

also include a reclassification of a substantial group of employees that has the same effect as amending the plan. These proposed regulations retain the rule that a plan that experiences coverage changes affecting 10% or less of the NHCEs disregards those changes in calculating the ADP for the NHCEs. Similarly, a plan that merely experiences a spin-off is not required to recalculate the ADP for the NHCEs.

5. Safe Harbor Section 401(k) Plans

Section 401(k)(12) provides a design-based safe harbor method under which a CODA is treated as satisfying the ADP test if the arrangement meets certain contribution and notice requirements. Section 1.401(k)-3 of these proposed regulations, which sets forth the requirements for these arrangements, generally follows the rules set forth in Notice 98-52 and Notice 2000-3. Thus, a plan satisfies the section 401(k) safe harbor if it makes specified QMACs for all eligible NHCEs. The matching contributions can be under a basic matching formula that provides for QMACs equal to 100% of the first 3% of elective contributions and 50% of the next 2% or an enhanced matching formula that is at least as generous in the aggregate, provided the rate of matching contributions under the enhanced matching formula does not increase as the employee's rate of elective contributions increases. In lieu of QMACs, the plan is permitted to provide QNECs equal to 3% of compensation for all eligible NHCEs. In addition, notice must be provided to each eligible employee, within a reasonable time before the beginning of the year, of their right to defer under the plan.

A plan using the safe harbor method must also comply with certain other requirements. Among these is the requirement in section 401(k)(12)(B)(ii) that provides that the rate of matching contribution for any elective contribution on the part of any HCE cannot exceed the rate of matching contribution that would apply to any NHCE with the same rate of elective contribution. Notice 98-52 advised that the general rules on aggregating contributions for HCEs eligible under more than one CODA would apply for this purpose. The IRS and Treasury have determined that such aggregation is not applicable under the ADP safe harbor. Accordingly, these proposed regulations would not require that elective or matching contributions on behalf of an HCE who is eligible to participate in more than one plan of the same employer be aggregated for purposes of the requirement of section

401(k)(12)(B)(ii). Thus, the rate of match for purposes of determining whether an HCE has a higher matching rate is based only on matching contributions with respect to elective contributions under the safe harbor plan. However, for an employer that uses the safe harbor method of satisfying the ACP test, the rule in Notice 98-52 is retained for applying the ACP safe harbor, with an exception for nonsimultaneous participation (as discussed in connection with the ACP safe harbor below).

These proposed regulations do not provide any rules relating to suspension of employee contributions under a plan that provides that safe harbor matching contributions are made with respect to the sum of elective contributions and employee contributions. Although Notice 2000-3 specifically permitted suspension of employee contributions in certain circumstances, the IRS and Treasury have determined that there are no limits on suspending employee contributions, provided that safe harbor matching contributions are made with respect to elective contributions. This is because the restrictions on suspension of elective contributions are sufficient to ensure an eligible NHCE can get the full matching contribution.

The proposed regulations do not include any exception to the requirements for safe harbor matching contributions with respect to catch-up contributions. Treasury and the IRS are aware that there are questions concerning the extent to which catch up contributions are required to be matched under a plan that provides for safe harbor matching contributions. Treasury and the IRS are interested in comments on the specific circumstances under which elective contributions by a NHCE to a safe harbor plan would be less than the amount required to be matched, e.g., less than 5% of safe harbor compensation, but would be treated by the plan as catch-up contributions, and on the extent to which a safe harbor plan should be required to match catch-up contributions under such circumstances.

Section 401(k)(12)(D) contains a requirement that each eligible employee be provided with a notice of the employee's rights and obligations under the plan. These proposed regulations do not address the extent to which the notice can be provided through electronic media. As noted in the preamble to other regulations, the IRS and the Treasury Department are considering the extent to which the notice described in section 401(k)(12)(D), as well as other notices

under the various Internal Revenue Code requirements relating to qualified retirement plans, can be provided electronically, taking into account the effect of the Electronic Signatures in Global and National Commerce Act (E-SIGN), Public Law 106-229 (114 Stat. 464 (2000)). The IRS and the Treasury Department anticipate issuing proposed regulations regarding these issues, and invite comments on these issues. Until those proposed regulations are issued, plan administrators and employers may continue to rely on the interim guidance in Q&A-7 of Notice 2000-3 on use of electronic media to satisfy the notice requirement in section 401(k)(12)(D).

These proposed regulations would clarify that a section 401(k) safe harbor plan must generally be adopted before the beginning of the plan year and be maintained throughout a full 12-month plan year. This requirement is consistent with the notion that the statute specifies a certain contribution level for nonhighly compensated employees in order to be deemed to pass the nondiscrimination requirements. If the contribution level is not maintained for a full 12-month year, the employer contributions made on behalf of nonhighly compensated employees should not support what could be a full year's contribution by the highly compensated employees.

The proposed regulations would adopt the exception to the requirement that a section 401(k) safe harbor plan be in place before the beginning of the plan year that was provided in Notice 2000-3. Under that option, an employer could adopt a section 401(k) safe harbor plan which has contingent non-elective contributions, provided the employer notifies employees of this contingent arrangement before the start of the year, amends the plan to provide the nonelective contributions no less than 30 days before the end of the year, and provides employees with a follow-up notice if the contribution will be made. Similarly, the proposed regulations would adopt the exception for a section 401(k) safe harbor plan that uses the matching contribution alternative. Under that exception, an employer can amend the plan to eliminate matching contributions with respect to future elective deferrals, provided that the matching contributions are made with respect to pre-amendment elective deferrals, employees are provided with notice of the change and the opportunity to change their elections, and the plan satisfies the ADP or ACP test for the plan year using the current year testing method.

The proposed regulations would recognize the practical difficulty in a 12-