

SECTION 410(b)

Non-discrimination in Benefit coverage

410(b) SUMMARY

- 1.410(b) - 1 Minimum coverage (Pre-1994)**
- 1.410(b) - 2 Minimum coverage (Post-1993)**
- 1.410(b) - 3 Employees benefiting, Former ees**
- 1.410(b) - 4 Nondiscrimin. classification test**
- 1.410(b) - 5 Average benefits percentage test**
- 1.410(b) - 6 Excludable employees**
- 1.410(b) - 7 What is "a plan", plan aggregation
and disaggregation rules**
- 1.410(b) - 8 Additional rules**
- 1.410(b) - 9 Definitions**
- 1.410(b) - 10 Effective dates, Transition rules**

§401(a)(4) NONDISCRIMINATION OVERVIEW

§401(a)(4) states that a qualified plan can't discriminate in favor of HCEs:

-) Plan coverage must be nondiscriminatory (410(b) testing)**
-) Plan benefits must be nondiscriminatory in amount (401(a)(4) testing)**
-) Coverage also includes benefits, rights, and features**
-) Timing of plan amendments must not discriminate in favor of HCEs**

§401(a)(4) VERSUS 410(b)

Regulations have definitions of tests for nondiscrimination:

) Amount of benefits under §401(a)(4)

) Coverage tests under §410(b)

Both 410(b) and 401(a)(4) tests are based on a ratio percentage test:

) 410(b) based on plan or controlled group

) 401(a)(4) based on rate groups (plan subset)

401(a)(4) regulations refer to many items defined in 410(b) regulations. We'll look at 410 first, then look at 401(a)(4) regulations.

§410(a) MINIMUM PARTICIPATION

§410(a)(1) Minimum age and service

-) Age 21 & 1 yr, or**
-) Age 21 & 2 yr if 100% immediate vesting, or**
-) Age 26 & 1 yr if 100% immediate vesting and educational institution**

§410(a)(2) No maximum age allowed

§410(a)(3) Year of service

-) 12 month period, at least 1000 hours**
-) 12 month periods - hire date anniversary**
-) Can use plan years if < 1000 hours 1st year**

§410(a)(4) Time of participation

Participation date no later than earlier of:

-) 1st day of plan year after satisfy age/svc reqt**
-) Six months after satisfy age+svc reqt**

§410(a) MINIMUM PARTICIPATION

§410(a)(5) Breaks in service

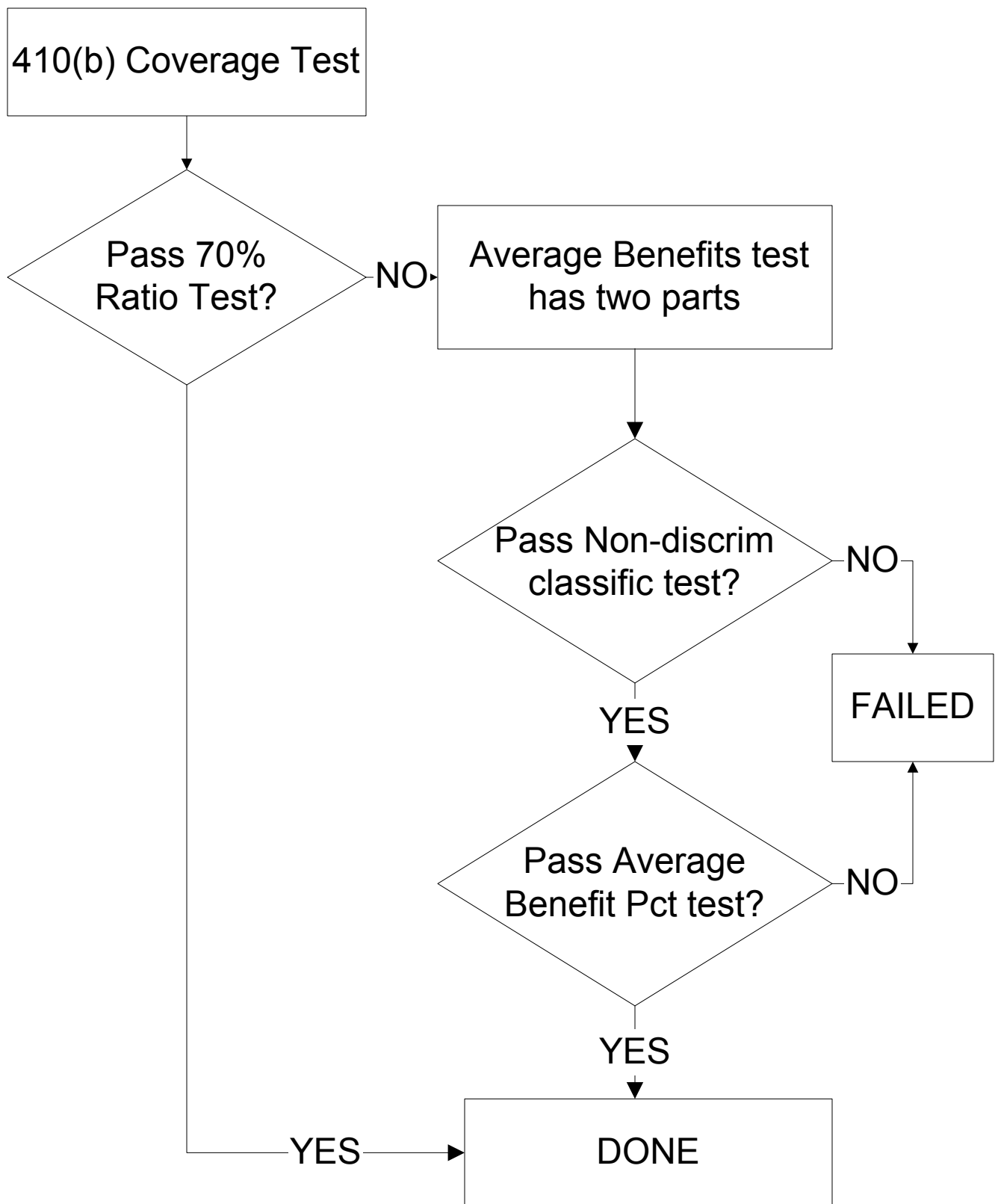
§411(a)(6)(A) Definition

12 consecutive month period as defined by plan, with less than 501 hours

§410(a)(5)(D) Non-vested participants

Ignore the prior service when # of consecutive one year breaks in service ≥ greater of 5, or the # of years of service before such period

410(b) TESTING FLOWCHART



§410(b) MINIMUM COVERAGE

§410(b) Satisfy (1)(A), (1)(B), or (2):

(1)(A) At least 70% of NHC benefit, or

**(1)(B) % of NHC benefiting is | 70% times %
of HCE who are benefiting, or**

(2) Average Benefits test:

**(2)(A)(i) Plan benefits a non-discriminatory
classification of employees, AND**

**(2)(A)(ii) Average benefit % for NHC is | 70%
times average benefit % for HCE**

**NOTE: Beware code versus regulation
differences, code is “brief outline”, but
regulations rule**

1.410(b)-9 DEFINITIONS

Employer

-) Employer maintaining the plan
-) Employers required to be aggregated with employer under 414(b), (c), (m), (o)
-) Owner of unincorporated trade or business
-) Partnership is treated as employer of each partner and employee of partnership

Employee

- Common law employee
- Self-employed treated as ee under 401(c)(1)
- Leased ees not excluded under 414(n)(5)

Former Employee

- Individual who was, but ceased to be an ee
- Become former ee on day following the day individual ceases performing services
- If treated as employee for plan year, would not be former employee that year

1.410(b)-2 MINIMUM COVERAGE REQ

For the plan year, the plan must satisfy 410(b) with respect to both

Employees:

At least one of the tests under 1.410(b)-2(b)(2)

Former employees:

1.410(b)-2(c) Based on facts + circumstances, group of former employees must not discriminate significantly in favor of former HCEs

Former HCE: defined based on satisfying HCE definition at date of exit, or any time after age 55

1.410(b)-2(b)(2) RATIO PERCENTAGE TEST OVERVIEW

Ratio % test:
$$\frac{\frac{\text{NonHCEs who benefit}}{\text{TotalNon-excludable nonHCEs}}}{\frac{\text{HCEs who benefit}}{\text{TotalNon-excludable HCEs}}}$$

If ratio \geq 70%, the entire plan passes §410(b)

If ratio $<$ 70% plan fails ratio test. Must pass one of other tests under 1.410(b)-2(b)

1.410(b)-2(b)(2) RATIO PERCENTAGE TEST DETAILS

-) Test is defined in 1.410(b)-9**
-) Rules at 1.410(b)-7 govern when you can voluntarily aggregate plans**
-) Numerator uses employees benefiting
 - (i) under a single plan, or**
 - (ii) all plans that are voluntarily aggregated (this may allow plan to pass 410(b))****
-) Denominator includes ALL non-excludable employees in the "entire testing group"**

For general test under §401(a)(4), also need to know if plan passes Average Benefit Percentage test (see page 401(a)(4)-25)

1.410(b)-7 DEFINITION OF “PLAN”

- 1. Start with 414(l) asset pool definition**
- 2. Mandatory disaggregation rules in -7(c)**
- 3. Permissive aggregation rules in -7(d)**
- 4. Result of first three steps is “plan” for 410(b) and 401(a)(4)**
- 5. For ABPT, “plans in testing group” is defined in -7(e)**

1.410(b)-7(c) MANDATORY DISAGGREGATION

Each plan must be tested separately under 410(b):

- 1. Section 401(k) and 401(m) plans**
- 2. ESOPs and non-ESOPs**
- 3. Plans benefiting otherwise excludable ees (if using otherwise excludable option P.20)**
- 4. Plans benefiting certain disaggregation populations of employees:**
 - **Employees of QSLOB**
 - **Employees covered under CBA**
 - **Employees of more than one employer**
- 5. Multiple QSLOB special rule – nondiscriminatory classification requirement**

1.410(b)-7(d) PERMISSIVE AGGREGATION

If employer elects NOT to aggregate plans, you use only the employees benefiting under a single plan for the numerator in the ratio percentage test.

Denominator includes all non-excludable employees - ALWAYS.

- 1. Aggregated plans treated as a single plan for all purposes under 410(b) + 401(a)(4)**
- 2. You can group multiple plans as a single plan, unless prohibited by 1.410(b)-7(c)**
- 3. Can not combine one plan with two or more plans to create more than one single plan**
- 4. Only can aggregate plans if same plan year**
- 5. Multiple QSLOB special rule**

EXAMPLE - RATIO TEST

Data for sponsor of three plans:

	Plan A		Plan B		401(k) Plan C	
	NHCEs	HCEs	NHCEs	HCEs	NHCEs	HCEs
Total employees	100	50	300	50	500	50
Excludable A+S	10	5	15	5	50	5
non-CBA Benefiting	80	40	100	40	400	40
CBA employees						
Not covered	0	0	150	0	0	0

-) No employee benefits under more than one plan
-) The age and service eligibility provisions are identical for all plans

1. What is the ratio percentage for Plan B, if the plans are not aggregated for testing?
2. What is the ratio percentage for Plan B, if the plans are aggregated for testing?

1.410(b)-7(e) ABPT TESTING GROUP

ABPT uses "all plans in the testing group"

Defined as the plan being tested, plus all plans that could be permissively aggregated under 1.410(b)-7(d).

This permissive aggregation for ABPT ignores

) 1.410(b)-7(d)(4) QSLOB rule

) 1.410(b)-7(d)(5) reqt re: same plan years

Apply 1.410(b)-7(d)(2) mandatory disaggregation rules without regard to

) 401(k) and 401(m) in 1.410(b)-7(c)(1)

) ESOP / non ESOP in 1.410(b)-7(c)(2)

1.410(b)-6 EXCLUDABLE EES

Many different groups may be excludable

- (b) Minimum age / service**
- (c) Nonresident aliens**
- (d) Collectively bargained employees**
- (e) Qualified Separate Lines of Business (QSLOB)**
- (f) Terminating employees**
- (g) Governmental / tax exempt**
- (h) Former ees**
- (i) Former ees treated as ees**

Most important groups are (b), (c), (d), and (f), discussed on following pages

1.410(b)-6(a) EMPLOYEES

1.410(b)-6(a)(1) General

) KEY POINT:

Excludable employees are not taken into account, even if they are benefiting under the plan

1.410(b)-6(a)(2) Rules of application

) Excludable employees are determined separately with respect to each plan

) If plans are aggregated voluntarily, then must apply rules based on “deemed single plan”

) For Average Benefit Percentage test (ABPT), must apply rules to entire testing group as a single plan

1.410(b)-6(b) AGE / SERVICE EXCLUSIONS

(1) General

) If plan excludes ees, they are excludable

(2) Multiple age / service

) Employees who satisfy any set of age / service conditions are not excludable

) Do not consider different method of crediting service as a different service condition

(3) Plans benefiting otherwise excludable ees

) OPTION - Plan can be separated into two plans, may be easier to pass non-discrim

) One plan benefits otherwise excludable, other plan benefits everyone else

) Example:

For plans with earlier participation than required under §410(a), can treat as separate plans those participants who have met (and who have not yet met) §410(a) requirements

EXAMPLE - MULTIPLE ELIGIBILITIES

Same three plans as page 16 except:

Plan A eligibility requirement: 6 months

Plan B eligibility requirement: age 21 + 1 year

Plan C eligibility requirement: 6 months

	Plan A		Plan B		401(k) Plan C	
	NHCEs	HCEs	NHCEs	HCEs	NHCEs	HCEs
Total employees	100	50	300	50	500	50
Excludable A+S	10	5	15	5	50	5
non-CBA Benefiting	80	40	100	40	400	40
CBA employees						
Not covered	0	0	150	0	0	0

1. What additional data would be required to calculate the ratio percentage for Plan A, if the plans are not aggregated for testing?
2. How would the answer change if the employer elects to test otherwise excludable employees separately?

1.410(b)-6(c) NON-RESIDENT ALIENS

Can be excludable if no earned income (subject to income tax)

1.410(b)-6(d) COLLECTIVELY BARGAINED

- 1) If plan does not benefit ees under CBA, then all ees under CBA are excludable**
- 2) If plan benefits both CBA ees and non-CBA, must disaggregate, and treat as two separate plans**
- 3) Multiemployer plan rules
- 4) Plans covering professional employees
 - a) If > 2% of CBA ees are professionals, then no ees treated as covered by CBA
 - b) Another CBA's ees could be excludable

1.410(b)-6(f) TERMINATING EMPLOYEES

- i. Ee does not benefit under plan for the plan year, and**
- ii. Ee is eligible to participate, and**
- iii. To accrue benefit (or get allocation), plan has minimum period of svc, or last-day requirement, and**
- iv. Ee fails to accrue benefit solely due to failure to satisfy item iii, and**
- v. Ee terminates with 500 hours or less, not ee on last day plan yr (Or use 91 days or 3 months, based on plan service equivalents)**

These requirements must be applied with respect to all ees for the plan year

1.410(b)-3 DEFINITION - BENEFITING EES

Employees treated as benefiting for a plan year when they

) DC plan:

- receive an allocation of contributions or forfeitures (excludes allocation of income, expenses and gains / losses attributable to ee account)**
- eligible for 401(k) deferral**

) DB plan: receive increase in benefit treated as accrued benefit under 411(d)(6)

) 412(i) plan: premium paid on behalf of ee

Former employees are treated as benefiting for a plan year when the plan provides an allocation or benefit increase described above for the plan year (Ad hoc COLA example)

NOTE: Excludable employees are not taken into account, even if benefiting under the plan

1.410(b)-3 BENEFITING EES

Examples of Employees NOT considered as benefiting under a plan:

-) Not a plan participant**
-) Plan has frozen benefit accruals**
-) No contribution/forfeiture in profit sharing**

1.410(b)-3(a)(2)(iii) BENEFITING EES

Employees considered benefiting even when there are no benefit accruals:

-) Maximum service / benefit limit**
-) Wear away provisions (prior plan min)**
-) Floor offset arrangement**
-) Target benefit safe harbor**
-) Over age 65, no increase 411(b)(1)(H)(iii)**

415 LIMITS

-) In general, these are ignored**
-) Otherwise, apply 415 limits for accrual rates under 401(a)(4) general test**
-) If applied, ees at 415 limit may not benefit**

1.410(b)-2(b) RATIO % TEST ALTERNATIVES

Must satisfy one of the other tests under 2(b)

- 2(b)(3) Must satisfy both the Average Benefit Percentage Test, and the Nondiscriminatory classification test**
- 2(b)(4) Tax credit ESOP**
- 2(b)(5) Employer with no NHCEs**
- 2(b)(6) Plan with no HCES benefiting**
- 2(b)(7) Plan benefits only ees under CBA**

NOTE: If plan benefits both CBA ees and non-CBA, must disaggregate, and treat as two separate plans

1.410(b)-4(c)(4) NHCCP / SAFE / UN-SAFE HARBOR PERCENT

**Non-highly compensated concentration
percentage (NHCCP):**

$$\frac{\text{Non-excludable non-HCEs}}{\text{Non-excludable HCEs} + \text{Non-excludable non-HCEs}}$$

NOTES:

-) NHCCP is defined for “all ees of employer”.
Excludable employees are based on ABPT.**
-) Employees excluded due to age and service
are those who don’t meet any plan’s eligibility
requirements**
-) Truncate calculated NHCCP to look up Safe
Harbor % and Unsafe Harbor % in table**

EXAMPLE - NHCCP

Same three plans as page 16:

	Plan A		Plan B		401(k) Plan C	
	NHCEs	HCEs	NHCEs	HCEs	NHCEs	HCEs
Total employees	100	50	300	50	500	50
Excludable A+S	10	5	15	5	50	5
non-CBA Benefiting	80	40	100	40	400	40
CBA employees						
Not covered	0	0	150	0	0	0

1. What is the NHCCP for Plan B (plans are not aggregated for testing)?
2. What is the NHCCP for Plan B (plans are aggregated for testing)?
3. How would the answers change if
Plan A eligibility requirement: 6 months
Plan B eligibility requirement: age 21 + 1
Plan C eligibility requirement: 6 months

1.410(b)-4(b) REASONABLE CLASSIFICATION

Plans that fail the Ratio % test must pass both Nondiscriminatory classification requirement and Average Benefit Percentage test (ABPT)

Reasonable classification:

-) Based on facts + circumstances, the classification is reasonable**
-) Objective business criteria**
-) Generally includes**
 - Specified job categories**
 - Nature of compensation (hourly, salary)**
 - Geographic location**
 - Other bona fide business criteria**

1.410(b)-4(c) NONDISCRIM CLASS REQ

Ratio % as defined earlier

) Ratio % \geq Safe harbor percentage
Pass if reasonable classification of ees

) Safe harbor percentage $>$ Ratio % \geq Unsafe harbor percentage
May pass, subject to IRS facts and circumstances test

) Ratio % $<$ Unsafe harbor percentage
Fails - no way out

1.410(b)-5 AVERAGE BENEFIT PCT TEST

Plans that fail the Ratio % test must pass both Nondiscriminatory classification requirement and ABPT

Average Benefit Percentage test (ABPT):

$$\frac{\text{Actual Benefit Percentages non-HCEs}}{\text{non-excludable non-HCEs}}$$

$$\frac{\text{Actual Benefit Percentages HCEs}}{\text{non-excludable HCEs}}$$

) Pass if ratio \geq 70%

) All non-excludable ees taken into account, even if they are not benefiting

) Numerator and denominator calculations for the entire testing group

) Different rules for voluntary aggregation and mandatory disaggregation (see page 17)

EXAMPLE - AVERAGE BENEFIT % TEST

Same situation as page 16:

	Plan A		Plan B		401(k) Plan C	
	NHCEs	HCEs	NHCEs	HCEs	NHCEs	HCEs
Total employees	100	50	300	50	500	50
Excludable A+S	10	5	15	5	50	5
non-CBA Benefiting	80	40	100	40	400	40
CBA employees						
Not covered	0	0	150	0	0	0
Benefit Accrual Rate	1.0%	1.5%	2.0%	2.5%	2.0%	3.0%

1. What is the ABPT result for Plan B (plans are not aggregated for testing)?
2. What is the ABPT result for Plan B (plans are aggregated for testing)?
3. How would the answers change if
Plan A eligibility requirement: 6 months
Plan B eligibility requirement: age 21 + 1
Plan C eligibility requirement: 6 months

1.410(b)-5(d) EMPLOYEE BENEFIT %

**) Include employer-provided benefits only
(401(k) deferrals count as ER provided)**

**) All / Only plans in the testing group are used
for employee benefit %**

**) Testing period consists of plan years ending
in same calendar year**

**Use contributions basis, or benefits basis – but
same for ALL plans in the testing group. If DB
and DC plans, must use cross-testing (see page
401(a)(4)-40.)**

**) Option to separately use Contributions basis
for DC plans, and Benefits basis for DB
plans**

1.410(b)-5(d)(5) EMPLOYEE BENEFIT %

- 1. For DB plans, would be normal accrual rate under 401(a)(4) (see page 401(a)(4)-9)**
- 2. Must aggregate all plans in “testing group”**
- 3. Must be determined on consistent basis for all employees and all plans**
- 4. Must use most valuable accrual rate for all plans (instead of normal accrual rate) if**
 - a. Any plan has average early retirement reduction less than 4% per year for any age within 5 years of NRA**
 - b. Don’t have to use MVAR if subsidized early retirement reductions are currently available to at least 70% of NHCEs (see page 401(a)(4)-29)**
- 5. If plans in testing group have different plan years, apply rules to each subset of plans with the same plan year or accrual computation period, and aggregate results**

1.410(b)-5(d)(6) EMPLOYEE BENEFIT % IMPUTED PERMITTED DISPARITY

Permitted disparity (PD)

- **PD not allowed for some plans
(see page 401(I)-4)**
- **If multiple plans, normally can be imputed
for only one plan**
- **Exceptions – impute PD for multiple plans**
 - **Plans with same plan year, or average
annual comp, or plan year comp**
 - **Add benefit % together for multiple plans,
then impute PD**

1.410(b)-5(f) SPECIAL RULE – CBA PLAN

Plan will be deemed to satisfy the ABPT if:

- 1) Plan benefits employees under CBA, and employees not covered by CBA
- 2) Plan would satisfy the ratio percentage test if
 - a) CBA ees are not treated as excludable, and
 - b) Mandatory disaggregation rule for CBA is ignored
- 3) Plan provisions are identical for both classes of employees (including all Benefits, Rights and Features)

1.410(b)-8(a) TESTING METHODS

1. General

- a) Must use one of 3 methods below**
- b) Apply method both 410(b) and 401(a)(4)**
- c) Must use annual method for 401(k) or 401(m) plans, both for 410(b) and ABPT**
- d) Use plan provisions at last day of plan year for daily or quarterly**

2. Annual testing

- a) Satisfy 410(b) on last day of plan year**
- b) Consider ees (former ees) on any day**

3. Quarterly testing

- a) Satisfy 410(b) on at least one day of each quarter**
- b) Consider ees (former ees) on that day**
- c) Eligibility rule / benefit formula must operate so the four days are representative of coverage for the year**

4. Daily testing

- a) Satisfy 410(b) on each day**
- b) Consider ees (former ees) on that day**

410(b) SUMMARY

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401(a)(26) REVISITED

Each defined benefit plan must benefit at least the lesser of 50 employees, or the greater of

-) 40% of employees, or**
-) 2 employees (or 1, if only 1 employee)**

1.401(a)(26) rules for benefiting (and excludable) employees almost identical to 1.410(b) rules

BUT - no aggregation of plans allowed

1.401(a)(26)-1(b) EXCEPTIONS

Plans not subject to 401(a)(26)

- (1) Plan does not benefit any HCEs**
- (2) Multiemployer plans which cover CBA employees**
- (3) Underfunded plans where no employees / former employees are benefiting under 1.410(b)-3(a)**
 - (a) Plans covered by the PBGC, or**
 - (b) Plans not covered by the PBGC that are NOT Top Heavy**
- (4) 401(k) plans maintained by Governmental or tax-exempt entities**
- (5) 410(b)(6)(C) acquisitions or dispositions**

1.401(a)(26)-2(d)(1)

MANDATORY DISAGGREGATION

- i ESOPs and non-ESOPs**
- ii Multiemployer and Multiple employer plans**
- iii DB plans with other arrangements**
- iv Plans benefiting employees of QSLOBs**

1.401(a)(26)-2(d)(2)

PERMISSIVE DISAGGREGATION

- i Plans benefiting CBA employees**
- ii Plans benefiting otherwise excludable employees**

NO permissive aggregation!!
Each plan must satisfy 401(a)(26) separately

1.401(a)(26)-5 BENEFITING EMPLOYEES

Benefiting employees based on same rules as 1.410(b)-3(a), except for 412(i) plan rule

Benefiting former employees based on same rules as 1.410(b)-3(b)

1.401(a)(26)-6(b) EXCLUDABLE EMPLOYEES

Similar to 410(b) excludables

- 1) Minimum age / service (see page 410(b)-20)**
- 2) Certain air pilots**
- 3) Nonresident aliens**
- 4) Employees covered under CBA**
- 5) Employees not covered under CBA**
- 7) Terminating employees (see page 410(b)-24)**
- 8) Qualified Separate Lines of Business**

1.401(a)(26)-6(b) EXCLUDABLE EMPLOYEES

Employees covered under CBA

**If plan does not benefit employees under CBA,
then all employees under CBA are excludable**

Employees not covered under CBA

**If plan only benefits employees under CBA,
then all employees not covered under CBA are
excludable**

1.401(a)(26)-7 TESTING METHODS

(a) Each day

Employee benefits on a day if
) a participant on that day, and
) benefiting under the plan for the year

(b) Simplified testing

) Only need to satisfy 401(a)(26) on a single day
) Day must be representative of employer's workforce and plan coverage
) Testing day can vary from year to year