

Internal Revenue Service, Treasury

§ 1.401(l)-1

- (3) Defined contribution plans.
- (4) Defined benefit plans.
- (c) Compliance during transition period.

[T.D. 8359, 56 FR 47617, Sept. 19, 1991; 57 FR 10818, Mar. 31, 1992, as amended by T.D. 8486, 58 FR 46830, Sept. 3, 1993]

§ 1.401(l)-1 Permitted disparity in employer-provided contributions or benefits.

(a) *Permitted disparity*—(1) *In general.* Section 401(a)(4) provides that a plan is a qualified plan only if the amount of contributions or benefits provided under the plan does not discriminate in favor of highly compensated employees. See § 1.401(a)(4)-1(b)(2). Section 401(a)(5)(C) provides that a plan does not discriminate in favor of highly compensated employees merely because of disparities in employer-provided contributions or benefits provided to, or on behalf of, employees under the plan that are permitted under section 401(l). Thus, if a plan satisfies section 401(l), permitted disparities in employer-provided contributions or benefits under a plan are disregarded, by reason of section 401(a)(5)(C), in determining whether the plan satisfies any of the safe harbors under §§ 1.401(a)(4)-2(b)(2) and 1.401(a)(4)-3(b). However, even if disparities in employer-provided contributions or benefits under a plan are permitted under section 401(l) and thus do not cause the plan to fail to satisfy § 1.401(a)(4)-1(b)(2), the plan may still fail to satisfy section 401(a)(4) for other reasons. Similarly, even if disparities in employer-provided contributions or benefits under a plan are not permitted under section 401(l) and thus may not be disregarded under section 401(a)(4) by reason of section 401(l), the plan may still be found to be nondiscriminatory under the tests of section 401(a)(4), including the rules for imputing permitted disparity under § 1.401(a)(4)-7.

(2) *Overview.* Rules relating to disparities in employer-provided contributions under a defined contribution plan are provided in § 1.401(l)-2. For rules relating to disparities in employer-provided benefits under a defined benefit plan, see § 401(l)-3. For rules relating to the application of section 401(l) to a plan maintained by a railroad employer, see § 1.401(l)-4. For rules relat-

ing to the overall permitted disparity limits, see § 1.401(l)-5. For rules relating to the effective date of section 401(l), see § 1.401(l)-6.

(3) *Exclusive rules.* The rules provided in §§ 1.401(l)-1 through 1.401(l)-6 are the exclusive means for a plan to satisfy sections 401(l) and 401(a)(5)(C). Accordingly, a plan that provides disparities in employer-provided contributions or benefits that are not permitted under §§ 1.401(l)-1 through 1.401(l)-6 does not satisfy section 401(l) or 401(a)(5)(C).

(4) *Exceptions.* Sections 401(a)(5)(C) and 401(l) are not available in the following arrangements—

(i) A plan maintained by an employer, determined for purposes of the Federal Insurance Contributions Act or the Railroad Retirement Tax Act, as applicable, that does not pay any wages within the meaning of section 3121(a) or compensation within the meaning of section 3231(e). For this purpose, a plan maintained for a self-employed individual within the meaning of section 401(c)(1), who is also subject to the tax under section 1401, is deemed to be a plan maintained by an employer that pays wages within the meaning of section 3121(a).

(ii) A plan, or the portion of a plan, that is an employee stock ownership plan described in section 4975(e)(7) (an ESOP) or a tax credit employee stock ownership plan described in section 409(a) (a TRASOP), except as provided in § 54.4975-11(a)(7)(ii) of this chapter, which contains a limited exception to this rule for certain ESOPs in existence on November 1, 1977.

(iii) With respect to elective contributions as defined in § 1.401(k)-1(g)(3) under a qualified cash or deferred arrangement as defined in § 1.401(k)-1(a)(4)(i) or with respect to employee or matching contributions defined in § 1.401(m)-1(f)(6) or (f)(12), respectively.

(iv) With respect to contributions to a simplified employee pension made under a salary reduction arrangement described in section 408(k)(6) (a SARSEP).

(5) *Additional rules.* The Commissioner may, in revenue rulings, notices, or other documents of general applicability, prescribe additional rules that may be necessary or appropriate to carry out the purposes of section 401(l),

including rules applying section 401(l) with respect to an employer that pays wages within the meaning of section 3121(a) or compensation within the meaning of section 3231(e) for some years and not other years.

(b) *Relationship to other requirements.* Unless explicitly provided otherwise, section 401(l) does not provide an exception to any other requirement under section 401(a). Thus, for example, even if the plan complies with section 401(l), the plan may not provide a benefit lower than the minimum benefit required under section 416. Moreover, a plan may not adjust benefits in any manner that results in a decrease in any employee's accrued benefit in violation of section 411(d)(6) and section 411(b)(1)(G). However, a plan does not fail to satisfy section 401(l) merely because, in order to ensure compliance with section 411, an employee's accrued benefit under the plan is defined as the greater of the employee's previously accrued benefit and the benefit determined under a strict application of the plan's benefit formula and accrual method. See section 401(a)(15) for additional rules relating to circumstances under which plan benefits may not be decreased because of increases in social security benefits.

(c) *Definitions.* In applying §§ 1.401(l)-1 through 1.401(l)-6, the definitions in this paragraph (c) govern unless otherwise provided.

(1) *Accumulation plan.* *Accumulation plan* means an accumulation plan within the meaning of § 1.401(a)(4)-12.

(2) *Average annual compensation.* *Average annual compensation* means average annual compensation within the meaning of § 1.401(a)(4)-3(e)(2).

(3) *Base benefit percentage.* *Base benefit percentage* means the rate at which employer-provided benefits are determined under a defined benefit excess plan with respect to an employee's average annual compensation at or below the integration level (expressed as a percentage of such average annual compensation).

(4) *Base contribution percentage.* *Base contribution percentage* means the rate at which employer contributions are allocated to the account of an employee under a defined contribution excess plan with respect to the employ-

ee's plan year compensation at or below the integration level (expressed as a percentage of such plan year compensation).

(5) *Benefit formula.* *Benefit formula* means benefit formula within the meaning of § 1.401(a)(4)-12.

(6) *Benefit, right, or feature.* *Benefit, right, or feature* means a benefit, right, or feature within the meaning of § 1.401(a)(4)-12.

(7) *Covered compensation*—(i) *In general.* *Covered compensation* for an employee means the average (without indexing) of the taxable wage bases in effect for each calendar year during the 35-year period ending with the last day of the calendar year in which the employee attains (or will attain) social security retirement age. A 35-year period is used for all individuals regardless of the year of birth of the individual. In determining an employee's covered compensation for a plan year, the taxable wage base for all calendar years beginning after the first day of the plan year is assumed to be the same as the taxable wage base in effect as of the beginning of the plan year. An employee's covered compensation for a plan year beginning after the 35-year period applicable under this paragraph (c)(7)(i) is the employee's covered compensation for the plan year during which the 35-year period ends. An employee's covered compensation for a plan year beginning before the 35-year period applicable under this paragraph (c)(7)(i) is the taxable wage base in effect as of the beginning of the plan year.

(ii) *Special rules*—(A) *Rounded table.* For purposes of determining the amount of an employee's covered compensation under paragraph (c)(7)(i) of this section, a plan may use tables, provided by the Commissioner, that are developed by rounding the actual amounts of covered compensation for different years of birth.

(B) *Proposed regulation definition.* For plan years beginning before January 1, 1995, in lieu of the definition of covered compensation contained in paragraph (c)(7)(i) of this section, a plan may define covered compensation as the average (without indexing) of the taxable wage bases in effect for each calendar year during the 35-year period ending

with the last day of the calendar year preceding the calendar year in which the employee attains (or will attain) social security retirement age.

(iii) *Period for using covered compensation amount.* A plan must generally provide that an employee's covered compensation is automatically adjusted for each plan year. However, a plan may use an amount of covered compensation for employees equal to each employee's covered compensation (as defined in paragraph (c)(7)(i) or (c)(7)(ii) of this section) for a plan year earlier than the current plan year, provided the earlier plan year is the same for all employees and is not earlier than the later of—

(A) The plan year that begins 5 years before the current plan year, and

(B) The plan year beginning in 1989.

In the case of an accumulation plan, the benefit accrued for an employee in prior years is not affected by changes in the employee's covered compensation that occur in later years.

(8) *Defined benefit plan.* *Defined benefit plan* means a defined benefit plan within the meaning of § 1.410(b)-9.

(9) *Defined contribution plan.* *Defined contribution plan* means a defined contribution plan within the meaning of § 1.410(b)-9. In addition, for purposes of §§ 1.401(l)-1 through 1.401(l)-6, a defined contribution plan includes a simplified employee pension as defined in section 408(k) (SEP), other than a SEP (or portion or a SEP) that is a salary reduction arrangement described in section 408(k)(6) (SARSEP).

(10) *Disparity.* *Disparity* means—

(i) In the case of a defined contribution excess plan, the amount by which the excess contribution percentage exceeds the base contribution percentage,

(ii) In the case of a defined benefit excess plan, the amount by which the excess benefit percentage exceeds the base benefit percentage, and

(iii) In the case of an offset plan, the offset percentage.

(11) *Employee.* *Employee* means employee within the meaning of § 1.401(a)(4)-12.

(12) *Employer.* *Employer* means the employer within the meaning of § 1.410(b)-9.

(13) *Employer contributions.* *Employer contributions* means all amounts taken

into account with respect to an employee under a plan under § 1.401(a)(4)-2(c)(2)(ii).

(14) *Excess benefit percentage.* *Excess benefit percentage* means the rate at which employer-provided benefits are determined under a defined benefit excess plan with respect to an employee's average annual compensation above the integration level (expressed as a percentage of such average annual compensation).

(15) *Excess contribution percentage.* *Excess contribution percentage* means the rate at which employer contributions are allocated to the account of an employee under a defined contribution excess plan with respect to the employee's plan year compensation above the integration level (expressed as a percentage of such plan year compensation).

(16) *Excess plan—(i) Defined benefit excess plan.* *Defined benefit excess plan* means a defined benefit plan under which the rate at which employer-provided benefits are determined with respect to average annual compensation above the integration level under the plan (expressed as a percentage of such average annual compensation) is greater than the rate at which employer-provided benefits are determined with respect to average annual compensation at or below the integration level (expressed as a percentage of such average annual compensation).

(ii) *Defined contribution excess plan.* *Defined contribution excess plan* means a defined contribution plan under which the rate at which employer contributions are allocated to the account of an employee with respect to plan year compensation above the integration level (expressed as a percentage of such plan year compensation) is greater than the rate at which employer contributions are allocated to the account of an employee with respect to plan year compensation at or below the integration level (expressed as a percentage of such plan year compensation).

(17) *Final average compensation—(i) In general.* *Final average compensation* for an employee means the average of the employee's annual section 414(s) compensation for the 3-consecutive-year period ending with or within the plan year or for the employee's period of

employment if shorter. The year in which an employee terminates employment may be disregarded in determining final average compensation. The definition of final average compensation used in the plan must be applied consistently with respect to all employees. For example, if the plan provides that the year in which the employee terminates employment is disregarded in determining final average compensation, the year must be disregarded for all employees who terminate employment in that year. The plan may specify any 3-consecutive-year period ending in the plan year, provided the period is determined consistently for all employees. See § 1.401(a)(4)-11(d)(3)(iii) and § 1.414(s)-1(f) for rules permitting service and compensation with another employer to be taken into account for purposes of non-discrimination testing, including satisfying section 401(l).

(ii) *Limitations.* In determining an employee's final average compensation under this paragraph (c)(17), annual section 414(s) compensation for any year in excess of the taxable wage base in effect at the beginning of that year must not be taken into account. A plan may provide that each employee's final average compensation for a plan year is limited to the employee's average annual compensation for the plan year.

(iii) *Determination of section 414(s) compensation.* A plan must use the same definition of section 414(s) compensation to determine final average compensation as the plan uses to determine average annual compensation (or plan year compensation in the case of an accumulation plan).

(18) *Gross benefit percentage.* *Gross benefit percentage* means the rate at which employer-provided benefits are determined under an offset plan (before application of the offset) with respect to an employee's average annual compensation (expressed as a percentage of average annual compensation).

(19) *Highly compensated employee.* *Highly compensated employee* means HCE within the meaning of § 1.401(a)(4)-12.

(20) *Integration level.* *Integration level* means the dollar amount specified in an excess plan at or below which the rate of employer-provided contribu-

tions or benefits (expressed in each case as a percentage of an employee's plan year compensation or average annual compensation up to the specified dollar amount) under the plan is less than the rate of employer-provided contributions or benefits (expressed in each case as a percentage of the employee's plan year compensation or average annual compensation above the specified dollar amount) under the plan above such dollar amount.

(21) *Nonexcludable employee.* *Nonexcludable employee* means nonexcludable employee within the meaning of § 1.401(a)(4)-12.

(22) *Nonhighly compensated employee.* *Nonhighly compensated employee* means NHCE within the meaning of § 1.401(a)(4)-12.

(23) *Offset level.* *Offset level* means the dollar limit specified in the plan on the amount of each employee's final average compensation taken into account in determining the offset under an offset plan.

(24) *Offset percentage.* *Offset percentage* means the rate at which an employee's employer-provided benefit is reduced or offset under an offset plan (expressed as a percentage of the employee's final average compensation up to the offset level).

(25) *Offset plan.* *Offset plan* means a defined benefit plan that is not a defined benefit excess plan and that provides that each employee's employer-provided benefit is reduced or offset by a specified percentage of the employee's final average compensation up to the offset level under the plan.

(26) *PIA.* *PIA* or *primary insurance amount* means the old-age insurance benefit under section 202 of the Social Security Act (42 U.S.C. 402) payable to each employee at a single age that is not earlier than age 62 and not later than age 65. PIA must be determined under the Social Security Act as in effect at the time the employee's offset is determined. Thus, it is determined without assuming any future increases in compensation, any future increases in the taxable wage base, any changes in the formulas used under the Social Security Act to determine PIA (for example, changes in the breakpoints), or any future increases in the consumer

price index. However, it may be assumed that the employee will continue to receive compensation at the same rate as that received at the time the offset is being determined, until reaching the single age described in the first sentence of this paragraph (c)(26). PIA must be determined in a consistent manner for all employees and in accordance with revenue rulings or other guidance provided by the Commissioner.

(27) *Plan.* *Plan* means a plan within the meaning of § 1.401(a)(4)-12 or a component plan treated as a plan under § 1.401(a)(4)-9(c).

(28) *Plan year compensation.* *Plan year compensation* means plan year compensation within the meaning of § 1.401(a)(4)-12.

(29) *Qualified plan.* *Qualified plan* means a qualified plan within the meaning of § 1.401(a)(4)-12.

(30) *Section 401(l) plan.* *Section 401(l) plan* means a section 401(l) plan within the meaning of § 1.401(a)(4)-12.

(31) *Section 414(s) compensation.* *Section 414(s) compensation* means section 414(s) compensation within the meaning of § 1.401(a)(4)-12.

(32) *Social security retirement age.* *Social security retirement age* for an employee means the social security retirement age of the employee as determined under section 415(b)(8).

(33) *Straight life annuity.* *Straight life annuity* means a straight life annuity within the meaning of § 1.401(a)(4)-12.

(34) *Taxable wage base.* *Taxable wage base* means the contribution and benefit base under section 230 of the Social Security Act (42 U.S.C. 430).

(35) *Year of service.* *Year of service* means a year of service as defined in the plan for purposes of the benefit formula and the accrual method under the plan, unless the context clearly indicates otherwise. See § 1.401(a)(4)-11(d)(3) for rules on years of service that may be taken into account for purposes of nondiscrimination testing, including satisfying section 401(l).

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§ 1.401(l)-2 Permitted disparity for defined contribution plans.

(a) *Requirements*—(1) *In general.* Disparity in the rates of employer contributions allocated to employees' accounts under a defined contribution plan is permitted under section 401(l) and this section for a plan year only if the plan satisfies paragraphs (a)(2) through (a)(5) of this section. A plan that otherwise satisfies this paragraph (a) will not be considered to fail section 401(l) merely because it contains one or more provisions described in § 1.401(a)(4)-2(b)(4). See § 1.401(a)(4)-8(b)(3)(i)(C) for special rules applicable to target benefit plans.

(2) *Excess plan requirement.* The plan must be a defined contribution excess plan.

(3) *Maximum disparity.* The disparity for all employees under the plan must not exceed the maximum permitted disparity prescribed in paragraph (b) of this section.

(4) *Uniform disparity.* The disparity for all employees under the plan must be uniform within the meaning of paragraph (c) of this section.

(5) *Integration level.* The integration level specified in the plan must satisfy paragraph (d) of this section.

(b) *Maximum permitted disparity*—(1) *In general.* The disparity provided for the plan year must not exceed the maximum excess allowance as defined in paragraph (b)(2) of this section. In addition, the plan must satisfy the overall permitted disparity limits of § 1.401(l)-5.

(2) *Maximum excess allowance.* The maximum excess allowance for a plan year is the lesser of—

(i) The base contribution percentage, or

(ii) The greater of—

(A) 5.7 percent, reduced as required under paragraph (d) of this section, or

(B) The percentage rate of tax under section 3111(a), in effect as of the beginning of the plan year, that is attributable to the old age insurance portion of the Old Age, Survivors and Disability Insurance provisions of the Social Security Act, reduced as required under paragraph (d) of this section. For a year in which the percentage rate of tax described in this paragraph (b)(2)(ii)(B) exceeds 5.7 percent, the