

MEMO# 1912

May 17, 1990

IRS PROPOSED AND TEMPORARY REGULATIONS CONCERNING NONDISCRIMINATION, MINIMUM PARTICIPATION AND OTHER QUALIFIED PLAN REQUIREMENTS

- 1 - May 17, 1990 TO: PENSION MEMBERS NO. 25-90 RE: IRS PROPOSED AND TEMPORARY REGULATIONS CONCERNING NONDISCRIMINATION, MINIMUM PARTICIPATION AND OTHER QUALIFIED PLAN REQUIREMENTS

Attached are the following IRS regulations: (1) proposed nondiscrimination requirements for qualified plans issued under section 401(a)(4); (2) proposed minimum participation requirements issued under section 401(a)(26); (3) temporary regulations concerning the definition of "compensation" issued under section 414(s); and (4) miscellaneous proposed amendments to existing and proposed regulations under sections 401(a)(17), 401(k), 401(l), 401(m) and 410(b). Nondiscrimination Requirements Section 401(a)(4) provides that a plan is a qualified plan only if the contributions or the benefits provided under the plan do not discriminate in favor of highly compensated employees. The rules in the proposed regulations are intended to be the exclusive rules for determining whether this requirement is met. The proposed regulations contain three requirements a plan must meet to satisfy section 401(a)(4): (1) either the contributions or the benefits provided under the plan must be nondiscriminatory in amount; (2) the benefits, rights and features provided under the plan must be available to employees in the plan in a nondiscriminatory manner (including optional forms of benefits, such as retirement annuities and single sum payments, and other rights and features, such as loans and investment options); and (3) the effect of the plan in certain special circumstances (such as plan amendments, grants of past service credit and plan terminations) must be nondiscriminatory. The proposed regulations contain safe-harbors for determining whether contributions or benefits are nondiscriminatory. For example, a defined contribution plan with - 2 - a uniform allocation formula, such as a plan which allocates the same percentage of compensation to each participant, satisfies this requirement and calculation of allocation rates for individual employees is not necessary. However, plans subject to section 401(k) or (m) must satisfy the respective average deferral percentage test or average contribution percentage test included in those provisions. In addition, the proposed regulations explain how to satisfy certain conditions that apply to nonelective contributions under the section 401(k) and (m) regulations in the case of a plan that used qualified nonelective contributions to satisfy the actual deferral percentage test or the actual contribution percentage test. With regard to plans which are integrated with Social Security, if a plan does not use the integration safe harbor rules, or if

two or more plans are combined for purposes of section 401(a)(4), specified formulas are contained in the proposed regulations to determine the permitted disparity that may be taken into account. The proposed regulations are effective for plan years beginning on or after January 1, 1991, however, the rules do not apply to state and local government plans until the first plan year beginning after December 31, 1992. Minimum Participation Section 401(a)(26) requires that at least the lesser of 50 employees or 40 percent of all employees of the employer participate in any qualified plan. On February 14, 1989, proposed regulations under section 401(a)(26) were released. (See Institute Memorandum to Pension Members No. 11-89 dated February 17, 1989.) These regulations have been withdrawn and new regulations are proposed. The prior proposed regulation required all plans to be tested for compliance with section 401(a)(26) with regard to both current and prior benefit structures. The current benefit structure tests contained in the prior proposed regulations are eliminated from the new proposal. In addition, the new proposal provides a single, flexible prior benefit structure test. The new proposed regulations allow testing under 401(a)(26) to occur on a single day in a plan year, as long as the day selected is reasonably representative of the employer's workforce and the plan's coverage. Finally, the proposed regulations contain a transition rule for section 403(b) annuities. Section 403(b) annuity plans are deemed to satisfy section 401(a)(26) for plan years beginning before January 1, 1993. - 3 - Compensation Temporary regulations under section 414(s) implement the definition of compensation within the meaning of section 415(c)(3) and contain alternative definitions of nondiscriminatory compensation. The regulations provide a safe harbor alternative definition and allow any other alternative definition to satisfy section 414(s) if it is reasonable, does not by design favor highly compensated employees and satisfies a nondiscrimination requirement. Elective contributions that are not includable in gross income under sections 125, 402(a)(8), 402(h), 403(b) and 457 may be included in compensation. Miscellaneous Regulatory Proposals Proposed regulations under section 401(k) have been simplified with regard to correction of excess contributions of highly compensated family members subject to the family aggregation rules of section 414(q)(6). In addition, the prior proposed regulations have been liberalized with regard to multiple use of the alternative limitations under sections 401(k) and 401(m) where the average deferral percentage and average contribution percentage of nonhighly compensated employees is less than 2 percent. The proposed regulations under section 410(b) regarding minimum coverage requirements has been amended in several respects one of which allows plans which contain the special two- year eligibility requirements to exclude all employees who have less than two years of service for 410(b) testing purposes. We will keep you informed of further developments. W. Richard Mason Assistant General Counsel Attachments