

MEMO# 17221

March 29, 2004

PROPOSED REGULATIONS EXCLUDE EMPLOYEES OF TAX-EXEMPT CHARITIES FROM 401(K) PLANS FOR 410(B) TESTING PURPOSES

[17221] March 29, 2004 TO: PENSION COMMITTEE No. 16-04 PENSION OPERATIONS ADVISORY COMMITTEE No. 27-04 RE: PROPOSED REGULATIONS EXCLUDE EMPLOYEES OF TAX-EXEMPT CHARITIES FROM 401(K) PLANS FOR 410(B) TESTING PURPOSES Treasury has released proposed regulations¹ that would permit, under certain circumstances, tax exempt organizations that offer both a 401(k) and a 403(b) plan to exclude those employees who participate in the 403(b) plan from the 401(k) plan² for purposes of the nondiscrimination test under 410(b). Tax Exempt Sponsorship of Both 401(k) and 403(b) Plans Creates Coverage Issue Prior to the enactment of the Small Business Job Protection Act of 1996 ("SBJPA"), both governmental and tax-exempt entities were subject to section 410(b)'s coverage requirements ("minimum coverage test") and were prohibited from maintaining section 401(k) plans. SBJPA amended section 401(k) to permit nongovernmental tax-exempt entities, including organizations exempt under section 501(c)(3), to maintain both 401(k) plans and 403(b) plans. This change raised the question of whether employees participating in a tax exempt organization's 403(b) plan must be covered under both plans or whether 403(b) participants could be excluded when applying the minimum coverage test to the 401(k) plan. Because of these new rules, and pursuant to a directive by Congress contained in the Economic Growth and Tax Relief Reconciliation Act of 2001, Treasury has issued the proposed regulations to provide that employees of tax-exempt organizations who are eligible to participate in 403(b) plans may be excluded for purposes of testing a 401(k) plan if (1) no employee of the tax-exempt organization is eligible to participate in the 401(k) plan and (2) at least 95% of the employees who are not employed by the tax-exempt organization are eligible to participate in the 401(k) plan. 1 Go to <http://benefitslink.com/taxregs/1.410b-6-prop-2004.pdf> to read the proposed regulations. 2 Employees may also be excluded from a section 401(m) plan provided under the same general arrangement as the 401(k) plan. 2 These amendments are proposed to be effective for plan years beginning after December 31, 1996. The due date for submitting comments and requests for a public hearing is June 14, 2004. Treasury has specifically requested comments on whether it would be appropriate to modify section 410(b)'s exclusion for governmental plans in light of the Taxpayer Relief Act of 1997's addition of new section 401(a)(5)(G), which provides that governmental plans are no longer subject to section 410(b)'s minimum coverage requirements. You may contact Lisa Robinson with any comments regarding the proposed regulations at 202-326-5835 or lrobinson@ici.org. Lisa Robinson Assistant Counsel

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