

September 15 Deadline for Final 401(k) Plan Regulation Amendments

September 7, 2007

As discussed in a prior Morgan Lewis LawFlash, the Internal Revenue Service and Treasury Department previously released final regulations governing 401(k) plans. The regulations were generally effective for plan years beginning after January 1, 2006, but could be adopted as early as any plan year that ended after December 29, 2004. All 401(k) plans are required to be amended to comply with the mandatory portions of the final regulations. The deadline for such amendments depends on a number of factors, but generally the amendments must be adopted no later than the employer's income-tax filing due date for the 2006 income tax return (plus extensions). Thus, for calendar-year taxpayers, the amendment due date is September 15, 2007.

Summary of Significant Changes

The final 401(k) regulations implemented a number of mandatory and discretionary changes. Some significant changes include:

Mandatory Changes

ADP/ACP Nondiscrimination Testing Clarifications. The final regulations clarified several issues relating to ADP/ACP nondiscrimination testing, including (i) the elimination of "bottom-up" QNECs to satisfy the ADP test; (ii) the requirement that 401(k) plans specifically state which testing method (current-year or prior-year) will be used to satisfy the ADP/ACP test; (iii) the requirement that gap period income (income from the end of the plan year in which the excess occurred through date of distribution) be included in any distribution of excess contributions or excess aggregate contributions; (iv) the ability to disaggregate the employee stock ownership (ESOP) portion and non-ESOP portions of a single plan for ADP/ACP testing; and (v) changes relating to safe harbor plans, including provisions permitting short plan years due to plan terminations, business hardship, mergers, and acquisitions.

Elective Deferrals Included for Vesting Break-in-Service Rules. The final regulations require that elective deferrals, which are immediately nonforfeitable, be included for purposes of determining whether a participant is vested under the break-in-service rules. This generally means that prior service will never be disregarded after a break in service for any participant who made elective deferrals to a 401(k) plan prior to such break. It also means that the deemed cash-out rules will not apply to any portion of a participant's nonvested account if the participant made elective deferrals to the 401(k) plan.

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