

# SECTION 401(1)

Permitted disparity  
Safe harbor plan design

# 401(I) SUMMARY

---

- 1.401(I) - 1    **Permitted disparity, Definitions**
- 1.401(I) - 2    **Permitted disparity - DC plans**
- 1.401(I) - 3    **Permitted disparity - DB plans**
- 1.401(I) - 4    **Railroad plans**
- 1.401(I) - 5    **Overall permitted disparity limits**
- 1.401(I) - 6    **Effective dates, Transition rules**

## **§401(I) OVERVIEW**

---

**Disparities in employer provided benefits / contributions permitted under 401(I) are OK - plan does not discriminate in favor of HCEs**

### **Permitted disparity**

- **Social Security benefits: higher % pay for employees with lower compensation**
- **Pension benefits: lower % pay for employees with lower compensation**
- **Total benefits similar to higher paid employees**

### **Integration level**

**Plan can provide higher allocations or benefit accruals for compensation above integration level (defined in plan document)**

## **§401(l) OVERVIEW**

---

**No Permitted Disparity allowed for plans described in 1.401(l)-1(a)(4):**

- ER does not pay wages for FICA / FUTA
- ESOP or TRASOP
- 401(k) pre-tax elective deferrals
- 401(m) EE or ER matching contrib.
- SARSEP

- Average annual compensation (next page)
- Covered compensation
- Final average compensation (FAC):  
3 year average compensation, limit each year to Taxable Wage Base
- Integration level
- Excess plan
- Base benefit / contribution percentage
- Excess benefit / contribution percentage
- Disparity
- Offset plan
- Offset level
- Offset percentage
- PIA

Year of birth	< 1938	1938-1954	> 1954
SSRA	65	66	67

## **1.401(a)(4)-3(e) AVERAGE ANNUAL COMP**

---

### **1) General rule**

**Average of 414(s) comp over ANY averaging period in comp. history → highest average**

### **2) Averaging period**

- a) At least 3 consecutive 12 mo. periods**
- b) Not greater than employment period**

### **3) Compensation history**

- a) May begin at any time**
- b) Must be continuous**
- c) Must be no shorter than averaging period**
- d) Must end in current plan year**

**Apply 401(a)(17) limit to each year's comp, produces higher benefit % for HCEs**

- 1) Only DC excess plan**
- 2) Uniform disparity requirements**
- 3) The integration level (IL) must not exceed Social Security Taxable Wage Base (TWB)**
- 4) The disparity must not exceed the DC maximum permitted disparity (MPD)**
  - a) For  $IL = TWB$ ,  $MPD =$  lesser of base contribution % or the greater of (5.7% and the old age portion of the FICA tax)**
  - b) For  $IL < TWB$ ,  $MPD$  must be  $< 5.7\%$**

## 1.401(I)-2(d)(4)

### DC PLANS - INTEGRATION LEVEL

---

#### PDF: Permitted Disparity Factor

Integration Level	PDF
<b>IL &gt; MAX(10,000 or 20% of TWB) AND IL ≤ 80% of TWB</b>	<b>4.3%</b>
<b>80% of TWB &lt; IL &lt; 100% of TWB</b>	<b>5.4%</b>
<b>IL = 100% of TWB</b>	<b>5.7%</b>



- 1) DB excess or DB offset plan**
- 2) Maximum permitted disparity**
- 3) Uniform disparity**
- 4) Integration or offset level**
- 5) Benefits, rights and features**
- 6) Overall permitted disparity limits**

## **1.401(l)-3(b) MAXIMUM PERMITTED DISPARITY**

---

- 1) Maximum excess allowance**
  - a) Lesser of .75% or**
  - b) Base benefit % for plan year**
  - c) .75% is reduced based on**
    - i) Integration level > 100% of covered compensation**
    - ii) Benefit commencement age < SSRA**

## 1.401(l)-3(b) MAXIMUM PERMITTED DISPARITY

---

### 2) Maximum offset allowance

a) Lesser of .75% or

b)  $\frac{1}{2}$  of gross benefit % for plan year times

$$\left[ \frac{\text{Average annual compensation}}{\text{FAC} < \text{Offset Level}} \right] < 1.0$$

c) .75% is reduced based on

i) Offset level  $> 100\%$  of  
covered compensation

ii) Benefit commencement age  $< \text{SSRA}$

## 1.401(l)-3(b)(4)(iii) OPTIONAL FORMS

---

- 1) **Must satisfy MPD% requirements (page 10) for normal form, and all optional forms**
- 2) **Level annuity forms**
  - a) **Payable over period  $\geq$  life of ee**
  - b) **Includes J&S annuity types**
  - c) **Do not have to normalize to life annuity**
- 3) **Non-level annuity forms**
  - a) **Must normalize to life annuity, then satisfy MPD% requirements**
  - b) **Excess plan - must normalize the "base portion", "excess portion" of benefit**
  - c) **Offset plan - must normalize the "gross amount", "offset amount" of benefit**

## 1.401(I)-3(c)(2)(iv)

### UNIFORM DISPARITY - OFFSET PLANS

---

- 1) Plan must use same gross and offset percent for ees with same number of years of service
- 2) Plan should adjust .75% for MOA by reducing offset percentage to allow for different SSRA

## 1.401(I)-3(c)(2)(iv)

### UNIFORM DISPARITY - EXCESS PLANS

---

- 1) Plan must use same base and excess pct for ees with same number of years of service
- 2) Plan should adjust .75% for MEA by increasing the base benefit percentage to allow for different SSRA

## **1.401(l)-3(d)      INTEGRATION / OFFSET LEVEL**

---

### **1) Covered Compensation**

- a) Use .75% if 100% covered comp**
- b) Reduce .75% if > 100% covered comp  
using complex table in 1.401(l)-3(d)(9)(iv)**
- c) Excess plans: Integration level can't  
exceed Taxable wage base**
- d) Offset plans: Offset level can't exceed Final  
average compensation (FAC)**

### **2) Single dollar amount**

- a) Less than greater of**
  - i) 10,000, or**
  - ii) 50% of covered comp for ee attaining  
SSRA in calendar year of the plan year**
- b) Still use .75% unadjusted**

### **3) Intermediate dollar amount - complex**

### **4) Intermediate dollar amount safe harbor**

## 1.401(l)-3(d)(9)(iv)

### DB PLANS - INTEGRATION / OFFSET LEVEL

---

#### PDF: Permitted Disparity Factor

PDF

<b>Integ / Offset level <math>\leq</math> 100% Covd Comp</b>	<b>.75%</b>
Integ / Offset level $\leq$ 125% Covd Comp	.69%
Integ / Offset level $\leq$ 150% Covd Comp	.60%
Integ / Offset level $\leq$ 175% Covd Comp	.53%
Integ / Offset level $\leq$ 200% Covd Comp	.47%

#### Excess Plans:

Integration level = Taxable Wage Base .42%

#### Offset Plans:

Offset level = FAC (Final Average Comp) .42%

## 1.401(l)-3(f)

### BENEFITS, RIGHTS AND FEATURES

---

#### EXAMPLES

- Optional forms of payment, including subsidized forms
- Early retirement eligibility
- Ancillary benefits: death, disability
- Many features for DC plans, including loan provisions, investment options, etc.

Offset plans - extra requirement for benefit commencement prior to NRA:

Gross benefit percentage must be reduced by amount at least as large as reduction in offset percentage.



## 1.401(l)-5(b) ANNUAL OVERALL PD LIMIT

---

- Prevents multiple 401(l) plans for single employee, each using .75% disparity
- Annual disparity fraction
  - DC plan –  $\left[ \frac{\text{Disparity for year}}{\text{Maximum excess allowance}} \right]$
  - DB excess –  $\left[ \frac{\text{Disparity for year}}{\text{Maximum excess allowance}} \right]$
  - DB offset –  $\left[ \frac{\text{Disparity for year}}{\text{Maximum offset allowance}} \right]$
  - 1.0 for imputed permitted disparity plans
- Total annual disparity fraction  
Sum annual disparity fractions under plans with plan years ending in current plan year
- Total annual disparity fraction may not exceed 1.0

## **1.401(l)-5(c) CUMULATIVE PD LIMIT**

---

- **Prevents plans from providing more than 35 years of .75% disparity for any employee**
- **Cumulative disparity fraction**  
**Sum of total annual disparity fractions (for all years of service) for all DB / DC plans - must not exceed 35**
- **Applies to employees who have benefited under 401(l) DB plans, or DB plans which impute permitted disparity**

**1998 #13 (1 point)**

**A plan has NO early retirement provisions**

**Normal retirement benefit:**

**1.20% [AAC < Cov'd Comp] times  
[service up to 35 years], plus**

**1.85% [AAC > Cov'd Comp] times  
[service up to 10 years], plus**

**1.65% [AAC > Cov'd Comp] times  
[service > 10 years (max of 25 years)]**

**True or False - the disparity under this plan  
does NOT exceed the maximum excess  
allowance**

**A plan has NO early retirement provisions**

**Normal retirement benefit:**

**1.20% [AAC < Cov'd Comp] times  
[service up to X years], plus**

**1.85% [AAC > Cov'd Comp] times  
[service up to 10 years], plus**

**1.65% [AAC > Cov'd Comp] times  
[service > 10 years (max of X-10 years)]**

**What is the maximum allowable value of X?**

**A plan has NO early retirement provisions**

**Normal retirement benefit:**

**1.20% [AAC < Cov'd Comp] times  
[service up to 40 years], plus**

**1.85% [AAC > Cov'd Comp] times  
[service up to 10 years], plus**

**X% [AAC > Cov'd Comp] times  
[service > 10 years (max of 30 years)]**

**What is the maximum allowable value of X?**

**A plan has NO early retirement provisions**

**Normal retirement benefit:**

**1.20% [AAC < Cov'd Comp] times  
[service up to 30 years], plus**

**X% [AAC > Cov'd Comp] times  
[service up to 10 years], plus**

**1.85% [AAC > Cov'd Comp] times  
[service > 10 years (max of 20 years)]**

**What is the maximum allowable value of X?**

## 401(I) SUMMARY

---

- 1.401(I) - 1 Permitted disparity, Definitions**
- 1.401(I) - 2 Permitted disparity - DC plans**
- 1.401(I) - 3 Permitted disparity - DB plans**
- 1.401(I) - 4 Railroad plans
- 1.401(I) - 5 Overall permitted disparity limits**
- 1.401(I) - 6 Effective dates, Transition rules

THIS PAGE WAS INTENTIONALLY LEFT BLANK