

**MEMO# 11594**

February 1, 2000

# **IRS RULES THAT AUTOMATIC CONTRIBUTIONS MAY BE TREATED AS ELECTIVE CONTRIBUTIONS**

1 See Institute Memorandum to Pension Members No. 31-98, June 5, 1998. [11594]  
February 1, 2000 TO: PENSION MEMBERS No. 9-00 PENSION OPERATIONS ADVISORY  
COMMITTEE No. 7-00 RE: IRS CLARIFIES RULING PERMITTING "AUTOMATIC DEFERRALS"

The Internal Revenue Service in Revenue Ruling 2000-8 has clarified the extent to which prior Revenue Ruling 98-30 may be applied to current employees, in addition to newly hired employees.<sup>1</sup> In Revenue Ruling 98-30, the Service ruled that employee contributions that an employer automatically makes to a profit-sharing plan will qualify as elective contributions under section 1.401(k)-1(g)(3) even if the employees do not affirmatively elect to make the contributions. This ruling amplifies and supersedes Revenue Ruling 98-30. In Revenue Ruling 98-30, the Service considered a plan that included an automatic contribution provision applicable to newly hired employees. Specifically, under the plan, if a newly hired employee did not affirmatively elect to receive cash or have a specified amount contributed to the plan, his compensation was automatically reduced by 3 percent and this amount contributed to the plan. The plan permitted the employee to elect at any time not to make the contributions or to contribute a different percentage of compensation. At the time hired, the employee would receive a notice explaining the automatic compensation reduction and the employee's right to elect out of it and an explanation of the procedure and time frame for doing so. The plan also provided that the contributions would be invested in accordance with the participant's election among the alternatives available in the plan, or if no election was made by the participant, in the plan trust's balanced fund, which included diversified equity and fixed income investments. Revenue Ruling 2000-8 adds a new factual example to address current employees subject to a similar provision. In this example, the facts are identical, except the plan is amended to apply the automatic contribution provision to current employees. Under the plan, all current employees who do not affirmatively elect during a "specified reasonable period" ending on January 1 to receive cash or have a specified amount contributed to the plan will have their compensation automatically reduced by 3 percent and this amount contributed to the plan beginning the first pay period that begins after the January 1 effective date of the plan amendment. The Service concludes that the 3 percent automatic contribution qualifies as an elective contribution. In reaching this conclusion, the Service notes, in accordance with the prior revenue ruling, that the employees receive advance notice of their right to elect out of the automatic contribution, the employees have a reasonable period of time in which to make elections, and the employees are able to change their elections in the future. In Revenue Ruling 2000-8, the Service also indicates that if the plan were to permit after-tax contributions,

then the amounts contributed to the plan would have to be designated or treated, at the time of the contribution, as pre-tax salary reduction contributions or after-tax employee compensation. Russell G. Galer Senior Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11594. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).

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