

## **Part 1**

### **Section 401.—Qualified Pension, Profit-Sharing, Stock Bonus Plans, etc.**

#### **Automatic Contribution Increases under Automatic Contribution Arrangements**

##### **Rev. Rul. 2009-30**

##### **ISSUES**

1. Will default contributions to a profit-sharing plan fail to be considered elective contributions merely because they are made pursuant to an automatic contribution arrangement under which an eligible employee's default contribution percentage automatically increases in plan years after the first plan year of the eligible employee's participation in the automatic contribution arrangement based in part on increases in the eligible employee's plan compensation?

2. Will default contributions under an automatic contribution arrangement fail to satisfy the qualified percentage requirement (including uniformity and minimum percentage requirements) relating to a "qualified automatic contribution arrangement" under section 401(k)(13) of the Internal Revenue Code (providing an automatic enrollment nondiscrimination safe harbor) or the uniformity requirement relating to an "eligible automatic contribution arrangement" under section 414(w) (permitting 90-day withdrawals) merely because default contributions are made pursuant to an arrangement under which the default contribution percentage for all eligible employees increases on a date other than the first day of a plan year?

##### **FACTS**

###### **Situation 1**

Employer X maintains Plan A, a profit-sharing plan intended to satisfy the requirements of sections 401(a), 401(k), and 401(m), and maintained on a calendar-year basis. Plan A is not intended to satisfy the requirements to be a qualified automatic contribution arrangement or eligible automatic contribution arrangement.

Under Plan A, any eligible employee of Employer X may affirmatively elect to receive his or her compensation entirely in cash or to have Employer X make specified contributions on the eligible employee's behalf to Plan A in lieu of receiving those amounts as cash compensation. Subject to certain limitations set forth in Plan A, the eligible employee may designate the amount of these elective contributions as a

percentage of the eligible employee's "plan compensation," defined under Plan A as base pay (excluding overtime, bonuses, and other special compensation).

Under Plan A, if any eligible employee of Employer X does not affirmatively elect to receive cash or to have a specified amount contributed to Plan A, default contributions are automatically contributed to Plan A (with a corresponding reduction in the eligible employee's cash compensation) beginning with the first pay period of the first plan year of the eligible employee's participation in the automatic contribution arrangement. For that first plan year, the default contribution percentage is 4 percent of plan compensation. Any eligible employee may elect at any time not to make elective contributions (including not to make default contributions) or to have Employer X contribute to Plan A a different percentage of plan compensation.

Employer X usually provides annual increases in base pay for its employees effective for pay periods beginning on or after the employment anniversary date for each employee. Under Plan A, for plan years after the first plan year of the eligible employee's participation in the automatic contribution arrangement, the default contribution percentage is automatically increased beginning with the first pay period that begins on or after the eligible employee's employment anniversary date. The increase in the default contribution percentage is equal to the greater of (1) 1 percentage point, or (2) a number of percentage points calculated as 30 percent of the percentage increase in the eligible employee's base pay for such first pay period over the eligible employee's base pay for the immediately preceding pay period (rounded to the nearest whole percentage). However, under Plan A, the default contribution percentage may never exceed 11 percent. For example, the default contribution percentage for an employee with default contributions beginning in 2009 would increase by 1 percentage point each plan year for pay periods beginning on or after the employee's employment anniversary date (to 5 percent in 2010, 6 percent in 2011, etc., up to 11 percent in 2016 and later plan years), even if his or her base pay were not to increase. If the employee's base pay were to increase by at least 5 percent during one or more plan years before 2016, the default contribution percentage would increase to 11 percent even earlier.

Eligible employees are provided notices satisfying the timing and content requirements of section 1.401(k)-1(e)(2)(ii) of the Income Tax Regulations that explain the default contribution percentage, automatic increases in the default contribution percentage in plan years after the first plan year, and the eligible employees' right to elect to have no elective contributions (including no default contributions) made to Plan A or to alter the amount of those contributions.

Plan A provides that elective contributions are immediately nonforfeitable and, if the eligible employee has not attained age 59-1/2, cannot be distributed prior to the eligible employee's death or severance from employment, except in the case of hardship. Plan A also provides that, for each eligible employee, Employer X will make matching contributions to Plan A on account of the eligible employee's elective contributions up to a specified percentage of the eligible employee's plan compensation.

Plan A provides that default contributions and related matching contributions will, absent a contrary election, be invested in a qualified default investment alternative (QDIA), as described in section 2550.404c-5 of Department of Labor regulations.

## **Situation 2**

Employer Y maintains Plan B, a profit-sharing plan intended to satisfy the requirements of sections 401(a), 401(k), and 401(m), and maintained on a calendar-year basis. Plan B is also intended to satisfy the requirements to be a qualified automatic contribution arrangement and an eligible automatic contribution arrangement.

Under Plan B, any eligible employee of Employer Y may affirmatively elect to receive his or her compensation entirely in cash or to have Employer Y make specified contributions on the eligible employee's behalf to Plan B in lieu of receiving those amounts as cash compensation. Subject to certain limitations set forth in Plan B, the eligible employee may designate the amount of these elective contributions as a percentage of the eligible employee's "plan compensation," defined under Plan B.

Under Plan B, if any eligible employee of Employer Y does not affirmatively elect to receive cash or to have a specified amount contributed to Plan B, default contributions are automatically contributed to Plan B (with a corresponding reduction in the eligible employee's cash compensation) beginning with the first pay period of the first plan year of the eligible employee's participation in the automatic contribution arrangement. For that first plan year, the default contribution percentage is 3 percent of plan compensation. Any eligible employee may elect at any time not to make elective contributions (including not to make default contributions) or to have Employer Y contribute to Plan B a different percentage of plan compensation.

Employer Y usually provides annual increases in compensation for its employees effective for pay periods beginning on or after April 1 each year. Under Plan B, for plan years after the first plan year of the eligible employee's participation in the automatic contribution arrangement, the default contribution percentage is automatically increased beginning with the first pay period that begins on or after April 1. The increase in the default contribution percentage is equal to 1 percentage point. However, under Plan B, the default contribution percentage may never exceed 10 percent.

Eligible employees are provided notices satisfying the timing and content requirements of sections 401(k)(13)(E) and 414(w)(4) that explain the default contribution percentage, automatic increases to the default contribution percentage in plan years after the first plan year, and the eligible employees' right to elect to have no elective contributions (including no default contributions) made to Plan B or to alter the amount of those contributions.

Plan B provides that elective contributions are immediately nonforfeitable and, if the eligible employee has not attained age 59-1/2, cannot be distributed prior to the eligible employee's death or severance from employment, except in the case of hardship or in the case of a distribution that satisfies the requirements of section 414(w)(2). Plan B also provides that, for each eligible employee, Employer Y will make specified matching contributions to Plan B on account of the eligible employee's elective contributions up to a specified percentage of the eligible employee's plan compensation under a matching formula that satisfies the rules of sections 401(k)(13)(D)(i)(I), (ii), (iii), and (iv) and 401(m)(12).

Plan B provides that default contributions and related matching contributions will, absent a contrary election, be invested in a QDIA.

## **LAW**

### **Automatic Contribution Arrangements under a Qualified Cash or Deferred Arrangement**

Section 401(k) provides that a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan can meet the requirements of section 401(a) even if it includes a qualified cash or deferred arrangement. Section 401(k) also sets forth the requirements that a cash or deferred arrangement must satisfy in order to be a qualified cash or deferred arrangement.

Section 1.401(k)-1(a)(2)(i) defines a cash or deferred arrangement as an arrangement under which an employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of section 401(a).

Section 1.401(k)-1(a)(3)(i) defines a cash or deferred election as any election (or modification of an earlier election) by an employee to have the employer either provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available or contribute an amount to a trust (or provide an accrual or other benefit) under a plan deferring the receipt of compensation.

Section 1.401(k)-1(a)(3)(ii) provides that, for purposes of determining whether an election is a cash or deferred election, it is irrelevant whether the default that applies in the absence of an affirmative election is (1) for the employer to receive an amount in cash or some other taxable benefit or (2) for the employer to contribute an amount to a trust or provide an accrual or other benefit under a plan deferring the receipt of compensation.

Section 1.401(k)-1(e)(2)(ii) provides that a qualified cash or deferred arrangement must provide an employee with an effective opportunity to make (or change) a cash or deferred election at least once during each plan year, and that whether an employee has an effective opportunity is determined based on all the relevant facts and circumstances,

including the adequacy of notice of the availability of the election, the period of time during which an election may be made, and any other conditions on elections.

### **Qualified Automatic Contribution Arrangements (Automatic Enrollment Nondiscrimination Safe Harbor)**

In general, section 401(k)(3) imposes nondiscrimination standards on qualified cash or deferred arrangements, including an actual deferral percentage (ADP) test. Similarly, in general, section 401(m) imposes nondiscrimination standards on employer matching contributions made to a defined contribution plan on behalf of the employee, including an actual contribution percentage (ACP) test.

Sections 401(k)(13) and 401(m)(12) provide alternative design-based safe harbors for a cash or deferred arrangement that provides for automatic contributions at a specified level and meets certain employer matching contribution (or employer nonelective contribution), uniformity, notice, and other requirements. A cash or deferred arrangement that satisfies these requirements is a qualified automatic contribution arrangement that is treated as satisfying the ADP test and the ACP test.

Sections 1.401(k)-3 and 1.401(m)-3 prescribe rules for qualified automatic contribution arrangements. These rules include, under section 1.401(k)-3(j)(1)(i), a requirement that the default election under a qualified automatic contribution arrangement be a contribution equal to a qualified percentage multiplied by the employee's eligible compensation from which elective contributions are permitted to be made under the cash or deferred arrangement. Under section 1.401(k)-3(j)(2), in general a default contribution percentage is a qualified percentage only if it is uniform for all eligible employees, does not exceed 10 percent, and satisfies certain minimum percentage requirements. Under section 1.401(k)-3(j)(2)(iii), several exceptions to the uniformity requirement apply, including that a plan does not fail to satisfy the uniformity requirement merely because the default contribution percentage varies based on the number of years (or portions of years) since the beginning of the initial period for an employee. For this purpose, the initial period begins when the employee first has contributions made pursuant to a default election under an arrangement that is intended to be a qualified automatic contribution arrangement for a plan year and ends on the last day of the following plan year. Section 1.401(k)-3(j)(2)(ii) sets out the minimum percentage requirements. In general, the minimum percentage is 3 percent for the initial period. The minimum percentage is 4 percent for the next succeeding plan year, 5 percent for the next succeeding plan year, and 6 percent for all succeeding plan years.

### **Eligible Automatic Contribution Arrangements (Permitting 90-day Withdrawals)**

Section 414(w) provides limited relief from generally-applicable distribution restrictions under sections 401(k)(2)(B), 403(b)(7), 403(b)(11), and 457(d)(1)(A) in the case of an eligible automatic contribution arrangement. In particular, sections 414(w)(1) and 414(w)(2) provide that an applicable employer plan that contains an eligible

automatic contribution arrangement is permitted to allow employees, within 90 days after the date of the first default contribution with respect to the employee under the arrangement, to elect to receive a distribution equal to the amount of default contributions (and attributable earnings) made with respect to the employee beginning with the first payroll period to which the eligible automatic contribution arrangement applies to the employee and ending with the effective date of the election. Sections 414(w)(1)(A) and 414(w)(1)(B) provide that the amount of the distribution is includible in gross income for the taxable year in which the distribution is made, but is not subject to the additional income tax under section 72(t). Under section 414(w), an automatic contribution arrangement must satisfy uniformity, notice, and other requirements in order to be an eligible automatic contribution arrangement.

Section 1.414(w)-1 prescribes rules under section 414(w), including, under section 1.414(w)-1(b)(2)(i), that the default contribution election under an eligible automatic contribution arrangement be a uniform percentage of compensation. Under section 1.414(w)-1(b)(2)(ii), several exceptions to the uniformity requirement apply by cross-reference to section 1.401(k)-3(j)(2)(iii), including a modified version of the exception under which a plan does not fail to satisfy the uniformity requirement merely because the default contribution percentage varies based on the number of years (or portions of years) since the beginning of the initial period for an employee.

## **ANALYSIS**

### **Situation 1**

The default contributions made for an eligible employee in Situation 1 are elective contributions made pursuant to a cash or deferred election and satisfy the requirement in section 1.401(k)-1(a)(3)(i) that the amount that each eligible employee may defer as an elective contribution be available to the eligible employee in cash (or some other taxable benefit). Pursuant to section 1.401(k)-1(a)(3)(ii), the election is a cash or deferred election and the contributions are elective contributions even though the contributions are made pursuant to a default election in the absence of an affirmative election.

Because a default contribution percentage can be increased or otherwise changed over time pursuant to a plan-specified schedule, the default contributions in Situation 1 do not cease to be elective contributions merely because default contribution percentages increase over time and such increases are, in part, determined by reference to the amount of, and are scheduled to take effect at or by reference to the time of, future increases in base pay.

The structure of increases in the default contribution percentage for years after the first plan year of an eligible employee's participation in the automatic contribution arrangement results in default contribution percentages for eligible employees that are not uniform percentages of plan compensation for all eligible employees, and the percentages do not vary based solely on the number of years (or portions of years) since the beginning of the initial period described in section 1.401(k)-3(j)(2)(iii)(A). However, because the

automatic contribution arrangement in Situation 1 is not intended to be an eligible automatic contribution arrangement or a qualified automatic contribution arrangement, this nonuniformity is permissible.

## **Situation 2**

The default contributions described in Situation 2 are elective contributions made pursuant to cash or deferred elections and satisfy the requirement in section 1.401(k)-1(a)(3)(i) that the amount that each eligible employee may defer as an elective contribution be available to the eligible employee in cash (or some other taxable benefit). Pursuant to section 1.401(k)-1(a)(3)(ii), the election is a cash or deferred election and the contributions are elective contributions even though the contributions are made pursuant to a default election in the absence of an affirmative election.

The default contributions described in Situation 2 do not cause the arrangement to fail to satisfy the requirements for a qualified automatic contribution arrangement and an eligible automatic contribution arrangement. In particular, the provisions in Plan B under which, for plan years after the first plan year of an eligible employee's participation in the automatic contribution arrangement, the default contribution percentage is automatically increased beginning with the first pay period that begins on or after April 1, do not cause Plan B to fail the uniformity requirement of sections 1.401(k)-3(j)(2)(i) and 1.414(w)-1(b)(2)(i). The increases are eligible for an exception to the uniformity requirement because they apply in the same manner to all eligible employees for whom the same number of years or portions of years have elapsed since default contributions were first made for them under the automatic contribution arrangement.

Also, the default contribution percentages for each plan year after the first plan year satisfy the minimum default contribution percentage requirements of section 1.401(k)-3(j)(2)(ii) for periods beginning both before and on or after April 1 of such a plan year. This is because, under section 1.401(k)-3(j)(2)(ii)(B), the minimum default contribution percentage of 4 percent is not required to apply until after the end of the plan year following the first plan year of an eligible employee's participation in the automatic contribution arrangement, whereas, under Plan B, the increased default contribution percentage of 4 percent applies earlier, beginning with the first pay period that begins on or after April 1 of the plan year following the first plan year. Similarly, the minimum default contribution percentages of 5 percent and 6 percent set out in section 1.401(k)-3(j)(2)(ii)(C) and (D) are satisfied under Plan B earlier than required. Alternatively, if under Plan B increased default contribution percentages had not begun to apply until April 1 of the second plan year following the first plan year, the minimum default contribution percentage requirements could have been satisfied by using an initial default contribution percentage of 4 percent (rather than 3 percent).

## **HOLDINGS**

1. Default contributions to a profit-sharing plan will not fail to be considered elective contributions merely because they are made pursuant to an automatic

contribution arrangement under which an eligible employee's default contribution percentage automatically increases in plan years after the first plan year of the eligible employee's participation in the automatic contribution arrangement based in part on increases in the eligible employee's plan compensation.

2. Default contributions under an automatic contribution arrangement will not fail to satisfy the qualified percentage requirement (including uniformity and minimum percentage requirements) relating to a qualified automatic contribution arrangement or the uniformity requirement relating to an eligible automatic contribution arrangement merely because default contributions are made pursuant to an arrangement under which the default contribution percentage for all eligible employees increases on a date other than the first day of a plan year.

#### **DRAFTING INFORMATION**

The principal author of this revenue ruling is Roger Kuehnle of the Employee Plans, Tax Exempt and Government Entities Division. Questions regarding this revenue ruling may be sent via e-mail to [RetirementPlanQuestions@irs.gov](mailto:RetirementPlanQuestions@irs.gov).