

# One Minute Memo™



## IRS Issues Final Regulations on Exempt Organization and 401(k) Non-Discrimination Testing

On July 21, 2006, the Internal Revenue Service issued final regulations permitting, in certain instances, employees of tax-exempt organizations described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, to be excluded for the purposes of testing whether a Section 401(k) plan meets the minimum coverage requirements of Section 410(b).

The final regulations generally provide that governmental or tax-exempt organizations who offer both a Section 403(b) plan and a Section 401(k) plan do not have to cover their employees under both plans in order to meet the requisite coverage rules.

As background, prior to the enactment of the Small Business Job Protection Act of 1996 (the "SBJPA"), both governmental and tax-exempt organizations were precluded from maintaining Section 401(k) plans. Following the enactment of the SBJPA, many governmental and tax-exempt organizations added 401(k) plans to their benefit programs (in addition to their existing 403(b) plans) because of the greater flexibility offered under the Section 401(k) plan rules. When these

employers performed the non-discrimination coverage testing, it was unclear if their employees had to be covered under both plans. The final Section 410(b) regulations now offer clarity on the subject.

The final Section 410(b) regulations provide that:

- Employees of tax-exempt organizations that participate in a Section 403(b) plan may be excluded from the coverage rules of a Section 401(k) plan if:
  - No employee of a tax-exempt organization is eligible to participate in such Section 401(k) plan; and
  - At least 95% of the employees (other than the employees of a tax-exempt organization or employees of a governmental entity that are precluded from participating in such Section 401(k) plan) are eligible to participate in such Section 401(k) plan; or

This One Minute Memo is a periodical publication of Seyfarth Shaw LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult a lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact any Seyfarth Shaw LLP office. Copyright © 2006 Seyfarth Shaw LLP. All Rights Reserved.

- Employees of governmental entities that are generally precluded from being a participant under a Section 401(k) plan due to Section 401(k)(4)(B)(ii) may be excluded if more than 95% of the employees (other than the employees of the governmental entity that are precluded from participating due to Section 401(k)(4)(B)(ii)) benefit under such Section 401(k) plan for the year.

By allowing Section 403(b) plan participants to remain excludable employees for coverage testing purposes, governmental and tax exempt organizations are not forced to switch their employees over to a 401(k) plan or cover all employees under both plans.

*If you have any questions or need additional information, please contact the Seyfarth Shaw LLP attorney with whom you work or Mary K. Samsa, [msamsa@seyfarth.com](mailto:msamsa@seyfarth.com) or Judith Wethall, [jwethall@seyfarth.com](mailto:jwethall@seyfarth.com).*