

September 24, 2009

TCRS 2009-06: Revenue Ruling 2009-30 and Notice 2009-65 Relating to Automatic Contribution Arrangements

On September 5, 2009, the Internal Revenue Service and Treasury Department (IRS) issued guidance in the form of a revenue ruling and a notice in response to the Obama Administration's new retirement initiative aimed at making saving for retirement easier for working Americans through automatic enrollment and automatic deferral increases (automatic escalation) in 401(k) plans.

Revenue Ruling 2009-30 provides guidance in two situations involving 2 different employer automatic escalation features. Notice 2009-65 provides two sample amendments that plan sponsors can use to facilitate adoption of an Automatic Contribution Arrangement (ACA) or an Eligible Automatic Contribution Arrangement (EACA). Both sample amendments contain an optional automatic escalation feature which plan sponsors can also adopt. The IRS did not provide a sample amendment for adding a Qualified Automatic Contribution Arrangement (QACA).

This TCRS will only address the structure and timing of the automatic escalation features described in the Revenue Ruling and for the sake of brevity, facts not directly related to the automatic escalation features have been omitted. As provided in the Revenue Ruling, the employee notice and other applicable requirements of the automatic contribution arrangement contained in each of the plans were met and both plans are intended to qualify under Internal Revenue Code sections 401(a), 401(k) and 401(m).

Revenue Ruling 2009-30 (click here to view a copy)

The issues addressed in this Revenue Ruling are:

- whether automatic deferrals made pursuant to an automatic contribution arrangement that includes an automatic escalation feature are considered "elective contributions" properly made to a 401(k)/profit sharing plan; and
- whether the structure and timing of the increases under the 2 automatic escalation features described in the Revenue Ruling meet the qualified percentage requirement (including the uniformity and minimum percentage requirements) in the Treasury Regulations relating to an automatic escalation feature that is part of a QACA or the uniformity requirement relating to an EACA when the automatic increases occur on a date other than the first day of a plan year.

Automatic Deferrals/Increases are Elective Contributions

With respect to the first issue, the IRS concluded that the automatic deferrals made under the 2 Situations described in the Revenue Ruling, including the increases made pursuant to the automatic escalation features included therein, are elective contributions properly made to a 401(k)/profit sharing plan.

Automatic Escalation – Situation 1

Under Situation 1, the employer maintains a plan that is intended to be an ACA. The employer typically provides annual increases in base pay on and after an employee's employment anniversary date. Under the plan's automatic escalation feature, the increase is scheduled to occur starting with the first pay period that begins on or after an employee's employment anniversary date and is equal to the greater of (1) 1% of base pay or (2) 30% of the employee's percentage increase in base pay. Under the plan, the maximum automatic deferral percentage can never exceed 11%.

The IRS concluded that the structure of this automatic escalation feature does not meet the uniformity requirement of the Treasury Regulations because it results in automatic deferral percentages that are not a uniform percentage of pay for all eligible employees and the percentages do not vary based solely on the number of years since the eligible employees are automatically enrolled. However, according to the

Revenue Ruling, since the plan is intended to be an ACA, (and not a QACA or an EACA) such an automatic escalation feature is permissible.

Automatic Escalation – Situation 2

Under Situation 2, the automatic deferral percentage for the plan year an eligible employee is first automatically enrolled is 3% of plan compensation. The employer typically provides annual increases in pay effective for pay periods beginning on or after April 1 of each year. Under the plan's automatic escalation feature, the increase is scheduled to occur at the rate of 1% of plan compensation, starting with the first pay period that begins on or after April 1 of the plan year after an employee is first automatically enrolled. The maximum automatic deferral percentage under the plan can never exceed 10%.

The IRS concluded that the structure and timing of this automatic escalation feature is permissible under an EACA or a QACA because:

- it applies uniformly to all eligible employees for whom the same number of years have elapsed since automatic deferrals were first made on their behalf to the plan;
- under the plan in Situation 2, the automatic deferral percentage for each plan year after the plan year an eligible employee was first automatically enrolled meets the minimum automatic deferral percentages (see below) under the Treasury Regulations relating to a QACA or an EACA earlier than is required. These minimum automatic deferral percentages are not required to apply until after the end of the plan year following the plan year the eligible employee is first automatically enrolled, whereas the automatic deferral percentages under the plan in Situation 2 apply earlier, i.e. by the first pay period that begins on or after April 1 of each plan year following the plan year the eligible employee was first automatically enrolled. Under the Treasury Regulations, the minimum automatic deferral percentage cannot exceed 10% and must be at least:
 - (1) 3% during the period ending on the last day of the plan year following the plan year the eligible employee is automatically enrolled,
 - (2) 4% during the plan year following the plan year in (1),
 - (3) 5% during the second plan year following the plan year in (1), and
 - (4) 6% during any subsequent plan year, with no increases required during any subsequent plan year; and
- the maximum automatic deferral percentage under the plan is 10%.

Notice 2009-65 (click here to view a copy)

Two sample plan amendments are provided in the Notice. Amendment 1 can be used to add an ACA and Amendment 2 can be used to add an EACA (permitting 90-day withdrawals). Both sample plan amendments include an optional automatic escalation feature. Plan sponsors wishing to adopt automatic enrollment by using one of the sample plan amendments are encouraged to work with their document provider in preparing the amendment to ensure that revisions necessary to conform the IRS sample to their plan's terms and administrative procedures are properly made.

The Notice states that the use of either sample amendment, as modified to conform to the plan's terms and administrative procedures, will not result in the loss of reliance on a favorable opinion, advisory or determination letter. In other words, such an amendment to an IRS pre-approved plan (master and prototype or volume submitter plan) will not cause the plan to become an individually designed plan.

This Summary is designed to provide an overview of Revenue Ruling 2009-30 and Notice 2009-65 relating to automatic contribution arrangements and is not intended to be comprehensive. The Transamerica Center for Retirement Studies® ("The Center") is a non-profit corporation and private foundation. The Center may be funded by contributions from Transamerica Life Insurance Company and its affiliates or other unaffiliated third-parties. For more information about The Center, please refer to www.transamericacenter.org. The Center and its representatives cannot give ERISA, tax or legal advice. This material is provided for informational purposes only and should not be construed as ERISA, tax or legal advice. Interested parties must consult and rely solely upon their own independent advisors regarding their particular situation and the concepts presented here. Although care has been taken in preparing this material and presenting it accurately, The Center disclaims any express or implied warranty as to the accuracy of any material contained herein and any liability with respect to it.