

or less likely to invest in employer securities than NHCEs.

Since the issuance of the existing regulations, the use of an ESOP as the employer stock fund in a section 401(k) plan has become much more widespread. In light of this development, the proposed regulations would eliminate disaggregation of the ESOP and non-ESOP portions of a single section 414(l) plan for purposes of ADP testing. The same rule would apply for ACP testing under section 401(m). In addition, the proposed regulations would provide that, for purposes of applying the ADP test or the ACP test, an employer could permissively aggregate two section 414(l) plans, one that is an ESOP and one that is not.

However, the exception to mandatory disaggregation of ESOPs from non-ESOPs set forth in these proposed regulations would not apply for purposes of satisfying section 410(b). Accordingly, the group of eligible employees under the ESOP and non-ESOP portions of the plan must still separately satisfy the requirements of sections 401(a)(4) and 410(b).

The proposed regulations would also provide that a single testing method must apply to all CODAs under a plan. This has the effect of restricting an employer's ability to aggregate section 414(l) plans for purposes of section 410(b), if those plans apply inconsistent testing methods. For example, a plan that applies the ADP test of section 401(k)(3) may not be aggregated with a plan that uses the ADP safe harbor of section 401(k)(12) for purposes of section 410(b).

D. Restrictions on Withdrawals

As discussed above, a qualified CODA must provide that elective contributions may only be distributed after certain events, including hardship and severance from employment. EGTRRA amended section 401(k)(2)(B)(i)(I) by replacing "separation from service" with "severance from employment." This change eliminated the "same desk rule" as a standard for distributions under section 401(k) plans.

In addition, EGTRRA amended Code section 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 the plan as the only distributable event described in section 401(k)(10). Finally, EGTRRA directs the Secretary of the Treasury to revise the regulations relating to distributions under section 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 § 1.401(k)-1(d)(2)(iv)(B)(4) of the existing regulations).²

Notice 2001-56 and Notice 2002-4 provided guidance on these EGTRRA changes to the distribution rules for elective contributions. That guidance is incorporated in these proposed regulations. In connection with the change to severance from employment, comments are requested on whether a change in status from employee to leased employee described in section 414(n) should be treated as a severance from employment that would permit a distribution to be made. In addition, the proposed regulations do not include reference to "retirement" (included in the existing regulation) as an event allowing distribution because retirement is not listed in the statute, and is subsumed by severance from employment.

In addition to the statutory changes, the rules relating to hardship distributions have been reorganized in order to clarify certain ambiguities, including the relationship between the generally applicable rules, employee representations, and the safe harbors provided under the existing regulations. The existing regulations set forth two basic requirements (*i.e.*, the employee has an immediate and heavy financial need and the distribution is necessary to satisfy that need) followed by safe harbor provisions. The proposed regulations would retain those basic requirements, but would clarify that each safe harbor is separately applicable to each basic requirement. In addition, the proposed regulations would provide that an employee representation used for purposes of determining that a distribution is necessary to satisfy an immediate and heavy financial need must provide that the need cannot reasonably be relieved by any available distribution or nontaxable plan loan (even if the distribution or loan would not be sufficient to satisfy the financial need), but need not provide that a loan from a commercial source will be taken if no such loan in an amount sufficient to satisfy the need is available on reasonable commercial terms.

² Under section 402(c), as amended by the IRS Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 685), and EGTRRA, a hardship distribution is not an eligible rollover distribution. While the change affects distributions from a section 401(k) plan, there is not specific reference to the change in these proposed regulations because these regulations are under sections 401(k) and 401(m).

The proposed regulations would also modify the existing regulations to add other types of defined contribution plans to the list of plans that an employer may maintain after the termination of the plan that contains the qualified CODA while still providing for distribution of elective contributions upon plan termination. The list of such plans has been expanded to include not only an ESOP and a SEP, but also a SIMPLE IRA plan, a plan or contract that satisfies section 403(b) and a section 457 plan.

Finally, under the existing regulations, a plan that receives a plan-to-plan transfer that includes elective contributions, QNECs, or QMACs, must provide that the restrictions on withdrawals continue after the transfer. These proposed regulations would also make explicit a requirement that the transferor plan will fail to comply with the restrictions on withdrawals if it transfers elective contributions, QNECs, or QMACs to a plan that does not provide for these restrictions. However, a transferor plan will not fail to comply with this requirement if it reasonably concludes that the transferee plan provides for restrictions on withdrawals. What constitutes a basis for a reasonable conclusion would be comparable to the rules related to acceptance of rollover distributions. See § 1.401(a)(31)-1, A-14.

E. Other Rules for Qualified CODAs

The proposed regulations would generally retain the additional requirements set forth in the existing regulations that a CODA must satisfy in order to be qualified, with some modifications. First, in order to be a qualified CODA the arrangement must provide an employee with an effective opportunity to elect to receive the amount in cash no less than once during the plan year. Under the proposed regulations, whether an employee has an effective opportunity is determined based on all the relevant facts and circumstances, including notice of the availability of the election, the period of time before the cash is currently available during which an election may be made, and any other conditions on elections.

The proposed regulations would also provide that a plan must provide for satisfaction of one of the specific nondiscrimination alternatives described in section 401(k). As with the existing regulations, the plan may accomplish this by incorporating by reference the ADP test of section 401(k)(3) and the regulations under proposed § 1.401(k)-2, if that is the nondiscrimination alternative being