

Internal Revenue Code Section 401(k)

Qualified pension, profit-sharing, and stock bonus plans.

...

(k) Cash or deferred arrangements.

(1) General rule. A profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan shall not be considered as not satisfying the requirements of subsection (a) merely because the plan includes a qualified cash or deferred arrangement.

(2) Qualified cash or deferred arrangement. A qualified cash or deferred arrangement is any arrangement which is part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan which meets the requirements of subsection (a)—

(A) under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash;

(B) under which amounts held by the trust which are attributable to employer contributions made pursuant to the employee's election—

(i) may not be distributable to participants or other beneficiaries earlier than—

(I) severance from employment, death, or disability,

(II) an event described in paragraph (10),

(III) in the case of a profit-sharing or stock bonus plan, the attainment of age 59 1/2 ,

(IV) in the case of contributions to a profit-sharing or stock bonus plan to which section 402(e)(3) applies, upon hardship of the employee, or

(V) in the case of a qualified reservist distribution (as defined in section 72(t)(2)(G)(iii)), the date on which a period referred to in subclause (III) of such section begins, and

(ii) will not be distributable merely by reason of the completion of a stated period of participation or the lapse of a fixed number of years;

(C) which provides that an employee's right to his accrued benefit derived from employer contributions made to the trust pursuant to his election is nonforfeitable, and

(D) which does not require, as a condition of participation in the arrangement, that an employee complete a period of service with the employer (or employers) maintaining the plan extending beyond the period permitted under section 410(a)(1) (determined without regard to subparagraph (B)(i) thereof).

(3) Application of participation and discrimination standards.

(A) A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement unless—

(i) those employees eligible to benefit under the arrangement satisfy the provisions of section 410(b)(1), and

(ii) the actual deferral percentage for eligible highly compensated employees (as defined in paragraph (5)) for the plan year bears a relationship to the actual deferral percentage for all other eligible employees for the preceding plan year which meets either of the following tests:

(I) The actual deferral percentage for the group of eligible highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 1.25.

(II) The excess of the actual deferral percentage for the group of eligible highly compensated employees over that of all other eligible employees is not more than 2 percentage points, and the actual deferral percentage for the group of eligible highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 2.

If 2 or more plans which include cash or deferred arrangements are considered as 1 plan for purposes of section 401(a)(4) or 410(b), the cash or deferred arrangements included in such plans shall be treated as 1 arrangement for purposes of this subparagraph.

If any highly compensated employee is a participant under 2 or more cash or deferred arrangements of the employer, for purposes of determining the deferral percentage with respect to such employee, all such cash or deferred arrangements shall be treated as 1 cash or deferred arrangement. An arrangement may apply clause (ii) by using the plan year rather than the preceding plan year if the employer so elects, except that if such an election is made, it may not be changed except as provided by the Secretary.

(B) For purposes of subparagraph (A), the actual deferral percentage for a specified group of employees for a plan year shall be the average of the ratios (calculated separately for each employee in such group) of—

- (i) the amount of employer contributions actually paid over to the trust on behalf of each such employee for such plan year, to
 - (ii) the employee's compensation for such plan year.

- (C) A cash or deferred arrangement shall be treated as meeting the requirements of subsection (a)(4) with respect to contributions if the requirements of subparagraph (A)(ii) are met.

- (D) For purposes of subparagraph (B), the employer contributions on behalf of any employee—
 - (i) shall include any employer contributions made pursuant to the employee's election under paragraph (2), and
 - (ii) under such rules as the Secretary may prescribe, may, at the election of the employer, include—
 - (I) matching contributions (as defined in 401(m)(4)(A)) which meet the requirements of paragraph (2)(B) and (C), and
 - (II) qualified nonelective contributions (within the meaning of section 401(m)(4)(C)).

- (E) For purposes of this paragraph, in the case of the first plan year of any plan (other than a successor plan), the amount taken into account as the actual deferral percentage of nonhighly compensated employees for the preceding plan year shall be—
 - (i) 3 percent, or
 - (ii) if the employer makes an election under this subclause, the actual deferral percentage of nonhighly compensated employees determined for such first plan year.

- (F) Special rule for early participation. If an employer elects to apply section 410(b)(4)(B) in determining whether a cash or deferred arrangement meets the requirements of subparagraph (A)(i), the employer may, in determining whether the arrangement meets the requirements of subparagraph (A)(ii), exclude from consideration all eligible employees (other than highly compensated employees) who have not met the minimum age and service requirements of section 410(a)(1)(A).

- (G) Governmental plan. A governmental plan (within the meaning of section 414(d)) shall be treated as meeting the requirements of this paragraph.

- (4) Other requirements.
 - (A) Benefits (other than matching contributions) must not be contingent on election to defer. A cash or deferred arrangement of any employer shall not be treated as a

qualified cash or deferred arrangement if any other benefit is conditioned (directly or indirectly) on the employee electing to have the employer make or not make contributions under the arrangement in lieu of receiving cash. The preceding sentence shall not apply to any matching contribution (as defined in section 401(m)) made by reason of such an election.

(B) Eligibility of state and local governments and tax-exempt organizations.

(i) Tax-exempts eligible. Except as provided in clause (ii), any organization exempt from tax under this subtitle may include a qualified cash or deferred arrangement as part of a plan maintained by it.

(ii) Governments ineligible. A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a State or local government or political subdivision thereof, or any agency or instrumentality thereof. This clause shall not apply to a rural cooperative plan or to a plan of an employer described in clause (iii).

(iii) Treatment of Indian tribal governments. An employer which is an Indian tribal government (as defined in section 7701(a)(40)), a subdivision of an Indian tribal government (determined in accordance with section 7871(d)), an agency or instrumentality of an Indian tribal government or subdivision thereof, or a corporation chartered under Federal, State, or tribal law which is owned in whole or in part by any of the foregoing may include a qualified cash or deferred arrangement as part of a plan maintained by the employer.

(C) Coordination with other plans. Except as provided in section 401(m), any employer contribution made pursuant to an employee's election under a qualified cash or deferred arrangement shall not be taken into account for purposes of determining whether any other plan meets the requirements of section 401(a) or 410(b). This subparagraph shall not apply for purposes of determining whether a plan meets the average benefit requirement of section 410(b)(2)(A)(ii).

(5) Highly compensated employee. For purposes of this subsection, the term "highly compensated employee" has the meaning given such term by section 414(q).

(6) Pre-ERISA money purchase plan. For purposes of this subsection, the term "pre-ERISA money purchase plan" means a pension plan—

(A) which is a defined contribution plan (as defined in section 414(i)),

(B) which was in existence on June 27, 1974, and which, on such date, included a salary reduction arrangement, and

(C) under which neither the employee contributions nor the employer contributions may exceed the levels provided for by the contribution formula in effect under the plan on such date.

(7) Rural cooperative plan. For purposes of this subsection—

(A) In general. The term "rural cooperative plan" means any pension plan—

(i) which is a defined contribution plan (as defined in section 414(i)), and

(ii) which is established and maintained by a rural cooperative.

(B) Rural cooperative defined. For purposes of subparagraph (A), the term "rural cooperative" means—

(i) any organization which—

(I) is engaged primarily in providing electric service on a mutual or cooperative basis, or

(II) is engaged primarily in providing electric service to the public in its area of service and which is exempt from tax under this subtitle or which is a State or local government (or an agency or instrumentality thereof), other than a municipality (or an agency or instrumentality thereof),

(ii) any organization described in paragraph (4) or (6) of section 501(c) and at least 80 percent of the members of which are organizations described in clause (i),

(iii) a cooperative telephone company described in section 501(c)(12),

(iv) any organization which—

(I) is a mutual irrigation or ditch company described in section 501(c)(12) (without regard to the 85 percent requirement thereof), or

(II) is a district organized under the laws of a State as a municipal corporation for the purpose of irrigation, water conservation, or drainage, and

(v) an organization which is a national association of organizations described in clause (i), (ii), (iii), or (iv).

(C) Special rule for certain distributions. A rural cooperative plan which includes a qualified cash or deferred arrangement shall not be treated as violating the requirements of section 401(a) or of paragraph (2) merely by reason of a hardship distribution or a distribution to a participant after attainment of age 59 1/2. For purposes of this section, the term "hardship distribution" means a distribution described in paragraph (2)(B)(i)(IV) (without regard to the limitation of its application to profit-sharing or stock bonus plans).

(8) Arrangement not disqualified if excess contributions distributed.

(A) In general. A cash or deferred arrangement shall not be treated as failing to meet the requirements of clause (ii) of paragraph (3)(A) for any plan year if, before the close of the following plan year—

- (i) the amount of the excess contributions for such plan year (and any income allocable to such contributions through the end of such year) is distributed, or
- (ii) to the extent provided in regulations, the employee elects to treat the amount of the excess contributions as an amount distributed to the employee and then contributed by the employee to the plan.

Any distribution of excess contributions (and income) may be made without regard to any other provision of law.

- (B) Excess contributions. For purposes of subparagraph (A), the term "excess contributions" means, with respect to any plan year, the excess of—
 - (i) the aggregate amount of employer contributions actually paid over to the trust on behalf of highly compensated employees for such plan year, over
 - (ii) the maximum amount of such contributions permitted under the limitations of clause (ii) of paragraph (3)(A) (determined by reducing contributions made on behalf of highly compensated employees in order of the actual deferral percentages beginning with the highest of such percentages).
- (C) Method of distributing excess contributions. Any distribution of the excess contributions for any plan year shall be made to highly compensated employees on the basis of the amount of contributions by, or on behalf of, each of such employees.
- (D) Additional tax under section 72(t) not to apply. No tax shall be imposed under section 72(t) on any amount required to be distributed under this paragraph.
- (E) Treatment of matching contributions forfeited by reason of excess deferral or contribution or permissible withdrawal. For purposes of paragraph (2)(C), a matching contribution (within the meaning of subsection (m)) shall not be treated as forfeitable merely because such contribution is forfeitable if the contribution to which the matching contribution relates is treated as an excess contribution under subparagraph (B), an excess deferral under section 402(g)(2)(A) a permissible withdrawal under section 414(w), or an excess aggregate contribution under section 401(m)(6)(B).
- (F) Cross reference.

For excise tax on certain excess contributions, see section 4979.

- (9) Compensation. For purposes of this subsection, the term "compensation" has the meaning given such term by section 414(s).
- (10) Distributions upon termination of plan.
 - (A) In general. An event described in this subparagraph is the termination of the plan without establishment or maintenance of another defined contribution plan (other than an employee stock ownership plan as defined in section 4975(e)(7)).

(B) Distributions must be lump sum distributions.

- (i) In general. A termination shall not be treated as described in subparagraph (A) with respect to any employee unless the employee receives a lump sum distribution by reason of the termination.
- (ii) Lump-sum distribution. For purposes of this subparagraph, the term "lump-sum distribution" has the meaning given such term by section 402(e)(4)(D) (without regard to subclauses (I), (II), (III), and (IV) of clause (i) thereof). Such term includes a distribution of an annuity contract from—
 - (I) a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501(a), or
 - (II) an annuity plan described in section 403(a).

(11) Adoption of simple plan to meet nondiscrimination tests.

(A) In general. A cash or deferred arrangement maintained by an eligible employer shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement meets—

- (i) the contribution requirements of subparagraph (B),
- (ii) the exclusive plan requirements of subparagraph (C), and
- (iii) the vesting requirements of section 408(p)(3).

(B) Contribution requirements.

- (i) In general. The requirements of this subparagraph are met if, under the arrangement—
 - (I) an employee may elect to have the employer make elective contributions for the year on behalf of the employee to a trust under the plan in an amount which is expressed as a percentage of compensation of the employee but which in no event exceeds the amount in effect under section 408(p)(2)(A)(ii),
 - (II) the employer is required to make a matching contribution to the trust for the year in an amount equal to so much of the amount the employee elects under subclause (I) as does not exceed 3 percent of compensation for the year, and
 - (III) no other contributions may be made other than contributions described in subclause (I) or (II).
- (ii) Employer may elect 2-percent nonelective contribution. An employer shall be treated as meeting the requirements of clause (i)(II) for any year if, in lieu of the contributions described in such clause, the employer elects (pursuant to the terms

of the arrangement) to make nonelective contributions of 2 percent of compensation for each employee who is eligible to participate in the arrangement and who has at least \$ 5,000 of compensation from the employer for the year. If an employer makes an election under this subparagraph for any year, the employer shall notify employees of such election within a reasonable period of time before the 60th day before the beginning of such year.

(iii) Administrative requirements.

(I) In general. Rules similar to the rules of subparagraphs (B) and (C) of section 408(p)(5) shall apply for purposes of this subparagraph.

(II) Notice of election period. The requirements of this subparagraph shall not be treated as met with respect to any year unless the employer notifies each employee eligible to participate, within a reasonable period of time before the 60th day before the beginning of such year (and, for the first year the employee is so eligible, the 60th day before the first day such employee is so eligible), of the rules similar to the rules of section 408(p)(5)(C) which apply by reason of subclause (I).

(C) Exclusive plan requirement. The requirements of this subparagraph are met for any year to which this paragraph applies if no contributions were made, or benefits were accrued, for services during such year under any qualified plan of the employer on behalf of any employee eligible to participate in the cash or deferred arrangement, other than contributions described in subparagraph (B).

(D) Definitions and special rule.

(i) Definitions. For purposes of this paragraph, any term used in this paragraph which is also used in section 408(p) shall have the meaning given such term by such section.

(ii) Coordination with top-heavy rules. A plan meeting the requirements of this paragraph for any year shall not be treated as a top-heavy plan under section 416 for such year if such plan allows only contributions required under this paragraph.

(E) ...

(12) Alternative methods of meeting nondiscrimination requirements.

(A) In general. A cash or deferred arrangement shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement—

(i) meets the contribution requirements of subparagraph (B) or (C), and

(ii) meets the notice requirements of subparagraph (D).

(B) Matching contributions.

- (i) In general. The requirements of this subparagraph are met if, under the arrangement, the employer makes matching contributions on behalf of each employee who is not a highly compensated employee in an amount equal to—
 - (I) 100 percent of the elective contributions of the employee to the extent such elective contributions do not exceed 3 percent of the employee's compensation, and
 - (II) 50 percent of the elective contributions of the employee to the extent that such elective contributions exceed 3 percent but do not exceed 5 percent of the employee's compensation.
- (ii) Rate for highly compensated employees. The requirements of this subparagraph are not met if, under the arrangement, the rate of matching contribution with respect to any elective contribution of a highly compensated employee at any rate of elective contribution is greater than that with respect to an employee who is not a highly compensated employee.
- (iii) Alternative plan designs. If the rate of any matching contribution with respect to any rate of elective contribution is not equal to the percentage required under clause (i), an arrangement shall not be treated as failing to meet the requirements of clause (i) if—
 - (I) the rate of an employer's matching contribution does not increase as an employee's rate of elective contributions increase, and
 - (II) the aggregate amount of matching contributions at such rate of elective contribution is at least equal to the aggregate amount of matching contributions which would be made if matching contributions were made on the basis of the percentages described in clause (i).
- (C) Nonelective contributions. The requirements of this subparagraph are met if, under the arrangement, the employer is required, without regard to whether the employee makes an elective contribution or employee contribution, to make a contribution to a defined contribution plan on behalf of each employee who is not a highly compensated employee and who is eligible to participate in the arrangement in an amount equal to at least 3 percent of the employee's compensation.
- (D) Notice requirement. An arrangement meets the requirements of this paragraph if, under the arrangement, each employee eligible to participate is, within a reasonable period before any year, given written notice of the employee's rights and obligations under the arrangement which—
 - (i) is sufficiently accurate and comprehensive to apprise the employee of such rights and obligations, and
 - (ii) is written in a manner calculated to be understood by the average employee eligible to participate.

(E) Other requirements.

- (i) Withdrawal and vesting restrictions. An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) of this paragraph unless the requirements of subparagraphs (B) and (C) of paragraph (2) are met with respect to all employer contributions (including matching contributions) taken into account in determining whether the requirements of subparagraphs (B) and (C) of this paragraph are met.
- (ii) Social security and similar contributions not taken into account. An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) unless such requirements are met without regard to subsection (I), and, for purposes of subsection (I), employer contributions under subparagraph (B) or (C) shall not be taken into account.

(F) Other plans. An arrangement shall be treated as meeting the requirements under subparagraph (A)(i) if any other plan maintained by the employer meets such requirements with respect to employees eligible under the arrangement.

(13) Alternative method for automatic contribution arrangements to meet nondiscrimination requirements.

(A) In general. A qualified automatic contribution arrangement shall be treated as meeting the requirements of paragraph (3)(A)(ii).

(B) Qualified automatic contribution arrangement. For purposes of this paragraph, the term "qualified automatic contribution arrangement" means any cash or deferred arrangement which meets the requirements of subparagraphs (C) through (E).

(C) Automatic deferral.

(i) In general. The requirements of this subparagraph are met if, under the arrangement, each employee eligible to participate in the arrangement is treated as having elected to have the employer make elective contributions in an amount equal to a qualified percentage of compensation.

(ii) Election out. The election treated as having been made under clause (i) shall cease to apply with respect to any employee if such employee makes an affirmative election—

(I) to not have such contributions made, or

(II) to make elective contributions at a level specified in such affirmative election.

(iii) Qualified percentage. For purposes of this subparagraph, the term "qualified percentage" means, with respect to any employee, any percentage determined under the arrangement if such percentage is applied uniformly, does not exceed 10 percent, and is at least—

- (I) 3 percent during the period ending on the last day of the first plan year which begins after the date on which the first elective contribution described in clause (i) is made with respect to such employee,
 - (II) 4 percent during the first plan year following the plan year described in subclause (I),
 - (III) 5 percent during the second plan year following the plan year described in subclause (I), and
 - (IV) 6 percent during any subsequent plan year.
- (iv) Automatic deferral for current employees not required. Clause (i) may be applied without taking into account any employee who—
- (I) was eligible to participate in the arrangement (or a predecessor arrangement) immediately before the date on which such arrangement becomes a qualified automatic contribution arrangement (determined after application of this clause), and
 - (II) had an election in effect on such date either to participate in the arrangement or to not participate in the arrangement.

(D) Matching or nonelective contributions.

- (i) In general. The requirements of this subparagraph are met if, under the arrangement, the employer—
 - (I) makes matching contributions on behalf of each employee who is not a highly compensated employee in an amount equal to the sum of 100 percent of the elective contributions of the employee to the extent that such contributions do not exceed 1 percent of compensation plus 50 percent of so much of such contributions as exceed 1 percent but do not exceed 6 percent of compensation, or
 - (II) is required, without regard to whether the employee makes an elective contribution or employee contribution, to make a contribution to a defined contribution plan on behalf of each employee who is not a highly compensated employee and who is eligible to participate in the arrangement in an amount equal to at least 3 percent of the employee's compensation.
- (ii) Application of rules for matching contributions. The rules of clauses (ii) and (iii) of paragraph (12)(B) shall apply for purposes of clause (i)(I).
- (iii) Withdrawal and vesting restrictions. An arrangement shall not be treated as meeting the requirements of clause (i) unless, with respect to employer contributions (including matching contributions) taken into account in determining whether the requirements of clause (i) are met—

(I) any employee who has completed at least 2 years of service (within the meaning of section 411(a)) has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from such employer contributions, and

(II) the requirements of subparagraph (B) of paragraph (2) are met with respect to all such employer contributions.

(iv) Application of certain other rules. The rules of subparagraphs (E)(ii) and (F) of paragraph (12) shall apply for purposes of subclauses (I) and (II) of clause (i).

(E) Notice requirements.

(i) In general. The requirements of this subparagraph are met if, within a reasonable period before each plan year, each employee eligible to participate in the arrangement for such year receives written notice of the employee's rights and obligations under the arrangement which—

(I) is sufficiently accurate and comprehensive to apprise the employee of such rights and obligations, and

(II) is written in a manner calculated to be understood by the average employee to whom the arrangement applies.

(ii) Timing and content requirements. A notice shall not be treated as meeting the requirements of clause (i) with respect to an employee unless—

(I) the notice explains the employee's right under the arrangement to elect not to have elective contributions made on the employee's behalf (or to elect to have such contributions made at a different percentage),

(II) in the case of an arrangement under which the employee may elect among 2 or more investment options, the notice explains how contributions made under the arrangement will be invested in the absence of any investment election by the employee, and

(III) the employee has a reasonable period of time after receipt of the notice described in subclauses (I) and (II) and before the first elective contribution is made to make either such election.