

**FREQUENTLY ASKED QUESTIONS
REGARDING THE 2006 INTERIM 401(k) AMENDMENT**

1. What are the rules regarding Plan amendments?

Pursuant to [IRS Revenue Procedure 2005-66](#), qualified defined contribution retirement plans must be completely amended and restated on a six-year amendment cycle. The first required amendment and restatement will occur during 2008. However, Revenue Procedure 2005-66 requires that Plan Sponsors adopt interim amendments if there is a change in the law or new guidance issued by the Internal Revenue Service. On December 29, 2004, the IRS published final Regulations that overhauled the Regulations under Internal Revenue Code section 401(k) (which relates to Elective Deferrals) and section 401(m) (which relates to Matching Contributions). The revised 401(k) Regulations represent a change in the qualification requirements, so an interim amendment is necessary. The IRS confirmed this in [Notice 2005-95](#). Copies of the IRS Notice and Revenue Procedure are available on the Internal Revenue Service website which can be accessed from the blue text links inserted above.

2. What are the changes that are most likely to affect my Plan?

The following are the changes that are most likely to affect the operation of your Plan:

- A. **Gap Period Earnings for Corrective Distributions.** Elective Deferrals (401(k) contributions) that exceed various limits with respect to 401(k) plans can be corrected by making distributions to the Participant after the end of the applicable Plan Year. The revised Regulations require that earnings for the "gap period" (i.e., from the end of the Plan Year to the date of date of distribution) also be distributed if the Plan otherwise credits earnings to account balances during the gap period.

- B. **Modifying "Targeted" Qualified Non-Elective Contributions (QNECs) and Matching Contributions.** Prior to the new Regulations, Contributions for Highly Compensated Employees that did not pass the testing limitations for Elective Deferrals (the ADP Test) or the testing limitations on Matching Contributions (the ADP Test) could be corrected by making Qualified Non-Elective Contributions for Non-Highly Compensated Employees. The least expensive method to correct the ADP or ACP Tests was referred to as the "bottoms-up" method where a contribution would be made for the lowest paid employee up to the maximum amount needed to pass the test. For example, the employer might contribute \$2,000 for an employee

who makes \$5,000 and thereby, have a deferral percentage equal to 40%.

Under the new Regulations, the bottoms-up method is no longer permitted. Corrective contributions will only be counted to the extent that they do not exceed the greater of (i) 5% of compensation or (ii) twice the Plan's representative contribution rate. The Plan's representative contribution rate is the greater of (i) the lowest NHCE contribution rate, taking into account at least 50% of the eligible NHCE or (ii) the lowest NHCE contribution rate of any eligible NHCE who was employed by the employer as of the last day of the Plan Year.

This rule will not affect employers who utilize the 401(k) safe harbor provisions.

- C. **Impermissible Pre-funding of Elective Deferrals and Matching Contributions.** The revised Regulations treat a contribution as an Elective Deferral only if the employer makes the contribution after the employee performs the services with respect to which the Elective Deferral is made (or when the cash or taxable benefit would be currently available, if earlier). In addition, an employer contribution cannot be treated as a Matching Contribution made with respect to an Elective Deferral if the employer contributes the match prior to the time it is permitted to contribute the underlying Elective Deferral. The effect of this rule is to treat any amount contributed as pre-funded Elective Deferrals or Matching Contributions as a contribution of a discretionary employer contribution that would have to be allocated under the allocation formula in the Plan. Therefore, it is important not to pre-fund Elective Deferrals or Matching Contributions before the Participant would be entitled to the Elective Deferrals or Matching Contributions. For example, if Participants are only entitled to a Matching Contribution if employed on the last day of the Plan Year and the completion of 1,000 Hours of Service, the Matching Contribution should not be contributed until after the end of the Plan Year. If the Plan matches Elective Deferrals regardless of whether the employee completes a specified number of hours or is employed on the last day of the Plan Year, then Matching Contributions can be contributed at the same time as Elective Deferrals are contributed to the Plan.

- D. **New Safe Harbor Events for Hardship Withdrawal Provisions.** The Regulations modify the safe harbor definition of a hardship to add two new types of expenses: (i) payments for burial or funeral expenses for the employee's deceased parent, spouse, children, or dependents, and (ii) expenses for the repair of damage to the employee's principal residence that would qualify for the casualty loss deduction under Internal Revenue Code §165.

Additionally, the Working Families' Tax Relief Act of 2004 (WFTRA) modified the Tax Code definition of a dependent. For purposes of hardship withdrawals from the 401(k) plan that are being made on account of medical care expenses or education-related expenses, which are allowed to include expenses of a dependent, the definition of dependent is determined under Internal Revenue Code §152 **without regard** to (1) whether the individual is treated as a dependent by someone else, (2) whether the individual filed a joint return with another taxpayer, or (3) whether a dependent who is a qualifying relative has gross income in excess of the personal exemption in effect for the taxable year. For purposes of hardship distributions relating to funeral expenses, which is one of the hardship events added by the revised Regulations, the dependent definition is determined without regard to whether a dependent who is a qualifying relative has gross income in excess of the personal exemption in effect for the taxable year.

By eliminating these requirements, the Plan Administrator is not required to solicit such information to determine if the individual is a proper dependent under Internal Revenue Code §152.

3. Are there other changes under the Amendment?

Yes, there are significant technical amendments that apply mostly to the testing rules for 401(k) plans. You should discuss with your third party administrator whether any of these technical rules will affect the operation of your Plan.

4. What should I do with the Plan Amendment?

We have signed the Plan Amendment on your behalf pursuant to the authority that you granted to us. The Plan Amendment is part of your Plan document and should be placed in your Plan Binder and retained with your permanent Plan records.

5. Do I need to distribute anything to the Participants?

If your Plan permits hardship distributions, you need to distribute a Summary of Material Modifications ("SMM") with respect to the two new distribution events for hardship distributions. The SMM was enclosed with the Plan Amendment.

6. When are the Amendments effective?

The Amendments are effective for Plan Years beginning on or after January 1, 2006. If your Plan relies on the ADP and ACP testing each year (i.e., your Plan is not a safe harbor 401(k) plan), you may want to discuss with us how these amendments might affect the operation of your Plan for 2006.