payroll-by-payroll limits, or similar limits that apply to a portion of the plan year, be permitted to determine amounts in excess of an applicable limit based on the period for which the limit is applied. These commentators noted that, although a plan is permitted to determine an additional amount of elective deferrals that a catch-up eligible participant is permitted to make on a payroll-by-payroll basis, the plan could not designate these elective deferrals as catch-up contributions on the same basis. These commentators suggested that for such a plan, an annual determination process would require the plan to collect and retain additional data during the year. In many cases, plans use a definition of compensation for purposes of ADP testing that is different from the definition used during the year to determine elective deferrals. Recordkeepers for these plans must collect and retain payroll-by-payroll compensation, and then determine the employer-provided limit on an annual basis before determining the amount of elective deferrals that are catch-up contributions.

A number of advocates for a payroll-by-payroll determination of catch-up contributions acknowledged that their proposal creates a risk that ADP testing could be distorted through changes in plan limits during the year. For example, if a plan were to provide that HCEs' elective deferrals are limited, on a payroll-by-payroll basis, to 1% of compensation for the first 2 months of the plan year, and then to 15% of compensation for the remainder of the year, the result would be equivalent to treating the first dollars deferred as catch-up contributions. While few employers might be likely to adopt such a design, a payroll-by-payroll system for determining catch-up contributions would require restrictions on the extent to which changes in employer-provided limits during the year could be made.

After considering these comments, Treasury and the IRS have determined that the need for rules to prevent abuse associated with a payroll-by-payroll

method of determining catch-up contributions outweighs the relative administrative advantages of that method, and these regulations retain the annual method. However, to address administrative concerns raised in these comments, these regulations also expand the alternative methods for determining an employer-provided limit in order to avoid requiring plans that use one definition of compensation for elective deferrals and another definition for ADP testing purposes to collect and retain data on both definitions.

These final regulations retain the rule in the proposed regulations that a plan that changes an employer-provided limit during the plan year is permitted to use a time-weighted average of these limits as the employer-provided limit. For example, under this alternative method, a plan that provides for an employer-provided limit of 8% for the first 6 months of the plan year and 10% for the second 6 months is permitted to use 9% as the employer-provided limit for the plan year. These final regulations also provide that the plan is permitted to use the definition of compensation used for ADP testing purposes for this weighted-average simplification, and can use this alternative method without regard to whether the employer-provided limit is changed during the plan year.

### *C. Treatment of Catch-up Contributions*

An elective deferral that is treated as a catch-up contribution is not subject to otherwise applicable limits under the applicable employer plan and the plan will not be treated as failing otherwise applicable nondiscrimination requirements because of catch-up contributions. Under these final regulations (including changes from the proposed regulations to reflect the provisions of JCWAA), catch-up contributions are not taken into account in applying the limits of section 401(a)(30), 402(h), 403(b), 408, 415(c), or 457(b)(2) (determined without regard to section 457(b)(3)) to other contributions or benefits under the plan offering catch-up contributions or under any other plan of the employer.

Elective deferrals that are treated as catch-up contributions under a plan because they exceed a statutory limit or an employer-provided limit are disregarded for purposes of ADP testing. These catch-up contributions are subtracted from the participant's elective deferrals for the plan year prior to determining the participant's actual deferral ratio. This subtraction applies without regard to whether the catch-up eligible participant is an HCE or a nonhighly compensated employee

(NHCE). If a plan needs to take corrective action under section 401(k)(8), the plan must determine the amount of elective deferrals for HCEs that are catch-up contributions because they are in excess of the ADP limit and retain such amounts. The plan would not be treated as failing section 401(k)(8) because these excess contributions are treated as catch-up contributions and retained.

Amounts in excess of an applicable limit are treated as catch-up contributions only to the extent that such excess amounts, combined with amounts previously treated as catch-up contributions for the taxable year, do not exceed the catch-up contribution limit for the year. As discussed above, whether elective deferrals in excess of an applicable limit can be treated as catch-up contributions is determined based on the year (e.g., plan year, calendar year, or limitation year) with respect to which each applicable limit is applied.

The interaction of this timing rule and the catch-up contribution limit for the year is most significant for a plan with a plan year that is not the calendar year. For example, in a plan with a plan year ending on June 30, 2005, elective deferrals in excess of the employer-provided limit or the ADP limit for the plan year ending June 30, 2005, would be treated as catch-up contributions as of the last day of the plan year, up to the catch-up contribution limit for 2005. These catch-up contributions are not taken into account for purposes of compliance with section 401(a)(30) for 2005. After June 30, 2005, the catch-up eligible participant is permitted to continue to make elective deferrals up to the section 401(a)(30) limit for 2005 (disregarding any amounts treated as catch-up contributions for 2005, as of June 30, 2005) and these additional contributions are not treated as contributions in excess of the section 401(a)(30) limit. Accordingly, these additional contributions are generally taken into account under the ADP test for the plan year ending June 30, 2006. In addition, to the extent the catch-up eligible participant has not made catch-up contributions up to the catch-up contribution limit for 2005, the participant can make additional catch-up contributions in excess of the section 401(a)(30) limit for 2005. These latter contributions are catch-up contributions which will not be taken into account under the ADP test for the plan year ending June 30, 2006.

Without regard to their special treatment under certain nondiscrimination provisions and limitations under the Code, catch-up