

# ARONBERG GOLDGEHN DAVIS & GARMISA

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## FINAL 401(K) REGULATIONS

Final Internal Revenue Service regulations apply to all Section 401(k) “cash or deferred” plans and require compliance starting with the 2006 plan year (for calendar year plans, compliance is required as of the plan year which began January 1, 2006). The final regulations require certain mandatory changes and offer planning options.

The mandatory changes that will require the amendment of Section 401(k) plan documents effective as of the 2006 plan year include:

- Annual nondiscrimination testing can be performed on the basis of current year contributions or contribution data from the prior year. Plan documents now must specify which testing method applies and the choice can be changed only by subsequent plan amendment.
- Allocations of employer contributions made in order to satisfy nondiscrimination testing (qualified nonelective contributions and qualified matching contributions) are subject to new allocation rules which must be specified in the plan document.
- Corrective distributions of excessive contributions to highly compensated employees made to meet antidiscrimination tests now must include any earnings on such distributions for the period from the end of the plan year until the distribution is made if there is a plan valuation date that occurs during that “gap” period. Accordingly, daily valuation plans will be required to include earnings with any such distributions.
- Plans which avoid nondiscrimination testing by providing additional employer “safe harbor” contributions must formally commit to following the safe harbor procedures and not choose each year whether to comply with the safe harbor rules or revert to nondiscrimination testing.

The final regulations also provide the following planning options:

- Events that permit hardship distributions have been expanded to include funeral expenses for a participant’s parent, spouse, child or dependent; medical expenses for a non-custodial child; and repair costs for damage to a participant’s principal residence that qualify as tax deductible casualty expenses. Any or all of these events can be added to a plan’s definition of financial “hardship.”

- Plans may provide an automatic enrollment feature that provides for employee 401(k) participation at a given contribution level unless the employee affirmatively elects a different contribution level or elects not to contribute at all. Unlike the automatic enrollment feature provided under the recently passed Pension Protection Act of 2006, this automatic enrollment provision is currently available and it does not require additional employer contributions.
- Plans may provide participants a one-time irrevocable election not to participate in the plan.

Plan sponsors who are interested in any of the optional plan provisions should consider including them in an amendment incorporating the mandatory provisions of the final Section 401(k) regulations. Those amendments should be completed and formally adopted by no later than the end of the 2006 plan year, or December 31, 2006 for calendar year plans.

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