Employee Benefit Plans

Explanation No. 5

Coverage and Nondiscrimination Requirements: Defined Contribution Plans

The purpose of Form 5627, Worksheet Number 5 and this explanation is to identify major problems in defined contribution plans relating to the minimum coverage and nondiscrimination requirements of the Code and associated requirements. These include the requirements of sections 401(a)(4) and 410(b) of the Code and the nondiscriminatory compensation requirements of section 414(s). (Certain related requirements, such as the limitation on compensation under section 401(a)(17) of the Code, are addressed in other worksheets.) This worksheet also addresses certain requirements of the qualified separate lines of business rules of section 414(r) of the Code.

If the plan is intended to satisfy the nondiscrimination in amount requirement under section 401(a)(4) as a design-based safe harbor plan and the plan provides for permitted disparity, Worksheet Number 5B may be used to determine whether the disparity satisfies the requirements of section 401(l) of the Code. Explanation Number 5C should also be used in reviewing a plan where the employer has requested a determination that the plan satisfies the nondiscrimination in amount requirement by satisfying a general test or where the plan is intended to satisfy the minimum coverage requirements by satisfying the average benefit test.

Although this worksheet relates to defined contribution plans, certain requirements that pertain primarily, or solely, to defined benefit plans are also discussed in the explanations.

Generally, a “Yes” answer to a question on the worksheet indicates a favorable conclusion while a “No” answer signals a problem concerning plan qualification. This rule may be altered by specific instructions for a given question. Please explain any “No” answer in the space provided on the worksheet.

References at the end of each paragraph in the explanation are to the Internal Revenue Code and the Income Tax Regulations unless otherwise noted.

The technical principles in this publication may be changed by future regulations or guidelines.

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I. GENERAL REQUIREMENTS

Determination letter applicants are generally required to include with their applications Schedule Q (Form 5300) which serves to identify particular issues to be considered in determining the qualified status of the plan and additional information (in the form of demonstrations) that the applicant is required to submit in support of its application.

Schedule Q is generally required to be submitted with all applications, including applications filed on Form 5307 (for M&P, regional prototype, and volume submitter plans) or Form 5310 (for terminating plans). The only exceptions are for state and local government plans and certain plan amendments filed on Form 6406 that do not involve a significant change to plan benefits or coverage.

The specific instructions to Schedule Q ask the applicant to enter in the application the letter below that corresponds to the best description of the plan. The applicant's response determines which other questions need to be answered and which demonstrations need to be submitted with the application. The applicant's response therefore identifies, in part, the issues that need to be considered in determining the plan's qualified status and, consequently, the parts of this worksheet that need to be completed. The specialist should use the following guide, based on the potential responses to Schedule Q, to identify the parts of this worksheet that should be completed.

A = This indicates that the plan benefits only collectively bargained employees. The worksheet does not have to be completed.

B = This indicates that the plan is a governmental plan as defined in section 414(d). The worksheet does not have to be completed.

C = This indicates that the plan is maintained by an employer exempt from income tax under section 501(a). Complete all applicable parts of the worksheet.

D = This indicates that the plan does not benefit any highly compensated noncollectively bargained employees and is treated as automatically satisfying the coverage and nondiscrimination requirements of sections 401(a)(4) and 410(b). The worksheet does not have to be completed.

E = This indicates that the plan is maintained by an employer that does not employ any nonhighly compensated noncollectively bargained employees and is treated as automatically satisfying the coverage and nondiscrimination requirements of sections 401(a)(4) and 410(b). The worksheet does not have to be completed.

F = This indicates that the plan is a nonstandardized safe harbor M&P or regional prototype plan approved under Rev. Proc. 93-10, 1993-1 C.B. 476, that (**1**) satisfies the coverage requirements without relying on the average benefit test; (**2**) is neither permissively aggregated with another plan to pass coverage, nor maintained by an employer that is treated as operating qualified separate lines of business; and (**3**) does not use a definition of compensation that must be tested for nondiscrimination under regulations section 1.414(s)-1(d). Complete only Part IV of the worksheet.

G = This indicates that the plan is a nonstandardized safe harbor M&P or regional prototype plan approved under Rev. Proc. 93-10 that would be described in the preceding paragraph except that it uses a definition of compensation that must be tested for nondiscrimination under regulations section 1.414(s)-1(d). Complete Parts IV and X only.

H = This indicates that the plan is not described above and **I** does not apply. Complete all applicable parts of the worksheet.

I = This indicates that the plan is a standardized M&P or regional prototype plan. The worksheet does not have to be completed.

II. Qualified Separate Lines of Business (QSLOB)

Section 414(r) of the Code and the regulations thereunder prescribe conditions under which an employer is treated as operating qualified separate lines of business (QSLOBs). If an employer (determined in accordance with the provisions of section 414(b), (c), (m), and (o)) is treated as operating QSLOBs, the minimum coverage requirements of section 410(b), including the nondiscrimination requirements of section 401(a)(4), and the minimum participation requirements of section 401(a)(26) that apply to defined benefit plans, may be applied separately with respect to the employees of each QSLOB. That is, the employees of each QSLOB are treated as if they were the only employees of the employer.

Additionally, if a plan benefits the employees of more than one QSLOB, the plan is disaggregated into two or more separate disaggregated plans (one for each QSLOB that has employees in the plan), and in testing each separate disaggregated plan for compliance with the coverage and nondiscrimination requirements, or the minimum participation requirements, the employees of the other QSLOBs are treated as excludable employees and are thus disregarded.

In general, if the employer is applying the minimum coverage and nondiscrimination requirements separately with respect to the employees of a QSLOB, it must do so with respect to all its plans, employees, and QSLOBs. The same all-or-nothing rule applies in the case of the minimum participation requirements of section 401(a)(26). (In both cases, there is an exception, discussed in line c). However, the fact that the employer is using the QSLOB rules for purposes of sections 410(b) and 401(a)(4) does not require the use of these rules for purposes of section 401(a)(26), or vice versa.

This is a year by year issue. That is, for any given testing year (i.e., calendar year), the employer may decide whether or not to treat itself as operating QSLOBs. Whatever the choice, it will generally apply to all plans of the employer for plan years that begin in the testing year.
414(r)
1.414(r)-0 through 11

Line a. When an employer files a determination letter request for a plan, it must indicate whether it is treating itself as operating QSLOBs for purposes of testing any plan's compliance with the coverage and nondiscrimination or minimum participation requirements. The employer must also include with its application a demonstration (which should be labeled Demo 1) that identifies each QSLOB that has employees benefiting under the plan and the section(s) of the Code for which it is testing on a QSLOB basis (i.e., 410(b) and 401(a)(4) or 401(a)(26)).

The determination of whether an employer is treated as operating QSLOBs is generally to be made by the employer. That is, employers may not rely on favorable determination letters issued for plans as evidence that they are entitled to be treated as operating QSLOBs and specialists should not seek to determine that the requirements of section 414(r) have been satisfied, except as described below.

In some situations, employers may request a determination from the National Office that a QSLOB satisfies a requirement of the regulations that is called the "administrative scrutiny" requirement. An employer that has a request for an administrative scrutiny determination pending with the National Office when it files a determination letter application is to attach a copy of National Office's confirmation receipt to its application. In this case, the specialist should contact the National Office regarding the status of the administrative scrutiny determination before issuing a determination letter for the plan.
414(r)
1.414(r)-1, 8, and 9
Rev. Proc. 93-41

Line b. If the employer has indicated that it is treating itself as operating QSLOBs for purposes of the minimum coverage requirements of section 410(b), then it is required to apply the minimum coverage requirements and nondiscrimination requirements separately to the employees of each QSLOB in testing whether all plans of the employer meet the coverage requirements. (An exception is discussed in line c.) In this case, the plan will satisfy the minimum coverage requirements only if (a) the plan benefits a classification of employees that is nondiscriminatory on an employer-wide basis and (b) the plan satisfies the minimum coverage requirements on a QSLOB basis. Thus, in addition to having to satisfy coverage on a QSLOB basis, the plan must first pass a nondiscriminatory classification "gateway" on an employer-wide basis.

The coverage requirements are discussed in general in Part IV of the worksheet. Complete Part IV to determine if the plan satisfies coverage on a QSLOB basis.

An employer that is using the QSLOB rules for purposes of coverage and nondiscrimination must include in Demo 1 a demonstration that the plan meets the gateway nondiscriminatory classification requirement. This requirement is satisfied if the demonstration shows that either (a) the plan satisfies the ratio percentage test, or (b) the plan satisfies the nondiscriminatory classification test. (See Part IV for definitions of these terms.)

Under the coverage rules, a plan that benefits the employees of more than one QSLOB is disaggregated and treated as consisting of separate plans for each QSLOB. In this case, the coverage requirements, including the gateway test, must be satisfied separately by each disaggregated plan.

The gateway test is performed on an employer-wide basis. Therefore, in making the demonstration, the employer may not treat employees as excludable merely because they are in separate QSLOBs. That is, all employees of the employer who are not otherwise excludable are counted as nonexcludable employees for purposes of the gateway test, regardless of QSLOB. However, because plans that benefit employees of more than one QSLOB are disaggregated, in testing a plan with respect to the employees of one QSLOB, the employees of other QSLOBs are not treated as benefiting even though they may not be treated as excludable.

Certain nondiscrimination rules under section 401(a)(4) require that a group of employees under the plan satisfy section 410(b) in order to satisfy section 401(a)(4). For example, the general tests for nondiscrimination in amount require each rate group under the plan to satisfy section 410(b). Also, a benefit, right, or feature will satisfy the current availability requirement only if it is currently available to a group of employees that satisfies section 410(b). (See Part V.) Likewise, in order to satisfy section 401(a)(4), a plan may be restructured into component plans provided each component plan would satisfy sections 401(a)(4) and 410(b) as if it were a separate plan. (See Part III.) If the employer is using the QSLOB rules for coverage and nondiscrimination, then in applying these nondiscrimination requirements, section 410(b) is to be applied in the same manner as it is applied for purposes of the coverage requirements. That is, the applicable group of employees must satisfy the gateway test on an employer-wide basis and must also satisfy section 410(b) on a QSLOB basis, in both cases as if the applicable group of employees were the only employees benefiting under the plan.

For example, if the employer is demonstrating that a benefit, right, or feature satisfies current availability and the employer is using the QSLOB rules for purposes of coverage and nondiscrimination, the employer must generally show that the group of employees to whom the benefit, right, or feature is currently available satisfies the gateway test on an employer-wide basis and section 410(b) on a QSLOB basis, in both cases as if the group of employees to whom the benefit, right, or feature is currently available were the only employees benefiting under the plan.

If the employer is demonstrating the gateway test by showing that the plan meets the nondiscriminatory classification test and the ratio percentage falls between the safe and unsafe harbor percentages, the gateway test is

satisfied. It is not necessary in this case to look at the facts and circumstances (as would otherwise be required by the nondiscriminatory classification test) because satisfaction of the requirements of section 414(r) is treated as satisfaction of the facts and circumstances requirement.

In certain circumstances, the employer may reduce the unsafe harbor percentage in the nondiscriminatory classification requirement by five percentage points. In these circumstances, the 20 percent floor on unsafe harbors is also eliminated. These modifications are allowed if the demonstration shows that the ratio percentage for the plan on a QSLOB basis is at least 90 percent. Where the nondiscrimination rules require a group of employees to satisfy section 410(b), as described above, the ratio percentage determined in applying the nondiscrimination rule (on a QSLOB basis) must also be at least 90 percent in order for these modifications to be allowed in applying the gateway test. For example, if the employer is demonstrating that the plan satisfies a general test, these modifications in applying the gateway test may not be made unless the ratio percentage for each rate group under the plan is at least 90 percent.

If a plan would satisfy the preceding paragraph, except that the ratio percentage on an employer-wide basis would still be below the reduced unsafe harbor percentage, it will nevertheless be deemed to satisfy the gateway test if the Commissioner determines, on the basis of all the relevant facts and circumstances, that the plan's classification is not discriminatory.
1.414(r)-8

Line c. An employer that treats itself as operating QSLOBs for purposes of the coverage and nondiscrimination requirements may apply these requirements to a plan on an employer-wide rather than QSLOB basis if the plan benefits at least 70 percent of the employer's nonexcludable nonhighly compensated employees. Where the nondiscrimination rules require a group of employees under the plan to satisfy section 410(b), as described above, the group of employees must also satisfy the 70 percent test on an employer-wide basis. For this purpose, the plan is not disaggregated on the basis of different QSLOBs. If the employer is applying this employer-wide rule to a plan for purposes of coverage and nondiscrimination, it may also use it for purposes of minimum participation for the same plan. Employers using this rule are required to include with Demo 1 a demonstration that they satisfy its requirement.
1.414(r)-1(c)(2)(ii)
1.414(r)-1(c)(3)(ii)

III. DISAGGREGATION, PERMISSIVE AGGREGATION, AND RESTRUCTURING

Generally, each single plan must separately satisfy the coverage and nondiscrimination requirements. However, certain types of plans are required to be disaggregated and the separate disaggregated plans that result must separately satisfy coverage and nondiscrimination. In some circumstances, employers may aggregate or combine two or more plans in applying the ratio percentage test or the nondiscriminatory classification test for coverage purposes. (See Part IV for a discussion of these terms.) In this case, the aggregate plan is also treated as a single plan for purposes of the nondiscrimination requirements. For example, one plan, when viewed alone, may not satisfy the coverage requirements, but when the plan is combined with another plan, the resulting aggregate plan satisfies both the coverage and nondiscrimination requirements.

Plans may be aggregated only if they have the same plan year. Also, separate plans that would be disaggregated if they were a single plan may not be aggregated, disaggregated parts of plans may not be aggregated, and ESOPs generally may not be aggregated with other ESOPs. Finally, a plan may not be combined with two or more plans to form more than one single plan.

When a defined benefit plan is aggregated with a defined contribution plan, the aggregate DB/DC plan must satisfy the nondiscriminatory amount requirement (discussed in Part VIII) on the basis of a general test (rather than safe harbors) and special rules apply. See Part VIII.

Solely for purposes of the nondiscrimination requirements (including the permitted disparity requirements of section 401(l), a plan may be treated as consisting of two or more component plans. This is referred to as restructuring. If each component plan satisfies the coverage and nondiscrimination requirements as if it were a separate plan, the whole plan will be treated as satisfying the nondiscrimination requirements. The plan must still satisfy the coverage requirements on a nonrestructured basis.

Section 401(k) and 401(m) plans may not be restructured. Also, the uniform points safe harbor allocation formula (discussed in Part VIII) may not be used by a component plan.
410(b)(6)(B)
1.410(b)-7
1.401(a)(4)-1(c)(4)
1.401(a)(4)-9

Line a. When an employer files a determination letter request for a plan, it must indicate whether the plan is mandatorily disaggregated (other than solely as a result of the plan benefiting both collectively bargained and noncollectively bargained employees), permissively aggregated with another plan, or restructured into component plans. If so, the employer is required to include with its application a schedule relating to the disaggregation, aggregation, or restructuring. This should be labeled Demo 4. The information required in this schedule is discussed in lines b. and c.

This line should be checked "Yes" if the employer has indicated that the plan is disaggregated, aggregated, or restructured. This line should also be checked "yes" if there is other evidence with the application that the plan is being aggregated with another plan for coverage and nondiscrimination purposes or restructured for nondiscrimination purposes. Lastly, regardless of the employer's response, this line should be checked "Yes" if the plan is required to be disaggregated (other than solely because the plan benefits both collectively bargained and noncollectively bargained employees).

Plans are required to be disaggregated in the following situations:

1. A section 401(k) plan must be disaggregated from the portion of a plan that is not a section 401(k) plan, and a section 401(m) plan must be disaggregated from the portion of a plan that is not a section 401(m) plan. See Alert Guidelines 11 and 12.

2. The ESOP portion of a plan is disaggregated from the nonESOP portion of the plan.

3. If the employer applies the coverage rules separately to the portion of a plan that benefits only employees who satisfy age and service conditions lower than the greatest conditions permissible under section 410(a), this portion is then disaggregated from the portion benefiting those employees who have met the greatest age and service conditions permissible. This is, in effect, permissive disaggregation.

4. The portion of a plan benefiting employees of one QSLOB is disaggregated from portions of the plan benefiting employees of other QSLOBs. However, see Part II for an exception where a plan is being tested on an employer-wide basis.

5. The portion of a plan benefiting collectively bargained employees is disaggregated from the portion benefiting noncollectively bargained employees. See Part IV for the definition of collectively bargained employee. (Do not check line a. "yes" merely because the plan is disaggregated under this rule. The collectively bargained portion of the plan automatically satisfies the coverage and nondiscrimination requirements.)

6. Plans benefiting the employees of more than one employer (multiemployer and multiple employer plans) are disaggregated along employer lines. Each employer's separate disaggregated plan must then satisfy the coverage and nondiscrimination requirements with reference only to that employer's employees.

When a plan is disaggregated as a result of the rules in paragraphs 4., 5., or 6., special rules apply with respect to employees who change status so that they move from one portion of the plan to another. These rules permit certain accruals or allocations for these employees that would otherwise be taken into account under one separate disaggregated plan to be taken into account under another separate disaggregated plan.
1.410(b)-7(c)

Line b. If the plan is disaggregated, aggregated, or restructured, the employer must submit a schedule (Demo 4) that provides the following information:

1. an explanation of the basis of the disaggregation, aggregation, or restructuring;

2. an identification of the aggregated, separate disaggregated, or restructured component plans; and

3. a demonstration of how any restructured component plans satisfy the minimum coverage requirements as if they were separate plans.

Check that the basis for any disaggregation is correct and conforms to the categories in line a. In the case of permissive aggregation, make sure that the employer is not aggregating plans with different plan years or plans that may not be aggregated, as described above.

If the plan is being restructured, the employer may select the groups of employees that will form the basis of the restructuring, but check that each component consists of all the allocations or accruals and other benefits, rights, and features (BFRs) provided to the selected group, that each employee is assigned to a particular component, and that components do not overlap.

A demonstration that a restructured component separately satisfies coverage should be made in accordance with the guidelines in Part IV. (Remember, the plan as a whole must still satisfy coverage.) However, certain special rules apply. In general, a component will satisfy the average benefit percentage test (discussed in Part IV) if the whole plan passes this test. Other special rules apply regarding the application of the average benefit percentage test with respect to plans benefiting both collectively bargained and noncollectively bargained employees and plans with early retirement window benefits. Note also that if the employer is using the QSLOB rules for purposes of coverage and nondiscrimination, the employer's demonstration that the restructured component plans satisfy section 410(b) as if they were separate plans must include a demonstration that each component satisfies the gateway test. Refer to Part II, lines b. and c., for a further discussion of the application of section 410(b) when the employer is using the QSLOB rules.
1.401(a)(4)-9(c)

Line c. If the plan is disaggregated, check that the employer has submitted coverage and nondiscrimination information (including demonstrations, if applicable) for each separate disaggregated plan (other than any separate disaggregated plan that benefits only collectively bargained employees.)

If the plan is permissively aggregated with another plan, make sure that the coverage and nondiscrimination information and demonstrations submitted reflect the terms of and the participants in the aggregated plan. If the plan is a DB/DC plan, make sure that the employer has identified the plan as a general test (not safe harbor) plan, and that any demonstration of the general test reflects the special rules that apply to these plans. (See Part VIII.)

If the plan is restructured, check that the nondiscrimination requirements (including the availability of BRFs discussed in Part V) are addressed separately with respect to each component. Also, ensure that section 401(k) or 401(m) plans are not being restructured and that no component is using the uniform points safe harbor allocation formula.

IV. COVERAGE

A qualified plan generally must satisfy either the "ratio percentage test" described in section 410(b)(1)(B) of the Code, or the "average benefit test" described in section 410(b)(2). (Certain nonelecting church plans may be

allowed to satisfy the coverage requirements as they were in effect prior to ERISA.)

When an employer files a determination letter application, the employer must indicate whether the plan is meeting coverage on the basis of the ratio percentage test or the average benefit test. If the plan is meeting coverage on the basis of the ratio percentage test, the employer must provide a demonstration on Form 5300 or Form 5307. If the employer is using the average benefit test, the employer may elect to submit a demonstration (which should be identified as Demo 5) or to receive a caveated letter.

The minimum coverage requirements apply to both current and former employees. However, the coverage of former employees is not an issue in defined contribution plans; therefore, line c., which discusses the coverage of former employees, does not apply to defined contribution plans.

The minimum coverage requirements must be satisfied using a daily, quarterly, or annual testing option for the plan year, which is the same option used to meet section 401(a)(4) for the plan year. Plan provisions and other relevant facts as of the last day of the plan year are applied to determine which employees benefit for such plan year. If the daily testing option is used, the plan satisfies 410(b) for a plan year if it satisfies the minimum coverage requirements on each day of the plan year, looking only to that day to determine employees and former employees. Under the quarterly testing option, section 410(b) is deemed satisfied for the plan year if the plan meets the minimum coverage requirements on one representative day in each quarter of the year, looking only to those four days to determine employees and former employees. Under the annual testing option (which must be used for section 401(k) and section 401(m) plans and average benefit plans), a plan is deemed to satisfy section 410(b) for the plan year if it satisfies the minimum coverage requirements as of the last day of such plan year; however, the whole year is looked at to determine employees and former employees. A plan that fails the minimum coverage requirements for the plan year may be retroactively amended by the 15th day of the 10th month following such year to satisfy section 410(b) by, for example, expanding coverage.

Rev. Proc. 93-42 allows employers to substantiate compliance with the nondiscrimination rules (including the minimum coverage requirements) on the basis of the employer's workforce on a single day during the plan year (snapshot day), provided that day is reasonably representative of the employer's workforce and the plan's coverage throughout the year. Even though a favorable determination letter may not be relied on with respect to the use of the substantiation guidelines in Rev. Proc. 93-42, employers may submit coverage and nondiscrimination demonstrations that are the result of single day "snapshot" testing. Rev. Proc. 93-42 also provides that the use of snapshot testing may overstate coverage in plans that have minimum service requirements for accruals or allocations (e.g., 1000 hours of service or employment on the last day of the plan year). Rev. Proc. 93-42 further provides that to compensate for this, an adjustment must be made to the section 410(b) test and provides that an adjustment of 5 percent (i.e., 70 percent becomes 73.5 percent) for a 1,000 hour rule and an adjustment of 10 percent (i.e., 70 percent becomes 77 percent) for a last day rule (or for a combination of a last day and another minimum service rule) will be treated as safe harbors.

Because a favorable determination letter is not a determination regarding the use of the substantiation guidelines in Rev. Proc. 93-42, the specialist generally should not question the use of snapshot testing (if this is evident in the application) or any adjustments that the employer has made to the section 410(b) test on account of the use of snapshot testing.

Where there has been a merger or stock or asset acquisition or disposition and as a result there is a change in the make up of the employer (i.e., the section 414(b), (c), (m), and (o) employer), a special transition rule applies. Under this transition rule, a plan of the employer may be treated as satisfying the minimum coverage requirements during a transition period following the transaction if it satisfied section 410(b) immediately before the transaction and there has been no significant change in the plan's coverage aside from the transaction. The transition period begins with the transaction and ends with the end of the first plan year beginning after the transaction.

If the adopting employer is a member of an affiliated service group, a member of a controlled group of corporations, or one of several trades or businesses under common control, then the employees of all these employers must generally be taken into account in determining whether the coverage requirements are satisfied. However, for an exception to this rule, refer to Part II, regarding employers that treat themselves as operating QSLOBs.

1.410(b)-2 through -10
Rev. Proc. 93-42, section 3

See IRC sections 414(b) and (c) and section 1.414(c)-1 through -5 of the regulations to determine whether the entities are members of a controlled group of corporations or trades or businesses under common control, section 414(m) and section 1.414(m)-1 through -4 of the proposed regulations regarding whether entities are members of an affiliated service group.

In addition, any leased employee of the adopting employer or any other member of an affiliated service group, controlled group of corporations, or group of trades or businesses under common control of which the adopting employer is a part shall be treated as an employee of the adopting employer, unless leased employees do not constitute more than 20 percent of the recipient's nonhighly compensated workforce, and the employee is covered by a money purchase plan providing: (1) a nonintegrated employer contribution rate of at least 10% of compensation, (2) immediate participation, and (3) full and immediate vesting. See section 414(n) of the Code and Notice 84-11, 1984-2 C.B. 469, to determine whether an individual is a leased employee.

Mandatory Disaggregation and Permissive Aggregation

Certain plans are required to be disaggregated, and each separate disaggregated plan that results must separately satisfy the coverage requirements. In some circumstances, employers may aggregate two or more

plans and treat them as a single plan for coverage purposes. For purposes of satisfying the nondiscrimination requirements, employers may restructure a single plan into separate component plans. When this is done, the plan and each separate component plan must separately satisfy the coverage requirements. See Part III for a discussion of these rules.
1.410(b)-7
1.401(a)(4)-9(c)

This section of the worksheet does not apply to the following plans (other than a plan subject to the requirements of section 403(b)(12)(A)(i)):

1. a church plan, unless the plan administrator makes an irrevocable election under IRC 410(d) to have the coverage requirements apply to the plan,
2. a plan which has not at any time after September 2, 1974, provided for employer contributions, and
3. a plan established by a society, order or association described in Code section 501(c)(8) or (9), if no part of the contributions under the plan are made by employers of participants in the plan.

These plans are subject to the requirements of section 401(a)(3) as in effect on September 1, 1974. If the employer has correctly indicated that it is subject to the pre-ERISA coverage requirements, complete only line a. of this Part and answer line a. "yes" unless it is determined that the plan fails to satisfy the pre-ERISA coverage requirements.
1.410(b)-2(e)
1.410(d)-1

Line a. A plan satisfies the "ratio percentage test" of IRC section 410(b)(1)(B) with respect to employees if the percentage of the employer's nonhighly compensated employees (nonHCE) who benefit under the plan divided by the percentage of highly compensated active employees (HCE) who benefit under the plan is at least 0.70. (percentages are calculated to the nearest hundredth.) That is,

$$\frac{\text{\% of nonHCE benefiting}}{\text{\% of HCE benefiting}} \geq 0.7$$

Example: Employer Y has 100 employees. Thirty of these employees are highly compensated employees under IRC section 414(q). Y maintains a qualified plan (Plan A) that benefits 15 of the 30 HCE, that is, 50 percent of Y's HCE. Plan A also benefits 25 of the 70 nonHCE, or 35.71 percent of all nonHCE. Plan A satisfies the ratio percentage test because the percentage of nonhighly compensated active employees benefiting (35.71 percent) is at least 70 percent of the percentage of highly compensated employees benefiting (50 percent).

$$\frac{\text{35.71\% of nonHCE}}{\text{50\% of HCE}} = 0.7142$$

The regulations merged the percentage test of IRC section 410(b)(1)(A) and the ratio test of IRC section 410(b)(1)(B) into the "ratio percentage test" because a plan that satisfies the percentage test of IRC section 410(b)(1)(A) (at least 70 percent of all nonhighly compensated employees benefit) will necessarily also satisfy the ratio test.
1.410(b)-2

An employee is an individual who performs services for the employer. An employee becomes a former employee on the day after the day on which he or she stops performing services for the employer. Thus, one employee may be both an employee and a former employee for the same plan year. A former employee is treated as an employee with respect to allocations that are taken into account under the defined contribution plan nondiscrimination in amount general test and with respect to increases in accrued benefits under a defined benefit plan based on ongoing service or compensation credits (including imputed service or compensation.)
1.410(b)-9

The definition of highly compensated employee is provided in IRC section 414(q). If a plan includes a definition of highly compensated employee the specialist should refer to Alert Guidelines #11 or #12 to determine if the definition satisfies the requirements of section 414(q). The simplified definition of highly compensated employee provided under section 4 of Rev. Proc. 93-42 and the guidance under Rev. Proc. 95-34 does not apply for years beginning after December 31, 1996. A nonhighly compensated employee is any employee who does not fit within the definition of highly compensated employee.

Note that under a special rule in section 1.410(b)-2(b)(5), if the employer has no nonhighly compensated employees the plan will be deemed to satisfy the coverage tests of IRC section 410(b). Also, under 1.410(b)-2(b)(6), if no highly compensated employees benefit under the plan section 410(b) will be deemed satisfied.
1.410(b)-2(b)(5), (6) and 1.410(b)-8(b), Notice 97-75

Excludable Employees

In testing a qualified plan for coverage, except as provided in 4., below, the following employees must be disregarded:

1. Minimum Age and Service: All employees who have not attained age 21 and completed one year of service, or two years in the case of a plan with immediate vesting, are disregarded in testing a qualified plan which has such eligibility requirements. However, if a plan benefits any such otherwise excludable employee, it must test coverage based on the minimum age and service requirements under the plan. In the alternative, employees who have not attained age 21 and completed one year of service but have attained the plan's minimum age and service requirements may be tested for coverage as if they were in a separate plan. The rest of the plan participants may then be tested for coverage disregarding employees who have not attained age 21 or do not have one year of service. A plan may continue to treat employees who have met the minimum age and service requirements as excludable until the first plan entry date on which any employee with the same age and service would be eligible to commence participation.
410(b)(4)
1.410(b)-6(b) and -7(c)(3)

2. Collective Bargaining Unit Employees: For the purposes of testing a plan or portion of a plan covering noncollectively bargained employees for coverage, employees who are included in a unit of employees covered by an agreement (within the meaning of section 7701(a)(46)) that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers are excluded if there is evidence that the retirement benefits were the subject of good faith bargaining between such employee representatives and such employer or employers. However, if more than 2 percent of the employees who are covered under a collective bargaining agreement are professional employees within the meaning of section 1.410(b)-9 of the regulations, all employees covered under such collective bargaining unit are treated as noncollective bargaining unit employees. Special rules apply with respect to employees who perform services both as collectively bargained and noncollectively bargained employees, and also with respect to employees in multiemployer plans.
1.410(b)-6(d)

3. Nonresident Aliens: Nonresident aliens (within the meaning of section 7701(b)(1)(B)) who receive no earned income (within the meaning of section 911(d)(2)) from the employer that constitutes income from sources within the United States (within the meaning of section 861(a)(3)) are excluded for the purposes of testing any qualified plan of the employer for coverage. In addition, nonresident aliens who do have income described in the previous sentence are also excluded if, pursuant to a treaty, it is exempt from U.S. income tax and all such aliens are excluded.
1.410(b)-6(c)

4. Last Day and < 501 Hours of Service: Employees who fail to receive an allocation or to accrue a benefit solely because they fail to satisfy a minimum hour of service or last day requirement under the plan may be excluded for the purposes of testing the plan for coverage if they do not have more than 500 hours of service and they are not employed on the last day of the plan year. Employees who have more than 500 hours of service or who are employed on the last day of the plan year may not be excluded merely because they are not employed on the last day of the plan year or did not have sufficient hours of service under the plan to accrue a benefit or receive an allocation for the plan year. Thus, even though these employees are ineligible to benefit under the plan for a plan year, they are taken into account in determining the percentage of employees who do benefit. For example, if an employer's profit-sharing plan required 1,000 hours of service in order to get an allocation from the plan and 10 of the employer's employees have more than 500 but less than 1,000 hours of service, the 10 employees will not be excludable employees because they have less than 1,000 hours of service and they will be treated as employees who do not benefit for the purposes of the coverage tests.

For a plan using elapsed time, "91 consecutive days" or "3 consecutive calendar months" should be substituted for "500 hours of service" in the preceding paragraph. Adjustment is also required if the plan uses one of the equivalencies for crediting hours of service in DOL Regs. section 2530.200(b)-3.
1.410(b)-6(f)

5. Employees of Qualified Separate Lines of Business: In testing a plan that benefits employees of an employer's QSLOB (within the meaning of section 414(r) and the regulations thereunder), employees of the employer's other QSLOBs are excluded. However, this rule does not apply in determining whether a plan satisfies the gateway test that requires the plan to satisfy the nondiscriminatory classification requirement on an employer-wide basis. It also does not apply when a plan is being tested as an employer-wide plan. See Part II.
1.410(b)-6(e)

6. Former Employees Treated as Employees: Formerly nonhighly compensated employees who are treated as employees under a defined benefit plan because of ongoing service or compensation credits after cessation of service (including imputed service or compensation) may be excluded.
1.410(b)-6(i)

7. Employees of Certain Governmental or Tax-Exempt Entities: If a section 401(k) plan, or a section 401(m) plan provided under the same general arrangement as a section 401(k) plan, is maintained by an employer that is part of a controlled group which contains governmental or tax-exempt entities which are precluded from adopting a section 401(k) plan by section 401(k)(4)(B), then employees who are so excluded from participating are excluded in testing for coverage but only if more than 95% of the employees who are not statutorily ineligible to participate benefit under the plan. Note that Notice 96-64 allows tax-exempt entities to continue to use this rule only through the 1997 plan year. Tax-exempt entities may not avail themselves of this rule in plan years after the 1997 plan year.
1.410(b)-6(g)
Notice 96-64

Benefiting

In general, an employee is treated as benefiting for the purposes of the coverage tests, only if the employee receives an allocation of contributions or forfeitures, or accrues a benefit under the plan for the plan year. However, employees are treated as benefiting if they fail to receive an allocation of contributions and/or forfeitures, or to accrue a benefit solely because the employee is subject to plan provisions that uniformly limit plan benefits, such as a provision for maximum years of service, maximum retirement benefits, or application of offsets or fresh start wear-away formulas. Limits designed to satisfy section 415 are disregarded for purposes of determining if an employee is benefiting under a defined benefit plan. Such limits may also be disregarded in determining if an employee is benefiting under a defined contribution plan, provided this is done on a consistent basis for all employees. Employees are not treated as benefiting solely because of increases in accrued benefits that result from increases in the section 415 limits due to the adjustment section 415(d)(1) or

additional service credited for section 415 purposes. (Plan provisions implementing section 415 may not be disregarded, however, if the employer is demonstrating compliance with the defined benefit general test and is taking these provisions into account in determining accrual rates.) Special rules apply in the case of target benefit plans and section 412(i) plans.

A defined contribution plan under which no employee receives an allocation of contributions or forfeitures for the plan year is treated as satisfying section 410(b) for such plan year because no highly compensated employee is benefiting. Thus, a defined contribution plan for which contributions cease and for which no forfeiture can be allocated satisfies the coverage rules. Similarly, a defined benefit plan under which no employee accrues any additional benefits for the plan year will satisfy section 410(b) for the plan year. However, if the plan is required to provide top-heavy accruals for the plan year, or if the plan takes future compensation increases into account in determining accrued benefits, the plan will have to be tested for coverage.

An employee is treated as benefiting under a plan to which elective contributions or after-tax employee contributions and matching contributions subject to section 401(k) or 401(m) may be made if the employee is currently eligible to make such elective or after-tax employee contributions, or to accrue a matching contribution, whether or not the employee actually makes or receives such contributions.

1.410(b)-3

Line b. Complete this line b. only if the employer has requested a determination that the plan satisfies the average benefit test. If the employer has requested such a determination, the employer is required to submit a demonstration that this test is satisfied. This demonstration should be identified as Demo 5.

The average benefit test is a two part test. First, the plan must satisfy the nondiscriminatory classification test. Second, the plan must satisfy the average benefit percentage test.

The explanation that follows relates to the nondiscriminatory classification test only. To determine if the plan satisfies the average benefit percentage test, refer to the discussion of this test in the appendix in Explanation 5C. The nondiscriminatory classification test is described here rather than in the appendix because this test may be used to determine whether the plan satisfies certain nondiscrimination requirements, such as the requirement that benefits, rights, and features be made available in a nondiscriminatory manner. See Part V.

410(b)(2)

1.410(b)-2(b)(3)

(i) In order to satisfy the nondiscriminatory classification test, the plan must meet two requirements. First, the classification of employees who benefit under the plan that is established by the employer must be reasonable. Second, it must be nondiscriminatory.

A reasonable classification is one that is both reasonable and based on objective business criteria that identify the categories of employees who will benefit, such as salaried or hourly. Enumeration by name or other criteria with the same effect is not reasonable.

Determining if a classification is nondiscriminatory may involve both a mechanical and a facts and circumstances analysis.

First, the classification will be nondiscriminatory if the plan's ratio percentage is at least equal to the employer's safe harbor percentage. (See line a. for the definition of ratio percentage, including the meaning of benefiting and excludable employee.) An employer's safe harbor percentage is 50 percent, reduced by 3/4 of one percent for each whole percent by which the nonhighly compensated employee (NHCE) concentration percentage exceeds 60 percent. The NHCE concentration percentage is the percentage of all the employees of the employer who are nonhighly compensated. The safe harbor percentages for the various possible NHCE percentages are shown in the table below.

Second, if the plan's ratio percentage is less than the safe harbor percentage, the classification will nevertheless be nondiscriminatory if the ratio percentage is at least equal to the employer's unsafe harbor percentage and the Service determines, on the basis of facts and circumstances, that the classification is nondiscriminatory. Thus, in this situation, the specialist will need to look at the employer's particular facts to make this determination.

An employer's unsafe harbor percentage is 40 percent, reduced by 3/4 of one percent for each percent by which the NHCE concentration percentage exceed 60 percent. The unsafe harbor percentage is never less than 20 percent.

Among the facts and circumstances the specialist should consider in determining whether a classification that falls between the safe and unsafe harbor percentages is nondiscriminatory are the following:

a. the business reason for the classification (reducing benefits costs is not relevant);

b. the percentage of all employees benefiting under the plan (the higher the better);

c. whether the plan benefits representative numbers of employees in each salary range;

d. how close the plan's ratio percentage is to the employer's safe harbor percentage; and

e. the extent to which the plan's average benefit percentage exceeds 70 percent.

No one fact is determinative.

Table of Safe and Unsafe Harbor Percentages

NHCE Concentration Percentage	Safe Harbor Percentage	Unsafe Harbor Percentage
0-60	50.00	40.00
61	49.25	39.25
62	48.50	38.50
63	47.75	37.75
64	47.00	37.00

65	46.25	36.25
66	45.50	35.50
67	44.75	34.75
68	44.00	34.00
69	43.25	33.25
70	42.50	32.50
71	41.75	31.75
72	41.00	31.00
73	40.25	30.25
74	39.50	29.50
75	38.75	28.75
76	38.00	28.00
77	37.25	27.75
78	36.50	26.50
79	35.75	25.75
80	35.00	25.00
81	34.25	24.25
82	33.50	23.50
83	32.75	22.75
84	32.00	22.00
85	31.25	21.25
86	30.50	20.50
87	29.75	20.00
88	29.00	20.00
89	28.25	20.00
90	27.50	20.00
91	26.75	20.00
92	26.00	20.00
93	25.25	20.00
94	24.50	20.00
95	23.75	20.00
96	23.00	20.00
97	22.25	20.00
98	21.50	20.00
99	20.75	20.00

1.410(b)-4

(ii) See the appendix in Explanation 5C to determine whether the plan satisfies the average benefit percentage test.
1.410(b)-5

V. Benefits, Rights, and Features

One of the requirements a plan must satisfy in order to meet the nondiscrimination requirement of section 401(a)(4) is that all benefits, rights, and features (BRFs) provided under the plan must be made available in the plan in a nondiscriminatory manner. BRFs include all optional forms of benefit, ancillary benefits, and other rights and features available to any employee under the plan. A BRF is made available in a nondiscriminatory manner if it meets both a current availability requirement and an effective availability requirement.

A BRF satisfies the current availability requirement if it is currently available to a group of employees that constitutes a nondiscriminatory coverage group under the minimum coverage rules of section 410(b). A BRF satisfies the effective availability requirement if, on the basis of facts and circumstances, it is available to a group of employees that does not substantially favor highly compensated employees. Special rules allow certain BRFs to be treated as satisfying these requirements.
1.401(a)(4)-1(b)(3)
1.401(a)(4)-4

Line a. Because the effective availability requirement is essentially an anti-abuse rule, determination letters may not be relied on as to whether any BRF satisfies this requirement and specialists should not review a plan with regard to this requirement. In general, determination letters are also caveated with respect to the current availability requirement. However, employers may request the Service to determine whether specific BRFs under the plan satisfy the current availability requirement. When an employer files a determination letter request for a plan, it must indicate whether it is requesting a determination regarding the current availability of BRFs.

Lines b. and c. If the employer requests a determination regarding the current availability of BRFs, the employer is required to specify each BRF for which it is seeking such a determination and to demonstrate that each such BRF satisfies the current availability requirement. (This should be identified in the employer's application as Demo 3.) Only those BRFs that are specified by the employer should be considered. Some employers may ask for a determination that a plan provision does not create a separate BRF that must separately meet the nondiscriminatory availability requirements. In this case, if it is determined that the provision does give rise to a separate BRF, the employer should be asked to demonstrate that the BRF satisfies the current availability requirement.

The instructions for Schedule Q contain guidelines that employers may follow in making this kind of demonstration. The explanation that follows tracks the guidelines in the Schedule Q instructions.

1.a. and b. Identification of the BRF

In reviewing this information, the specialist should determine that the specified BRF is a separate BRF within the meaning of the regulations (however, also see 2. below) and that all terms that could affect the availability of the BRF to employees have been identified.

Each different optional form of benefit, ancillary benefit, and other right and feature available to any employee under the plan is generally a separate BRF that must separately meet the nondiscriminatory availability requirements. (See 2., below, for circumstances in which BRFs may be permissively aggregated for this purpose.)

An optional form of benefit is any distribution alternative (including the normal form of benefit) that is available with respect to accrued benefits, early retirement benefits, and retirement-type subsidies. Different optional forms exist if a distribution alternative is not payable on substantially the same terms as another alternative. Such differences can arise from any terms affecting the value of the optional form, such as timing, commencement, election rights, and actuarial assumptions. Ancillary benefits generally include, but are not limited to the following:

Social Security supplements (other than qualified Social Security Supplements, as defined in the regulations)
Disability benefits not in excess of the qualified disability benefit described in section 411(a)(9)
Ancillary life and health insurance
Death benefits
Plant shut-down benefits

Other rights and features include:

Loans
Self-direction investment rights
Right to a given form of investment
Right to invest in employer securities
Right to make each rate of elective and employee contributions
Right to each rate of matching contributions
Right to purchase additional ancillary benefits
Right to make rollovers and transfers

Different ancillary benefits (or rights and features) exist if an ancillary benefit (or right or feature) is not available on substantially the same terms as another ancillary benefit (or right or feature).

A distribution alternative will not fail to be a single optional form of benefit simply because benefit or allocation formulas, accrual methods, or vesting schedules pertaining to the accrued benefit that is paid in the form of the distribution alternative are different for different employees to whom the distribution alternative is available. Differences in the normal retirement ages of employees, however, are taken into account in determining whether a distribution alternative constitutes one or more optional forms of benefit.

1.401(a)(4)-4(a)
1.401(a)(4)-4(e)

1.c. Conditions disregarded in determining current availability

The determination of whether a BRF is currently available is based on the current facts and circumstances of the employee, except that conditions specified in the regulations including conditions requiring a specific vesting percentage, termination of employment, death, disability, family status, hardship, execution of a covenant not to compete, and, in the case of optional forms of benefit and social security supplements only, attainment of specified age and/or service (other than time-limited age or service conditions) are disregarded. Also disregarded is a loan condition requiring a minimum account balance for a minimum loan amount (not in excess of $1,000). If a plan provides for mandatory cash-outs of all terminated employees with vested accrued benefits not in excess of $5,000 (or lower stated amount), it can also disregard a condition that requires the employee to have a vested accrued benefit of that amount in order to receive a benefit, right or feature. Special rules also apply in the case of multiemployer plans.

1.401(a)(4)-4(b)(2)

1.d. Unpredictable contingent event benefits

Although current availability is generally determined on current facts and circumstances, the current availability of an unpredictable contingent event benefit, such as a plant shut-down benefit, is determined as if the event has occurred, disregarding any age or service conditions for eligibility for the benefit (other than time-limited conditions).

1.401(a)(4)-4(d)(7)

1.e. Early retirement window benefits

There is a special rule for determining the current availability of early retirement window benefits. For this purpose, an early retirement window benefit is an early retirement benefit or subsidy or other BRF that is available only to employees who terminate employment during a "window" period of not more than one year set by the plan. Under this special rule, an early retirement window benefit is treated as not being available to an employee for a plan year other than the first plan year in which the benefit is currently available to the employee. If the specified benefit is an early retirement window benefit, the specialist should ensure that the employer's demonstration shows that this special testing rule has been properly applied.

1.401(a)(4)-4(d)(3)

2. Permissive aggregation

An employer may permissively aggregate an optional form of benefit, ancillary benefit, or other right or feature with another optional form of benefit, ancillary benefit, or other right or feature, respectively, and treat the combined BRF as a single BRF. Aggregation is permitted only if

(a) one of the two BRFs is inherently of equal or greater value than the other, and

(b) the BRF that is of inherently equal or greater value must separately satisfy nondiscriminatory availability.

If a specified benefit for which the employer is providing a demonstration is an aggregated benefit, the employer must also demonstrate that the requirements in (a) and (b) have been satisfied.

A BRF is of inherently equal or greater value than another only if it is impossible under any circumstances for an employee to receive less under the first BRF than under the second. For example, a fully subsidized joint and survivor annuity is of inherently equal or greater value than a normal form straight life annuity but is not of inherently equal or greater value than a lump sum that is actuarially equivalent to the normal form because under some circumstances the participant would receive less under the fully subsidized QJSA than under the lump sum.

1.401(a)(4)-4(d)(4)

3. Employees to whom the BRF is available

The employer must describe the group of employees to whom the BRF is currently available (as determined by the preceding rules) and must indicate whether this group includes any "frozen participants." Frozen participants are nonexcludable employees with accrued benefits who are not currently benefiting under the plan. A plan must satisfy the nondiscriminatory availability requirements separately with respect to any frozen participants. See 5., below.

1.401(a)(4)-4(d)(2)

4. Satisfaction of the current availability requirement

The employer's demonstration must show that the specified BRF satisfies current availability by being currently available to a nondiscriminatory coverage group or by meeting one of the special rules, as described below.

a. Ratio percentage and nondiscriminatory classification tests

The BRF will satisfy current availability if the employer's demonstration shows that the group of employees to whom the BRF is currently available satisfies section 410(b) without regard to the average benefit percentage test. That is, the group must satisfy the ratio percentage test or the nondiscriminatory classification test. See Part V for definitions of these terms and for guidance in determining whether one of these tests has been satisfied. Note that if the employer is using the QSLOB rules for purposes of coverage and nondiscrimination, the employer's demonstration that the group of employees to whom the BRF is currently available satisfies section 410(b) must include a demonstration that the availability of the BRF satisfies the gateway test. Refer to Part II, lines b. and c., for a further discussion of the application of section 410(b) when the employer is using the QSLOB rules.

1.401(a)(4)-4(b)(1)

b. Prospectively eliminated benefits

If the BRF has been prospectively eliminated with respect to benefits accrued after a certain date, but satisfied section 410(b), as described above, as of the elimination date, it will be treated as satisfying current availability for all periods after the elimination date. Therefore, if the BRF is one that has been prospectively eliminated, the employer's demonstration should be based on the availability of the BRF as of the elimination date. Note that the regulations contain special rules for determining whether a BRF has been prospectively eliminated, but, generally, a BRF is eliminated with respect to benefits accrued after a given date if the amount or value of the BRF depends solely on the amount of the accrued benefit as of the elimination date (including subsequent income, etc., in the case of a defined contribution plan).

1.401(a)(4)-4(b)(3)

c. Mergers and acquisitions

If a BRF is available only to a group of employees who were "acquired" as a result of a merger or acquisition, it may satisfy the current availability requirement under a special rule. This special rule operates to provide that if the BRF satisfies current availability under the acquiring employer's plan, taking into account all of that employer's nonexcludable employees (including the acquired employees), after the merger or acquisition, it will be treated as satisfying current availability thereafter. This rule is available if the BRF is available under the employer's plan on the same terms as it was available under the other employer's plan. The effect of this rule is that even though the acquired group of employees may at some point after the merger no longer constitute a nondiscriminatory coverage group, this will not taint the BRF.

If the employer is using this rule, it should demonstrate that as of a date selected by the employer as the last date by which employees can come into the acquired group, the BRF satisfies the ratio percentage or nondiscriminatory classification test, taking into account all the employer's nonexcludable employees.

1.401(a)(4)-4(d)(1)

d. Spousal benefits

If the employer is permissively aggregating plans for purposes of coverage and nondiscrimination (see Part III), any QJSA, QPSA, or required spousal death benefit (under plans exempt from the QJSA requirement) in the aggregated plan is generally treated as satisfying the nondiscriminatory availability requirements and a demonstration of actual availability is not necessary. This rule does not apply to subsidized benefits under a defined benefit plan.

1.401(a)(4)-4(d)(5)

e. ESOPs

Demonstrations of actual availability are not required in the case of certain diversification rights, distribution options, or restrictions that apply to ESOPs. BRFs arising from these rights, options, and restrictions are treated as satisfying the nondiscriminatory availability requirements.

1.401(a)(4)-4(d)(6)

f. DB/DC plans

If the employer is permissively aggregating defined benefit and defined contribution plans (see Part III concerning DB/DC plans), a BRF that is provided only under the DB plan(s) or only under the DC plan(s) in the DB/DC plan is deemed to satisfy current availability if it is currently available to all NHCEs in all plans of that type. However, this special rule does not apply to the following types of BRFs: single sum benefits, loans, ancillary benefits, and benefit commencement dates(including the availability of in-service withdrawals).

1.401(a)(4)-9(b)(3)

5. Frozen participants

If the employer has indicated that the BRF is provided to frozen participants, it must separately demonstrate that it satisfies the nondiscriminatory availability requirement with respect to these participants. Special rules apply to determine that this requirement is met. One rule provides that the BRF will satisfy availability if there has been no change in the current plan year with respect to its availability to any frozen participant. Even if this rule is not met, the BRF will still pass if the employer's demonstration shows that the change in availability has been made in a nondiscriminatory manner, the group of frozen participants to whom the BRF is available constitutes a nondiscriminatory coverage group (taking into account all nonexcludable employees), or the group of employees to whom the BRF is available continues to constitute a nondiscriminatory coverage group when the frozen participants are counted as currently benefiting employees.

1.401(a)(4)-4(d)(2)

6. Elimination of age 70½ distribution option

An employer that decides to eliminate the availability of a preretirement optional form of benefit for a participant (other than a 5-percent owner) who attains age 70½ after a specified year has relief from the applicable sections of 401(a)(4) under Notice 97-75. A preretirement age 70½ distribution is an optional form of benefit under which benefits payable in a particular distribution form (including any modifications that may be elected after benefit commencement) commence during the 70½ period (beginning January 1 of the year in which the employee attains age 70½ and ending on the April 1 of the following year) prior to the employee's retirement from employment with the employer maintaining the plan. An optional form of benefit available to a 5-percent owner at age 70½ and retirement and to other participants only at retirement will be treated as the same optional form of benefit for purposes of testing the nondiscriminatory availability of benefits, rights,

and features. Additional relief is provided as stated in Notice 97-75. See Explanation # 9 for additional discussion.

VI. SERVICE-CREDITING

A plan must be nondiscriminatory with respect to the manner in which service is credited under the plan. For this purpose service-crediting means service credited for each purpose under the plan, including benefit service, accrual service, vesting service, and eligibility service, and the nondiscrimination requirement must be separately satisfied for each purpose.

A plan is deemed to satisfy this requirement with respect to service credited for periods prior to 1994 under a plan provision adopted and in effect on February 11, 1993 that satisfied the nondiscrimination requirements then in effect.

Whether the manner in which the plan credits service is nondiscriminatory is a facts and circumstances determination. However, the manner in which service is credited for a particular purpose will be deemed to be nondiscriminatory if each combination of service-crediting provisions applied for that purpose would satisfy the nondiscriminatory availability requirements if that combination were an other right or feature.

Generally, service for periods in which an employee did not perform services for the employer or in which the employee did not participate in the plan may not be taken into account in determining whether the nondiscrimination in amount requirement (see Parts VIII and IX) or the nondiscriminatory availability requirement (see Part V) are satisfied, although the crediting of any service required by other qualification rules (e.g., section 411(a)) will not cause the plan to fail to satisfy this requirement. There are several exceptions to this general rule.

First, past service may be taken into account. For this purpose, past service is service for periods in which service was performed for the employer and in which the employee did not participate in the plan but would have had the plan (or the amendment extending coverage to the employee) been in existence.

Second, pre-participation service that meets certain requirements described below may be taken into account. Pre-participation service means years of service with the employer or a prior employer for periods before the employee commenced or recommenced participation in the plan, other than past service.

Third, imputed service that meets the requirements described below may be taken into account. Imputed service is any service credited for periods after the employee commenced participation in the plan while the employee is not performing services as an employee of the employer or while the employee is on a reduced work schedule but receiving service credit that would not otherwise be credited under the general terms of the plan.

In order to be taken into account for purposes of nondiscrimination in amount or nondiscriminatory availability, pre-participation or imputed service must be provided under provisions that apply to all similarly situated employees and must be provided for legitimate business reasons. In addition, the provision must not by design or operation discriminate significantly in favor of highly compensated employees. This is a facts and circumstances determination.

When an employer submits a determination letter request, the employer is also required to indicate whether the plan provides for pre-participation or imputed service. If so, the employer is also required to describe the nature of the service, to indicate whether it is being taken into account for purposes of nondiscrimination in amounts testing (see Parts VIII and IX), and to identify the relevant plan provisions. This information should be labeled Demo 7.

If it is determined that the manner in which the plan credits service may be discriminatory, the employer may be asked to provide a demonstration that this requirement is satisfied.
1.401(a)(4)-11(d)

VII. OTHER NONDISCRIMINATION REQUIREMENTS

Line a. A qualified plan may not discriminate in favor of HCEs in the manner in which employees vest in their accrued benefits under a plan. This is a facts and circumstances determination.

For this purpose, the vesting schedules in sections 411(a)(2)(A) (five-year cliff) and (B) (three-to-seven-year graded) are treated as equivalent to each other. The two top-heavy minimum vesting schedules are also treated as equivalent to each other.

The manner in which employees vest is deemed to be nondiscriminatory if each combination of plan provisions affecting nonforfeitability would satisfy the nondiscriminatory availability requirements if it were an other right or feature.
1.401(a)(4)-11(c)

Line b. A qualified plan must also satisfy the nondiscriminatory amount and availability requirements with respect to former employees. However, this requirement is generally relevant only in the case of benefits provided through an amendment that is effective in the plan year.

A plan will satisfy the nondiscriminatory amount requirement with respect to former employees if, based on all the facts and circumstance, the amounts of contributions or benefits provided to former employees do not discriminate significantly in favor of HCEs. A plan under which no former employee currently benefits is deemed to satisfy this requirement. Thus, only amendments to defined benefit plans adjusting former employees' benefits (e.g. COLA adjustments) are taken into account.

A plan will satisfy the nondiscriminatory availability requirement with respect to benefits, rights, and features provided to former employees if any change in the availability to any former employee is applied in a manner that, based on all the facts and circumstance, does not discriminate significantly in favor of HCEs. If there is a question as to whether the plan may fail to satisfy these requirements, the specialist may request a demonstration from the employer.
1.401(a)(4)-10

VIII. NONDISCRIMINATORY CONTRIBUTIONS OR BENEFITS

This part of the worksheet deals with the requirement of the regulations under section 401(a)(4) that a plan be nondiscriminatory with respect to the amount of contributions or benefits under the plan.

A plan can satisfy the requirement that it be nondiscriminatory with respect to the amounts of contributions or benefits under the plan in two ways. First, this requirement will be satisfied if the plan satisfies a general test that compares the actual accrual or allocation rates of highly compensated and nonhighly compensated employees under the plan. Second, the requirement will be satisfied if the plan satisfies a nondiscrimination safe harbor. Generally, the safe harbors operate to allow plans to meet the nondiscrimination in amount requirement without actually comparing accrual or allocation rates. These types of safe harbors are referred to as "design-based." However, there are two safe harbors that merely simplify the process of comparing accrual or allocation rates, without eliminating the need to do so. These are referred to as "nondesign-based" safe harbors.

1.401(a)(4)-1(b)
1.401(a)(4)-2(a)
1.401(a)(4)-3(a)

Line a. When an employer submits a determination letter application, the employer is required to indicate whether the plan is intended to satisfy the requirement that it be nondiscriminatory in amount by meeting one of the design-based safe harbors under the section 401(a)(4) regulations. A design-based safe harbor allows for a determination that the plan, by design, satisfies the nondiscrimination in amount requirement without the need to test the actual allocations or benefits under the plan. If the plan is not intended to satisfy a design-based safe harbor, the employer is given the option of receiving a caveated letter or demonstrating that a general test or a nondesign-based safe harbor is satisfied. Do not complete this part if the employer has indicated that the plan satisfies a design-based safe harbor. Instead, skip to Part IX.

If the plan is not a design based safe harbor plan, the remaining Parts of the worksheet are generally not applicable. However, the explanations for these parts of the worksheets may contain information that is relevant to the determination of whether a plan satisfies a general test or a nondesign-based safe harbor or the average benefits test. In addition, Part X of the worksheet, relating to nondiscriminatory compensation, should be completed in the case of a section 401(k) or 401(m) plan that is required to demonstrate that the definition of compensation used in the plan's ADP or ACP test is nondiscriminatory.

Line b. If the employer has requested a determination that the plan satisfies a general test, the employer is required to submit a demonstration that the test is met. This demonstration should be labeled Demo 6. A special rule in the regulations provides that under certain circumstances a defined benefit plan that would otherwise fail to satisfy the general test will be considered to satisfy the test if the facts and circumstances warrant such a determination. Employers that are requesting application of this special rule are required to so indicate in their applications and should include with their demonstration a description of the relevant facts and circumstances supporting application of this rule.

See the appendix in Explanation 5C to determine if the plan satisfies a general test.

1.401(a)(4)-3(c)(3)

Line c. If the employer is requesting a determination that the plan satisfies the uniform points allocation formula safe harbor, the employer is required to submit a demonstration that the safe harbor is satisfied. This demonstration should be labeled Demo 6. The instructions for Schedule Q contain guidelines that employers should generally follow in preparing this demonstration.

A defined contribution plan (other than an ESOP) will satisfy the uniform points allocation formula safe harbor if it meets two requirements.

First, the plan must allocate amounts to employees under a uniform formula that determines each employee's allocation as the product of employer contributions and forfeitures multiplied by the ratio of the employee's points for the plan year to the total of all employee's points for the year. Points may be granted for age, service, and units of plan year compensation, provided employees receive the same number of points for each year of service or each year of age or each unit of plan year compensation. The plan does not have to give points for both age and service, but must give points for one. A uniform cap may be applied to the number of years of service taken into account. The plan also does not have to give points for units of plan year compensation, but if it does the unit must be a single amount that does not exceed $200.

Line IX.a. of this explanation describes certain plan features that will not cause a plan to fail to satisfy the defined contribution plan uniform allocation formula safe harbor. These rules are also generally applicable to the uniform points allocation formula safe harbor. However, plans intending to satisfy this safe harbor may not provide for permitted disparity.

Second, the average of the allocation rates for the highly compensated employees benefiting under the plan may not exceed the average of the allocation rates of the nonhighly compensated employees benefiting under the plan. Each employee's allocation rate is equal to the allocations of employer contributions and forfeitures made to the employee's account expressed as a percentage of the employee's plan year compensation or as a dollar amount. Thus, the allocation rates for each employee in the two groups must be separately determined and then an average for all employees in each group is determined. The employer is not required to submit information regarding individual allocation rates, merely the average rates for the groups of highly compensated and nonhighly compensated employees.

In determining allocation rates, the employer may not impute permitted disparity nor group allocation rates. (These concepts are discussed in the appendix in Explanation 5C, concerning the general tests.)

Plan year compensation is section 414(s) compensation for the plan year or a 12-month period ending within the plan year and may not take into account compensation in excess of the limit under section 401(a)(17). See Alert Guidelines #4. For the year in which participation in the plan begins or ends, the plan may limit plan year compensation to the period of participation provided the use of period of participation is done in a nondiscriminatory and reasonably consistent manner from year to year. If allocation rates are expressed as a percentage of plan year compensation, the employer must include with its demonstration the definition of section 414(s) compensation used in determining plan year compensation. The employer should also demonstrate that the definition is nondiscriminatory unless the definition satisfies one of the safe harbor definitions contained in section 1.414(s)-1(c)(2) or section 1.414(s)-1(c)(3) of the regulations. Part X of the worksheet may be completed to determine that a nonsafe harbor definition of compensation is nondiscriminatory.

1.401(a)(4)-2(b)(3) and (4)
1.401(a)(4)-12

IX. DESIGN-BASED SAFE HARBORS

This part of the worksheet deals with the design-based safe harbors and should be completed if the employer has indicated that the plan is intended to satisfy such a safe harbor. A design-based safe harbor allows for a determination that the plan, by design, satisfies the nondiscrimination in amount requirement without the need to test the actual allocations or benefits under the plan. The employer is asked to specify the particular safe harbor that the plan is intended to satisfy. Those lines of the worksheet that do not pertain to the specified safe harbor should not be completed.

The remaining part of the worksheet (Part X) generally should be completed only in the case of design-based safe harbor plans. However, some of the requirements addressed in this part of the worksheet may be relevant to a determination of whether a plan satisfies a general test or a nondesign-based safe harbor or the average benefit test. In addition, Part X, relating to nondiscriminatory compensation, should be completed in the case of a section 401(k) or 401(m) plan that is required to demonstrate that the definition of compensation used in the plan's ADP or ACP test is nondiscriminatory.

Line a. The safe harbor for defined contribution plans with uniform allocation formulas is satisfied if the plan (including an ESOP) allocates contributions and forfeitures under a formula that allocates the same percentage of compensation, the same dollar amount, or the same amount per unit of service (not to exceed one week) to every participant under the plan. For this purpose, the contributions taken into account are all employer contributions other than elective and matching contributions that are subject to the actual deferral percentage (ADP) and actual contribution percentage (ACP) requirements of sections 401(k) and 401(m), respectively.

A plan will not fail to satisfy these requirements merely because:

1. Allocations are limited in accordance with section 415 or section 409(n).

2. Allocations are limited to a maximum dollar amount or a maximum percentage of compensation, or the plan limits the compensation taken into account, provided these limits apply either to all employees under the plan or only to some or all highly compensated employees under the plan.

3. Allocations for all employees are conditioned on a last day of the plan year or minimum hours of service (not over 1,000) requirement. (An exception can be made for all employees who terminate or just for those who terminate because of retirement, disability, death, or military service.)

4. The plan provides for permitted disparity in a manner that satisfies section 401(l).

5. The plan provides one or more entry dates during the plan year.

6. One or more HCEs receive lower allocations than would otherwise be provided if the plan satisfied the safe harbor disregarding this rule.

7. The plan provides that an employee's allocation is the greater of, or the sum of, two or more formulas each of which satisfies the safe harbor. Formulas that are available solely to some or all nonhighly compensated employees (but not to any highly compensated employees) fall within this exception, as do the following types of top-heavy formulas: formulas available solely to all non-key employees on the same terms as other formulas; formulas conditioned on the plan being top-heavy; and formulas available only to all non-key employees who have not separated from service before the end of the plan year, provided the plan would meet coverage when employees receiving a top-heavy minimum allocation only are not counted as benefiting.

A plan will not satisfy this safe harbor if it weights allocations on the basis of age or service.

1.401(a)(4)-2(b)(2) and (4)

Line b. A target benefit plan is a defined contribution money purchase pension plan under which contributions to an employee's account are determined by reference to the amounts necessary to fund the employee's stated benefit under the plan. The benefit formula under a target benefit plan is similar to that under a defined benefit plan. However, the actual benefit that the participant will receive will be the account balance which will vary from the stated benefit based on investment performance. Thus, the stated benefit is a "target benefit."

A target benefit plan satisfies the target benefit plan safe harbor if it meets the following requirements:

1. Each employee's stated benefit is expressed as a straight life annuity under a formula that would satisfy the fractional rule unit credit or flat benefit safe harbor and the defined benefit uniformity requirements if the plan were in fact a defined benefit plan (see lines XI.a. through XI.a.(iii) of

Worksheet 5A). Thus, for example, in order to satisfy the flat benefit safe harbor, a target benefit plan with a flat benefit formula must provide that the maximum benefit under the plan is reduced pro rata for years of credited service less than 25. Likewise, in order for the target benefit formula to satisfy one of the defined benefit design based safe harbors, the plan's definition of compensation for purposes of the benefit formula must satisfy the compensation formula requirements described in lines a. and b. of Part XI of Worksheet 5A.

2. The stated benefit may not credit service for years before the employee first benefited under the plan nor service in years in which the target benefit safe harbor was not satisfied. However, these rules generally do not apply to a plan that was adopted and in effect on September 19, 1991, and that was qualified under prior law.

3. Employer contributions are based on the employee's stated benefit using the funding method set forth in the regulations and discussed below.

4. Forfeitures reduce employer contributions.

5. Employee contributions are not used to fund the stated benefit.

6. Disparity must satisfy the permitted disparity rules that apply to defined benefit plans (see Worksheet 5B for special rules).

The requirements of section 411(b)(1)(H) that prohibit a defined benefit plan from ceasing or reducing accruals on account of the participant's attainment of any age generally also apply to a target benefit plan. (See Alert Guidelines 2A for a discussion of these rules). Thus, the uniform post-normal retirement benefits rule discussed in line XI.a. of Worksheet 5A may apply. Such benefits must be provided under the stated benefit formula, subject to any uniformly applicable service cap under the formula. Actuarial increases in the stated benefit for delayed retirement are impermissible.

The regulations contain a detailed formula for calculating the required employer contribution that must be followed by a target benefit safe harbor plan. Specialists should refer to the regulations when reviewing a target benefit plan for the actual step-by-step calculations, but the main steps and some important points to keep in mind are described below.

First, a theoretical reserve is calculated based on the stated benefit as of the date the employer's required contribution for the current plan year is determined. The initial reserve for the participant's first year of participation (or the first plan year taken into account under the stated benefit formula, if that is the current year) is zero.

(The theoretical reserve for the first plan year following any plan year in which the plan failed to satisfy this safe harbor is also zero. However, if the plan was adopted and in effect on September 19, 1991, and met the qualification requirements for target benefit plans under prior law, it may be allowed to take into account years of service for years in which this safe harbor was not met. In this case, the theoretical reserve as of the determination date for the last year before the plan satisfies this safe harbor is the excess, if any, of the actuarial present value of the stated benefit the employee is projected to have at NRA over the actuarial present value of future employee contributions required through NRA.)

The subsequent years' reserves are the sum of the theoretical reserve for the prior year plus the required contribution for the prior year, increased, using a standard interest rate, for interest between the prior year determination date and the current year determination date.

Next, the actuarial present value of the participant's fractional rule benefit under the stated formula is determined as of the current plan year's determination date, using a standard interest rate and mortality table set forth in the plan and uniformly applied.

The required contribution for the current year is determined by amortizing the difference between the theoretical reserve and the fractional rule benefit on a level basis from the determination date for the current year and the determination date for the year in which the participant is projected to reach NRA.

Where the participant is at or past NRA, the required contribution is the difference between the actuarial present value of the stated benefit for the current year, using a straight life annuity factor based on the employee's NRA (rather than attained age), and the theoretical reserve as of the determination date.

Required contributions must be limited or increased, if necessary, to comply with sections 415 and 416, respectively.

For purposes of these calculations, interest rates between 7.5% and 8.5% are standard interest rates. The UP-84 mortality table is an example of a standard mortality table.
1.401(a)(4)-8(b)(3)

X. NONDISCRIMINATORY COMPENSATION

Line a. If a design-based safe harbor plan bases benefits or contributions on compensation, it must use a definition of compensation that is nondiscriminatory under section 1.414(s)-1 of the regulations. (The requirement to use a nondiscriminatory definition of compensation would also apply in the case of the definition of compensation that a section 401(k) or 401(m) plan must use in its actual deferral percentage (ADP) or actual contribution percentage (ACP) test.) The regulations contain certain definitions that are automatically nondiscriminatory under section 414(s). A plan may use an alternative definition, provided the definition is reasonable, not designed to favor highly compensated employees, and if the facts and circumstances show that the average percentage of total compensation included for highly compensated employees as a group does not exceed the average percentage for nonhighly compensated employees by more than a de minimis amount. In addition, under certain circumstances a plan may use rate of compensation, imputed compensation, or prior-employer compensation under a definition of compensation that satisfies section 414(s).

The following definitions of compensation automatically satisfy section 414(s):

1. Compensation within the meaning of section 415(c)(3). For years beginning after December 31, 1997, this definition of compensation includes elective deferrals defined in section 402(g)(3) and amounts deferred under a section 125

cafeteria plan or under a section 457 plan. Under this definition, a self-employed person's compensation is earned income as defined in section 401(c)(2).

2. Wages as defined in section 3401(a) plus all other compensation required to be reported by the employer under sections 6041, 6051 and 6052, or wages as defined in 3401(a), both determined without regard to any rules that limit wages based on the nature or location of employment.

3. A safe-harbor definition that starts with 1 or 2, but excludes all of the following: reimbursements or other expense allowances, fringe benefits, moving expenses, deferred compensation, and welfare benefits. This safe-harbor generally permits the following definition to fall within the scope of section 414(s): Regular or base salary or wages, plus commissions, tips, overtime and other premium pay, bonuses, and any other item of compensation includible in gross income not listed in the safe-harbor exclusions. If this definition is used, any self-employed individual's compensation is to be limited to earned income multiplied by the percentage of nonhighly compensated employees' total compensation (determined on a group basis) that is included under the plan definition.

Under any of these definitions, the employer can elect to include or exclude elective contributions not includible in income, section 457(b) deferred compensation, and section 414(h)(2) pick-up contributions. If any of these are included (excluded), they must all be included (excluded).

1.414(s)-1

If the plan's definition of compensation does not meet any of the preceding definitions, then the applicant is required to submit a demonstration that, under the plan definition, the average percentage of total compensation included for highly compensated employees as a group does not exceed the average percentage for nonhighly compensated employees by more than a de minimis amount. (Self-employed individuals are not counted in either group.) This demonstration should be labeled Demo 9.

The plan definition must also be reasonable and not designed to favor highly compensated employees. A definition is reasonable only if it is described in one of the four preceding paragraphs and modified to exclude certain types of irregular or additional compensation or is limited to a dollar amount. (However, see below for rules allowing definitions of compensation that are based on rate of compensation or that include prior-employer compensation or imputed compensation.)

For this purpose, total compensation means compensation based on one of the definitions permissible under section 415(c)(3) (either including or excluding all elective contributions, etc.), limited to the amount described in section 401(a)(17). If the plan's alternative definition excludes amounts from the compensation of some (but not all) highly compensated employees, these amounts must also be excluded from the same employees' total compensation.

The employer may elect to consider either all employees in the plan (other than self-employed individuals) or all employees (other than self-employed individuals) in all the plans that use the same alternative definition of compensation in performing this calculation. Employees who have no total compensation are disregarded for purposes of testing a definition of compensation.

Whether the average percentage of total compensation included for highly compensated employees as a group exceeds the average percentage for nonhighly compensated employees by more than a de minimis amount is a question of facts and circumstances. The applicant should submit an explanation supporting a claim that such a difference is de minimis. This may include showing the difference for prior periods. Also, a difference that is more than de minimis may be disregarded if it is an isolated instance due to an extraordinary, unforeseeable event (such as overtime payments due to a major hurricane).

1.414(s)-1(d)

A plan can base allocations or benefits on employees' basic or regular rate of compensation using an hourly pay scale, weekly salary, or similar unit of basic or regular compensation. (Rate of compensation may not be used in a definition used for ADP or ACP testing in a section 401(k) or section 401(m) plan.) A plan could also, for example, define compensation as basic or regular compensation, determined using a rate of compensation, plus irregular or additional compensation. The amount of basic or regular compensation must be determined using the rate of compensation as of a designated date or dates. Also, if the plan does not use the same date to determine employees' rates of compensation, the dates selected must be designed to determine such rates in a consistent manner. An employer may continue to credit an employee who has ceased performing services with compensation based on a rate of compensation for up to 31 days after the event causing the cessation.

A defined benefit plan can include imputed compensation or prior-employer compensation in an alternative definition of compensation. Prior-employer compensation is compensation from another employer credited for periods prior to the employee's employment with the employer. Imputed compensation is compensation credited for periods after commencement of participation in the plan while the employee receives no compensation or reduced compensation because no services or reduced services are performed for the employer. Included in this definition of imputed compensation would be compensation credited while the employee is performing services for a joint venture.

If the employer is including prior-employer or imputed compensation in the plan's definition of compensation, the provisions must apply to all similarly situated employees, there must be a legitimate business purpose for crediting the service, and the provisions must not by design or operation significantly favor highly compensated employees. A definition of compensation that credits prior-employer compensation or imputed compensation must actually be used to calculate benefits under the plan.

If the definition of compensation includes rate of pay, the definition must be demonstrated to be nondiscriminatory. If the definition includes prior-employer or imputed compensation, it must also be shown to be nondiscriminatory unless the definition is otherwise one of the safe harbor definitions.

If the employer is providing a demonstration with respect to a definition that includes rate of compensation, imputed

compensation, or prior-employer compensation, the following adjustments apply to the testing method:

1. Compensation treated as included under the alternative definition (the numerator in the test), may not exceed 100 percent of total compensation.

2. Total compensation (the denominator in the test) must include all elective contributions and deferred compensation that could otherwise be disregarded and may not include prior-employer or imputed compensation.

1.414(s)-1(e) and (f)

Line b. If the plan is using a definition of compensation permissible under section 415(c)(3), then it must define compensation for any self employed individual as earned income within the meaning of section 401(c)(2).

If the plan is using the alternative safe harbor definition that excludes certain expenses and other items or an alternative definition that requires a demonstration, then the terms of the plan must provide for an equivalent alternative definition for self-employed individuals, determined as follows.

The self-employed individual's earned income (increased by elective contributions, if any of these are included in the plan's alternative definition) is multiplied by the percentage of total compensation (including elective contributions, if any of these are included in the plan's alternative definition) that is included for the group of nonhighly compensated common-law employees. (This calculation is to be performed consistent with the rules for determining whether an alternative definition of compensation is nondiscriminatory, except that highly compensated common-law employees are disregarded.)

The plan's alternative definition may also limit the compensation of some or all self-employed individuals who are also highly compensated employees to a portion of the equivalent compensation.

1.414(s)-1(g)