

**MEMO# 12736**

October 12, 2000

## **IRS ISSUES PROPOSED REGULATIONS ON "NEW COMPARABILITY" PLANS**

[12736] October 12, 2000 TO: PENSION COMMITTEE No. 77-00 RE: IRS ISSUES PROPOSED REGULATIONS ON "NEW COMPARABILITY" PLANS The Internal Revenue Service has issued proposed regulations providing conditions under which "new comparability" plans may satisfy the Code's nondiscrimination rules.<sup>1</sup> The proposed regulations follow Notice 2000-142 issued earlier this year, which invited public comments on such plans. Written comments to the proposed regulations are due by January 5, 2001. A public hearing on the proposed regulations is scheduled for January 25, 2001.<sup>3</sup> The proposed regulations would permit application of the current cross-testing rules to defined contribution plans with "broadly available allocation rates." Alternatively, defined contribution plans that do not meet this requirement may be eligible for cross-testing if they satisfy a "gateway" test that prescribes minimum allocation rates for non-highly compensated employees (NHCEs).

**Broadly Available Allocation Rates.** To be broadly available, each allocation rate under a plan must be currently available to a group of employees that satisfies section 410(b) (without regard to the average benefit percentage test). Thus, for example, if within one plan, an employer provides different allocation rates for nondiscriminatory groups of employees at different locations or different profit centers, the plan would be eligible for cross-testing. A plan that provides allocation rates based on an employee's age or service would be viewed as having broadly available allocation rates if the same schedule of allocation rates is available to all employees in the plan, and if the schedule provides for "smoothly" increasing allocation rates at regular intervals of age or service. The proposed regulations specifically invite comments on whether there are plans using schedules of allocation rates (such as those based on points or otherwise combining age and service) that would fall outside the definition of broadly available allocation rates, but that do afford "sufficient opportunity" for NHCEs to "grow into" higher allocation rates.

<sup>1</sup> New comparability plans are defined contribution plans that generally provide higher rates of employer contributions to highly compensated employees. Such plans may satisfy the Code's nondiscrimination requirements through "cross-testing," under which participant benefits are actuarially projected to normal retirement age.

<sup>2</sup> See Institute Memorandum to Pension Committee No. 18-00, dated February 28, 2000.

<sup>3</sup> Requests to participate in the hearing must be submitted by the comment deadline.

**Minimum Allocation Gateway Alternative.** Plans that do not provide broadly available allocation rates must satisfy a minimum allocation gateway in order to be eligible for cross-testing. A plan would satisfy the gateway if (i) each NHCE received an allocation of at least 5-percent of the NHCE's compensation, or (ii) each NHCE in the plan has an allocation rate that is at least one-third of the allocation rate of the highly-compensated employee (HCE) with the highest allocation rate. The proposed regulations would not modify the general rule that prohibits aggregation of a 401(k) plan or 401(m) plan with a plan providing nonelective contributions. Thus,

elective and matching contributions would not be considered for purposes of meeting the gateway requirement. However, if an employer also provides a 401(k) plan, then to the extent the HCEs are electing contributions under that plan, the highest HCE allocation rate may be lower for purposes of determining the minimum allocation rate for NHCEs. Additionally, nonelective 401(k) safe harbor contributions may be taken into account in determining the NHCE allocation rate. Combined Defined Benefit/Defined Contribution Plans. The proposed regulations also contain a set of rules under which nondiscrimination may be demonstrated by combining a defined benefit plan and a defined contribution plan. In order to do so, the combined plan must (i) be primarily defined benefit in character, (ii) consist of broadly available separate plans, or (iii) satisfy a minimum aggregate allocation gateway (that differs from the test applicable to non-combined plans). Detailed requirements with respect to each alternative are provided in the regulations. Component Plans and Permitted Disparity. "Component plans" may not be used to determine whether a defined contribution plan provides broadly available allocation rates or satisfies the minimum allocation gateway. Similarly, such plans may not be considered in determining whether a combined defined benefit/defined contribution plan satisfies the rules set forth in the proposed regulations. In addition, permitted disparity may not be used in determining whether the minimum allocation gateways and the "defined benefit in character" test are met. Permitted disparity may be used, however, to determine whether a combined defined benefit/defined contribution plan consists of broadly available separate plans. In such cases, permitted disparity may be applied to either the defined contribution plan or the defined benefit plan, but not to both. Effective Date. The regulations are proposed to be applicable for plan years beginning on or after January 1, 2002. Thomas T. Kim Assistant Counsel Attachment Attachment (in .pdf format)