Nondiscrimination Rules for Plans Maintained by Governments and Tax-Exempt Organizations

Notice 96–64

I. PURPOSE

This notice addresses certain issues relating to the nondiscrimination rules that apply to qualified plans maintained by governments and by organizations exempt from taxation under § 501(a) of the Internal Revenue Code (‘‘tax-exempt organizations’’).

For governmental plans, this notice—

- Extends the date for applying the regulations under § 401(k) and (m) until the first plan year beginning on or after October 1, 1997 (or, if later, 90 days after the opening of the first legislative session beginning on or after October 1,

1997, of the governing body with authority to amend the plan, if that body does not meet continuously);

- Clarifies that deemed satisfaction of the § 401(a)(4) and § 410(b) nondiscrimination and minimum coverage rules also applies for purposes of the references to those sections under § 401(k) and (m);
- Provides a special option for applying the § 401(k) and (m) nondiscrimination tests for years before 1999; and
- Allows governments until the 2001 plan year to apply, for nondiscrimination purposes, a reasonable, good faith interpretation of existing law in determining which entities must be aggregated, with any further guidance applying prospectively for plan years beginning in or after 2001.

For plans maintained by tax-exempt organizations, this notice—

- Extends the date for applying the regulations under §§ 401(a)(4), 401(a)(5), 401(l), 410(b), 414(r), and 414(s) until the first plan year beginning on or after October 1, 1997;
- Extends the remedial amendment period and other administrative relief until the last day of the first plan year beginning on or after October 1, 1997;
- Extends through the 1997 plan year the relief under existing regulations permitting employees of certain tax-exempt entities to be disregarded in applying § 410(b) to a § 401(k) plan maintained by a taxable entity; and
- Allows tax-exempt organizations until the 2001 plan year to apply, for nondiscrimination purposes, a reasonable, good faith interpretation of existing law in determining which entities must be aggregated, with any further guidance applying prospectively for plan years beginning in or after 2001.

II. BACKGROUND

A. Governmental Plans

Announcement 95–48, 1995–23 I.R.B. 13, provides that, in the case of governmental plans described in § 414(d), the regulations under § 401(k) and (m) apply to plan years beginning on or after the later of January 1, 1997, or 90 days after the opening of the first legislative session beginning on or after January 1, 1997, of the governing body with authority to amend the plan, if that body does not meet continuously. The regulations under §§ 401(a)(4), 401(a)(26), 410(b), and 414(s) apply to plan years beginning on or after the later of January 1, 1999, or 90 days after the opening of the first legislative session beginning on or after January 1, 1999, of the governing body with authority to amend the plan, if that body does not meet continuously (''1999 legislative date''). For plan years beginning before the applicable effective date, governmental plans are deemed to satisfy §§ 401(a)(4), 401(a)(26), 401(k), 401(m), 410(b), and 414(s).

Announcement 95–48 also provides that the remedial amendment period under § 401(b) for governmental plans extends to the last day of the first plan year beginning on or after the later of January 1, 1999, or the 1999 legislative date. During the remedial amendment period, additional administrative relief provided under Notice 92–36, 1992–2 C.B. 364, continues to be available.

Announcement 95–48 solicited comments on the application of the nondiscrimination requirements to governmental plans. Comments included discussion of state law restrictions on modifying benefits for current employees and noted that it may be difficult to identify the appropriate governmental entity to be treated as the employer for purposes of nondiscrimination testing. For example, in the case of a state-wide plan covering members of a particular occupation (such as public school teachers), questions have been raised whether the employers for testing purposes would be the special districts (such as the school districts), the local governments, or other governmental entities. Comments also raised the issue of whether deemed satisfaction of § 401(a)(4) and § 410(b) by a governmental plan applies for purposes of certain requirements under § 401(k) and (m).

B. Plans Maintained by Tax-Exempt Organizations

Announcement 95–48 provides that, in the case of plans maintained by tax-exempt organizations, other than church plans described in § 410(c)(1)(B) (''nonelecting church plans''), the regulations under §§ 401(a)(4), 401(a)(5), 401(l), 410(b), 414(r), and 414(s) apply to plan years beginning on or after January 1, 1997. For plan years beginning before that effective date, a plan maintained by a tax-exempt organization must be operated in accordance with a reasonable, good faith interpretation of §§ 401(a)(4), 401(a)(5), 401(l), 410(b), 414(r), and 414(s). The remedial amendment period for plans maintained by tax-exempt organizations was extended in Announcement 95–48 to the last day of the first plan year beginning on or after January 1, 1997. During the remedial amendment period, additional administrative relief provided under Notice 92–36 continues to be available. (See section V of Notice 92–36, and section IV of Rev. Proc. 94–13, 1994–1 C.B. 566, for the definition of ''plan maintained by a tax-exempt organization.'')

Announcement 95–48 solicited comments on the issue of which entities must be aggregated under § 414(b) and (c) (relating to the definition of employer) and on any other related nondiscrimination issues affecting tax-exempt organizations. No comments were submitted on behalf of tax-exempt organizations in response to Announcement 95–48, and the Treasury and the Service have not identified any other unique characteristics of tax-exempt organizations that require special rules for applying §§ 401(a)(4), 401(a)(5), 401(l), 410(b), 414(r), or 414(s) to plans maintained by tax-exempt organizations (other than nonelecting church plans).

C. Nonelecting Church Plans

Under Announcement 95–48, in the case of nonelecting church plans, the regulations under §§ 401(a)(4), 401(a)(5), 401(l), and 414(s) apply to plan years beginning on or after January 1, 1999. For plan years beginning before that effective date, a nonelecting church plan must be operated in accordance with a reasonable, good faith interpretation of §§ 401(a)(4), 401(a)(5), 401(l), and 414(s). The remedial amendment period for nonelecting church plans was extended in Announcement 95–48 to the last day of the first plan year beginning on or after January 1, 1999. During the remedial amendment period, additional administrative relief provided under Notice 92–36 continues to be available.

III. EXTENSION OF EFFECTIVE DATES

A. Governmental Plans

Under the extension provided by this notice, in the case of governmental plans, the regulations under § 401(k) and (m) apply only to plan years beginning on or after the later of October 1, 1997, or 90 days after the opening of the first legislative session beginning on or after October 1, 1997, of the governing body with authority to amend the plan, if that body does not meet continuously. For plan years beginning before

this extended effective date, governmental plans are deemed to satisfy § 401(k) and (m). The special rule in § 1.402(a)–1(d)(3)(v) of the Income Tax Regulations (providing an income tax deferral for certain elective contributions) is extended for the same period. The Treasury and the Service do not anticipate issuing any further guidance on the application of the regulations under § 401(k) and (m) to governmental plans prior to the effective date.

B. Plans Maintained by Tax-Exempt Organizations

Under the extension provided by this notice, in the case of plans maintained by tax-exempt organizations (other than nonelecting church plans), the regulations under §§ 401(a)(4), 401(a)(5), 401(l), 410(b), 414(r), and 414(s) apply only to plan years beginning on or after October 1, 1997. For plan years beginning before this extended effective date, such plans must be operated in accordance with a reasonable, good faith interpretation of these sections. The Treasury and the Service do not anticipate issuing any further guidance on the application of the regulations under these sections to plans maintained by tax-exempt organizations prior to the effective date.

C. Nonelecting Church Plans

As noted above, under Announcement 95–48, in the case of nonelecting church plans, the regulations under §§ 401(a)(4), 401(a)(5), 401(l), and 414(s) do not apply until the 1999 plan year.

IV. EXTENSION OF REMEDIAL AMENDMENT PERIOD AND ADMINISTRATIVE RELIEF

A. Remedial Amendment Period

Notice 92–36 and Announcement 95–48 set forth the remedial amendment period described in § 401(b) applicable to governmental plans and plans maintained by tax-exempt organizations. The remedial amendment period is the period during which a plan may be amended retroactively to comply with certain plan qualification requirements. Notice 92–36 makes additional administrative relief available during the remedial amendment period. For example, the transition relief under Alternative II D of Notice 88–131, 1988–2 C.B. 546, applies. This permits, during the remedial amendment period, the continued accrual of certain benefits under a plan that would otherwise fail to comply with § 401(a)(4) until the plan is amended to comply with that section. In addition, for purposes of testing benefits, rights and features for the first plan year in which the regulations under § 401(a)(4) are effective, Notice 92–36 provides that any amendment made during the plan year regarding eligibility for a benefit, right or feature may be treated as if it had been in effect for the entire plan year.

B. Governmental Plans and Nonelecting Church Plans

As noted above, under Announcement 95–48, administrative relief under Notice 92–36, including the remedial amendment period, extends to the last day of the first plan year beginning on or after the later of January 1, 1999, or the 1999 legislative date in the case of governmental plans, and to the last day of the first plan year beginning on or after January 1, 1999, in the case of nonelecting church plans.

C. Plans Maintained by Tax-Exempt Organizations

Under this notice, the remedial amendment period for plans maintained by tax-exempt organizations (other than nonelecting church plans) is extended to the last day of the first plan year beginning on or after October 1, 1997. The additional administrative relief provided under Notice 92–36 also applies through this extended remedial amendment period. Thus, in the case of a plan with a plan year of October 1 through September 30, any amendments required to comply with the regulations under §§ 401(a)(4), 401(a)(5), 401(l), 410(b), 414(r), and 414(s) for the plan year beginning October 1, 1997, must be made by September 30, 1998. In the case of a plan using a calendar plan year, these regulations are first effective for the 1998 plan year, and any amendments required to comply with these regulations for that year must be made by December 31, 1998.

V. SPECIAL RULES FOR § 401(k) AND (m) PLANS

A. Governmental Plans

1. Application of §§ 401(a)(4) and 410(b)

As noted above, for governmental plans, the regulations under §§ 401(a)(4), 401(a)(26), 410(b), and 414(s) apply to plan years beginning on or after the later of January 1, 1999, or the 1999 legislative date. For plan years beginning before the applicable effective date, governmental plans are deemed to satisfy these provisions. Certain provisions of § 401(k) and (m) and the regulations thereunder separately require that a plan, or certain aspects of a plan, satisfy § 401(a)(4) or 410(b). For example, § 401(k)(3)(A)(i) requires that the employees eligible to benefit under a cash or deferred arrangement satisfy § 410(b)(1). This notice clarifies that, for plan years beginning before the later of January 1, 1999, or the 1999 legislative date, a governmental plan is deemed to satisfy § 401(a)(4) and § 410(b) for all purposes, including for purposes of § 401(k) and (m). Thus, for example, a governmental plan that is subject to § 401(k) is deemed to satisfy § 401(k)(3)(A)(i) without regard to whether the group of eligible employees satisfies § 410(b)(1), and a governmental plan that is subject to § 401(m) is deemed to satisfy § 401(a)(4) and § 410(b) for purposes of § 1.401(m)–1(a)(2) and (e)(4).

2. Special Testing Rule

Under §§ 1.410(b)–7(c)(4)(ii)(C), 1.401(k)–1(g)(11), and 1.401(m)–1(f)(14), in the case of a plan that covers employees of more than one employer, the tests under § 401(k)(3) and § 401(m)(2) must be applied on an employer-by-employer basis. As discussed above, comments have noted that it may be difficult to identify the appropriate employer for purposes of testing a plan that covers employees of different governmental entities. Under this notice, for plan years beginning before the later of January 1, 1999, or the 1999 legislative date, in applying the tests under § 401(k)(3) and § 401(m)(2) to a governmental plan the employees covered by the plan may be treated as employed by a single governmental employer. Thus, the tests under § 401(k)(3) and § 401(m)(2) may be applied to a governmental plan on a plan-wide basis, notwithstanding the fact that the plan may cover employees of more than one governmental employer.

B. Plans Maintained by Controlled Groups Consisting of Tax-Exempt and Taxable Entities

Some employers consist of tax-exempt entities and taxable entities that must be aggregated under § 414(b) or (c) in determining whether a plan is qualified. Under § 401(k)(4)(B), prior to its amendment by § 1426 of the Small Business Job Protection Act of 1996

(''SBJPA''), tax-exempt organizations were precluded from establishing plans that included qualified cash or deferred arrangements under § 401(k). Thus, an employer that included both taxable and tax-exempt entities was only permitted to maintain a plan that included a qualified cash or deferred arrangement under § 401(k) for the taxable entities. However, the SBJPA amended § 401(k)-(4)(B) to repeal this prohibition and permit tax-exempt entities to establish such plans for plan years beginning after 1996.

Special rules are provided in §§ 1.401(a)(26)–1(b)(4) and 1.410(b)–6(g) for a qualified cash or deferred arrangement under § 401(k) for the employees of a taxable entity that must be aggregated with a tax-exempt entity. Under these special rules, if certain requirements are met, the employees of the tax-exempt entity that are precluded from being covered in the qualified cash or deferred arrangement may be disregarded when determining whether the arrangement maintained by the taxable entity satisfies § 401(a)(26) or § 410(b). The special rules apply only to employees whose employer is precluded under § 401(k)(4)(B) from maintaining a qualified cash or deferred arrangement.

Beginning in 1997, these special rules would no longer apply because employees of a tax-exempt entity are permitted to be covered by a qualified cash or deferred arrangement. The Treasury and the Service recognize that this change presents practical issues for employers consisting of both tax-exempt and taxable entities as they consider possible redesign of their retirement programs in light of § 1426 of the SBJPA. Consequently, this notice extends the relief provided under § 1.410(b)–6(g) for these employers through the 1997 plan year. Through the 1997 plan year only, these employers may continue to disregard employees of tax-exempt entities when testing a qualified cash or deferred arrangement maintained by a taxable entity in accordance with § 1.410(b)–6(g).

Section 1432 of the SBJPA provides that, beginning in the 1997 plan year, § 401(a)(26) applies only to defined benefit plans. Accordingly, it is not necessary to extend the relief provided by § 1.401(a)(26)–1(b)(4) with respect to § 401(a)(26).

VI. 403(b) PLANS

Notice 89–23, 1989–1 C.B. 654, discusses the nondiscrimination requirements under § 403(b)(12)(A) for annuity contracts, custodial accounts, or retirement income accounts purchased under plans eligible for favorable tax treatment under § 403(b) (''403(b) plans''). Section 403(b)(12)(A)(i) provides that, with respect to nonelective contributions, a 403(b) plan must meet the requirements of §§ 401(a)(4), (5), (17) and (26), 401(m), and 410(b). Notice 89–23 provides that § 403(b)(12) is satisfied if an employer operates its 403(b) plan in accordance with a reasonable, good faith interpretation of § 403(b)(12). As provided in Announcement 95–48, until further guidance is issued, employers maintaining 403(b) plans may continue to rely on Notice 89–23. However, employers maintaining 403(b) plans may not continue to rely on a reasonable, good faith interpretation of § 401(a)(17), but must comply with the regulations under § 401(a)(17) as of the applicable effective dates set forth in § 1.401(a)(17)–1(d). Of course, for the period for which a qualified plan is deemed to satisfy any particular statutory nondiscrimination requirement, the nonelective contributions under a governmental 403(b) plan also are deemed to satisfy that requirement.

VII. APPLICATION OF § 414(b) AND (c)

Until further guidance is issued, governments and tax-exempt organizations (including churches) may apply a reasonable, good faith interpretation of existing law in determining which entities must be aggregated under § 414(b) and (c). Any further guidance will be applied on a prospective basis only and will not be effective before plan years beginning in 2001.

The Treasury and the Service invite specific suggestions for an aggregation standard or standards appropriate for tax-exempt organizations under § 414-(b), (c) and (o). In particular, comments are requested on the appropriateness of the standard described in Section V.B.2.a of Notice 89–23, under which two entities are in the same controlled group if at least 80% of the directors, trustees or other individual members of one entity's governing body are either representatives of or directly or indirectly control, or are controlled by, the other entity. However, because questions have arisen as to whether this standard would be appropriate and sufficient in all circumstances, the Treasury and the Service intend to consider alternative and additional standards as well.

VIII. COMMENTS

Comments or suggestions in response to this notice should be submitted by April 30, 1997, and should be addressed to: CC:DOM:CORP:T:R (Notice 96–64), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Alternatively, taxpayers may hand-deliver comments between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:T:R (Notice 96–64), Courier's desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC, or may submit comments electronically via the IRS internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

IX. EFFECT ON OTHER DOCUMENTS

Notice 89–23 and Notice 92–36 are modified.

DRAFTING INFORMATION

The principal author of this notice is Diane S. Bloom of the Employee Plans Division. For further information regarding this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622–6074 or (202) 622–6075, between the hours of 1:30 p.m. and 4 p.m. Eastern Time, Monday through Thursday, or Ms. Bloom at (202) 622–6214. Alternatively, please contact Patricia McDermott of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations) at (202) 622–6030. (These telephone numbers are not toll-free.)