

supplementing the benefits provided by other Federal or State laws. See section 401(a)(5).

(5) If a plan provides contributions or benefits for a self-employed individual, the rules relating to the integration of such a plan with the contributions or benefits under the Social Security Act are set forth in paragraph (c) of § 1.401-11 and paragraph (h) of § 1.401-12.

(6) This paragraph (e) does not apply to plan years beginning on or after January 1, 1989.

(f) An employer may designate several trusts or a trust or trusts and an annuity plan or plans as constituting one plan which is intended to qualify under section 401(a)(3), in which case all of such trusts and plans taken as a whole may meet the requirements of such section. The fact that such combination of trusts and plans fails to qualify as one plan does not prevent such of the trusts and plans as qualify from meeting the requirements of section 401(a).

(g) It is provided in section 401(a)(6) that a plan will satisfy the requirements of section 401(a)(3), if on at least one day in each quarter of the taxable year of the plan it satisfies such requirements. This makes it possible for a new plan requiring contributions from employees to qualify if by the end of the quarter-year in which the plan is adopted it secures sufficient contributing participants to meet the requirements of section 401(a)(3). It also affords a period of time in which new participants may be secured to replace former participants, so as to meet the requirements of either subparagraph (A) or (B) of section 401(a)(3).

[T.D. 6500, 25 FR 11672, Nov. 26, 1960, as amended by T.D. 6675, 28 FR 10119, Sept. 17, 1963; T.D. 6982, 33 FR 16499, Nov. 13, 1968; T.D. 7134, 36 FR 13592, July 22, 1971; 36 FR 13990, July 29, 1971; T.D. 8359, 56 FR 47614, Sept. 19, 1991]

§ 1.401-4 Discrimination as to contributions or benefits (before 1994).

(a)(1)(i) In order to qualify under section 401(a), a trust must not only meet the coverage requirements of section 401(a)(3), but, as provided in section 401(a)(4), it must also be part of a plan under which there is no discrimination in contributions or benefits in favor of

officers, shareholders, employees whose principal duties consist in supervising the work of other employees, or highly compensated employees as against other employees whether within or without the plan.

(ii) Since, for the purpose of section 401, a profit-sharing plan is a plan which provides for distributing the funds accumulated under the plan after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as illness, disability, retirement, death, lay-off, or severance of employment, any amount allocated to an employee which is withdrawn before the expiration of such a period of time or the occurrence of such a contingency shall not be considered in determining whether the contributions under the plan discriminate in favor of officers, shareholders, employees whose principal duties consist in supervising the work of other employees, or highly compensated employees. Thus, in case a plan permits employees to receive immediately the whole or any part of the amounts allocated to their accounts, or to have the whole or any part of such amounts paid to a profit-sharing plan for them, any amounts which are received immediately shall not, for the purpose of section 401, be considered contributed to a profit-sharing plan.

(iii) Funds in a stock bonus or profit-sharing plan arising from forfeitures on termination of service, or other reason, must not be allocated to the remaining participants in such a manner as will effect the prohibited discrimination. With respect to forfeitures in a pension plan, see § 1.401-7.

(2)(i) Section 401(a)(5) sets out certain provisions which will not in and of themselves be discriminatory within the meaning of section 401(a)(3) or (4). See § 1.401-3. Thus, a plan will not be considered discriminatory merely because the contributions or benefits bear a uniform relationship to total compensation or to the basic or regular rate of compensation, or merely because the contributions or benefits based on that part of the annual compensation of employees which is subject to the Federal Insurance Contributions Act (chapter 21 of the Code) differ

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from the contributions or benefits based on any excess of such annual compensation over such part. With regard to the application of the rules of section 401(a)(5) in the case of a plan which benefits a self-employed individual, see paragraph (c) of § 1.401-11.

(ii) The exceptions specified in section 401(a)(5) are not an exclusive enumeration, but are merely a recital of provisions frequently encountered which will not of themselves constitute forbidden discrimination in contributions or benefits.

(iii) Variations in contributions or benefits may be provided so long as the plan, viewed as a whole for the benefit of employees in general, with all its attendant circumstances, does not discriminate in favor of employees within the enumerations with respect to which discrimination is prohibited. Thus, benefits in a stock bonus or profit-sharing plan which vary by reason of an allocation formula which takes into consideration years of service, or other factors, are not prohibited unless they discriminate in favor of such employees.

(b) A plan which excludes all employees whose entire remuneration constitutes wages under section 3121(a)(1) (relating to the Federal Insurance Contributions Act), or a plan under which the contributions or benefits based on that part of an employee's remuneration which is excluded from "wages" under such act differs from the contributions or benefits based on that part of the employee's remuneration which is not so excluded, or a plan under which the contributions or benefits differ because of any retirement benefit created under State or Federal law, will not be discriminatory because of such exclusion or difference, provided the total benefits resulting under the plan and under such law establish an integrated and correlated retirement system satisfying the tests of section 401(a).

(c)(1) Although a qualified plan may provide for termination at will by the employer or discontinuance of contributions thereunder, this will not of itself prevent a trust from being a qualified trust. However, a qualified pension plan must expressly incorporate provisions which comply with

the restrictions contained in subparagraph (2) of this paragraph at the time the plan is established, unless (i) it is reasonably certain at the inception of the plan that such restrictions would not affect the amount of contributions which may be used for the benefit of any employee, or (ii) the Commissioner determines that such provisions are not necessary to prevent the prohibited discrimination that may occur in the event of any early termination of the plan. Although these provisions are the only provisions required to be incorporated in the plan to prevent the discrimination that may arise because of an early termination of the plan, the plan may in operation result in the discrimination prohibited by section 401(a)(4), unless other provisions are later incorporated in the plan. Any pension plan containing a provision described in this paragraph shall not fail to satisfy section 411(a), (d)(2) and (d)(3) merely by reason of such a plan provision. Paragraph (c)(7) of this section sets forth special early termination rules applicable to certain qualified defined benefit plans for plan years affected by the Employee Retirement Income Security Act of 1974 ("ERISA"). Paragraph (c)(7) of this section does not contain all the rules required by the enactment of ERISA.

(2)(i) If employer contributions under a qualified pension plan may be used for the benefit of an employee who is among the 25 highest paid employees of the employer at the time the plan is established and whose anticipated annual pension under the plan exceeds \$1,500, such plan must provide that upon the occurrence of the conditions described in subdivision (ii) of this subparagraph, the employer contributions which are used for the benefit of any such employee are restricted in accordance with subdivision (iii) of this subparagraph.

(ii) The restrictions described in subdivision (iii) of this subparagraph become applicable if—

(A) The plan is terminated within 10 years after its establishment,

(B) The benefits of an employee described in subdivision (i) of this subparagraph become payable within 10 years after the establishment of the plan, or

(C) The benefits of an employee described in subdivision (i) of this subparagraph become payable after the plan has been in effect for 10 years, and the full current costs of the plan for the first 10 years have not been funded. In the case of an employee described in (B) of this subdivision, the restrictions will remain applicable until the plan has been in effect for 10 years, but if at that time the full current costs have been funded the restrictions will no longer apply to the benefits payable to such an employee. In the case of an employee described in (B) or (C) of this subdivision, if at the end of the first 10 years the full current costs are not met, the restrictions will continue to apply until the full current costs are funded for the first time.

(iii) The restrictions required under subdivision (i) of this subparagraph must provide that the employer contributions which may be used for the benefit of an employee described in such subdivision shall not exceed the greater of \$20,000, or 20 percent of the first \$50,000 of the annual compensation of such employee multiplied by the number of years between the date of the establishment of the plan and—

(A) The date of the termination of the plan,

(B) In the case of an employee described in subdivision (ii)(B) of this subparagraph, the date the benefit of the employee becomes payable, if before the date of the termination of the plan, or

(C) In the case of an employee described in subdivision (ii)(C) of this subparagraph, the date of the failure to meet the full current costs of the plan. However, if the full current costs of the plan have not been met on the date described in (A) or (B) of this subdivision, whichever is applicable, then the date of the failure to meet such full current costs shall be substituted for the date referred to in (A) or (B) of this subdivision. For purposes of determining the contributions which may be used for the benefit of an employee when (b) of this subdivision applies, the number of years taken into account may be re-computed for each year if the full current costs of the plan are met for such year.

(iv) For purposes of this subparagraph, the employer contributions which, at a given time, may be used for the benefits of an employee include any unallocated funds which would be used for his benefits if the plan were then terminated or the employee were then to withdraw from the plan, as well as all contributions allocated up to that time exclusively for his benefits.

(v) The provisions of this subparagraph apply to a former or retired employee of the employer, as well as to an employee still in the employer's service.

(vi) The following terms are defined for purposes of this subparagraph—

(A) The term "benefits" includes any periodic income, any withdrawal values payable to a living employee, and the cost of any death benefits which may be payable after retirement on behalf of an employee, but does not include the cost of any death benefits with respect to an employee before retirement nor the amount of any death benefits actually payable after the death of an employee whether such death occurs before or after retirement.

(B) The term *full current costs* means the normal cost, as defined in § 1.404(a)-6, for all years since the effective date of the plan, plus interest on any unfunded liability during such period.

(C) The term *annual compensation* of an employee means either such employee's average regular annual compensation, or such average compensation over the last five years, or such employee's last annual compensation if such compensation is reasonably similar to his average regular annual compensation for the five preceding years.

(3) The amount of the employer contributions which can be used for the benefit of a restricted employee may be limited either by limiting the annual amount of the employer contributions for the designated employee during the period affected by the limitation, or by limiting the amount of funds under the plan which can be used for the benefit of such employee, regardless of the amount of employer contributions.

(4) The restrictions contained in subparagraph (2) of this paragraph may be exceeded for the purpose of making current retirement income benefit payments to retired employees who would

otherwise be subject to such restrictions, if—

(i) The employer contributions which may be used for any such employee in accordance with the restrictions contained in subparagraph (2) of this paragraph are applied either (A) to provide level amounts of annuity in the basic form of benefit provided for under the plan for such employee at retirement (or, if he has already retired, beginning immediately), or (B) to provide level amounts of annuity in an optional form of benefit provided under the plan if the level amount of annuity under such optional form of benefit is not greater than the level amount of annuity under the basic form of benefit provided under the plan;

(ii) The annuity thus provided is supplemented, to the extent necessary to provide the full retirement income benefits in the basic form called for under the plan, by current payments to such employee as such benefits come due; and

(iii) Such supplemental payments are made at any time only if the full current costs of the plan have then been met, or the aggregate of such supplemental payments for all such employees does not exceed the aggregate employer contributions already made under the plan in the year then current.

If disability income benefits are provided under the plan, the plan may contain like provisions with respect to the current payment of such benefits.

(5) If a plan has been changed so as to increase substantially the extent of possible discrimination as to contributions and as to benefits actually payable in event of the subsequent termination of the plan or the subsequent discontinuance of contributions thereunder, then the provisions of this paragraph shall be applied to the plan as so changed as if it were a new plan established on the date of such change. However, the provision in subparagraph (2)(iii) of this paragraph that the unrestricted amount of employer contributions on behalf of any employee is at least \$20,000 is applicable to the aggregate amount contributed by the employer on behalf of such employee from the date of establishment of the original plan, and, for purposes of deter-

mining if the employee's anticipated annual pension exceeds \$1,500, both the employer contributions on the employee's behalf prior to the date of the change in the plan and those expected to be made on his behalf subsequent to the date of the change (based on the employee's rate of compensation on the date of the change) are to be taken into account.

(6) This paragraph shall apply to taxable years of a qualified plan commencing after September 30, 1963. In the case of an early termination of a qualified pension plan during any such taxable year, the employer contributions which may be used for the benefit of any employee must conform to the requirements of this paragraph. However, any pension plan which is qualified on September 30, 1963, will not be disqualified merely because it does not expressly include the provisions prescribed in this paragraph.

(7)(i) A qualified defined benefit plan subject to section 412 (without regard to section 412(h)(2)) shall not be required to contain the restriction described in paragraph (c)(2)(ii)(c) of this section applicable to an employee in a plan whose full current costs for the first 10 years have not been funded.

(ii) A qualified defined benefit plan covered by section 4021(a) of ERISA ("qualified Title IV plan") shall satisfy the restrictions in paragraph (c)(2) of this section only if the plan satisfies this paragraph (c)(7). A plan satisfies this paragraph (c)(7) by providing that employer contributions which may be used for the benefit of an employee described in paragraph (c)(2) of this section who is a substantial owner, as defined in section 4022(b)(5) of ERISA, shall not exceed the greater of the dollar amount described in paragraph (c)(2)(iii) of this section or a dollar amount which equals the present value of the benefit guaranteed for such employee under section 4022 of ERISA, or if the plan has not terminated, the present value of the benefit that would be guaranteed if the plan terminated on the date the benefit commences, determined in accordance with regulations of the Pension Benefit Guaranty Corporation ("PBGC").

(iii) A plan satisfies this paragraph (c)(7) by providing that employer contributions which may be used for the benefit of all employees described in paragraph (c)(2) of this section (other than an employee who is a substantial owner as defined in section 4022(b)(5) of ERISA) shall not exceed the greater of the dollar amount described in paragraph (c)(2)(iii) of this section or a dollar amount which equals the present value of the maximum benefit described in section 4022(b)(3)(B) of ERISA (determined on the date the plan terminates or on the date benefits commence, whichever is earlier and determined in accordance with regulations of PBGC) without regard to any other limitations in section 4022 of ERISA.

(iv) A plan provision satisfying this paragraph (c)(7) may be adopted by amendment or by incorporation at the time of establishment. Any allocation of assets attributable to employer contributions to an employee which exceeds the dollar limitation in this paragraph (c)(7) may be reallocated to prevent prohibited discrimination.

(v) The early termination rules in the preceding subparagraphs (1) through (6) apply to a qualified Title IV plan except where such rules are determined by the Commissioner to be inconsistent with the rules of this paragraph (c)(7), § 1.411(d)-2, and section 4044(b)(4) of ERISA. The early termination rules of this paragraph (c)(7) contain some of the rules under section 401(a)(4) and (a)(7), as in effect on September 2, 1974, and section 411(d) (2) and (3). Section 1.411(d)-2 also contains certain discrimination and vesting rules which are applicable to plan terminations.

(vi) Paragraph (c)(7) of this section applies to plan terminations occurring on or after March 12, 1984. For distributions not on account of plan terminations, paragraph (c)(7) applies to distributions in plan years beginning after December 31, 1983. However, a plan may elect to apply that paragraph to distributions not on account of plan termination on or after January 10, 1984.

(d)(1) Except as provided in paragraph (d)(2) of this section, the provisions of this section do not apply to plan years beginning on or after January 1, 1994. For rules applicable to plan

years beginning on or after January 1, 1994, see §§ 1.401(a)(4)-1 through 1.401(a)(4)-13.

(2) In the case of plans maintained by organizations exempt from income taxation under section 501(a), including plans subject to section 403(b)(12)(A)(i) (nonelective plans), the provisions of this section do not apply to plan years beginning on or after January 1, 1996. For rules applicable to plan years beginning on or after January 1, 1996, see §§ 1.401(a)(4)-1 through 1.401(a)(4)-13.

(Secs. 411 (d)(2) and (3) and 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 88 Stat. 912; 26 U.S.C. 411(d)(2) and (3) and 7805))

[T.D. 6500, 25 FR 11674, Nov. 26, 1960, as amended by T.D. 6675, 28 FR 10119, Sept. 17, 1963; T.D. 7934, 49 FR 1183, Jan. 10, 1984; 49 FR 2104, Jan. 18, 1984; T.D. 8360, 56 FR 47536, Sept. 19, 1991; T.D. 8485, 58 FR 46778, Sept. 3, 1993]

§ 1.401-5 Period for which requirements of section 401(a) (3), (4), (5), and (6) are applicable with respect to plans put into effect before September 2, 1974.

A pension, profit-sharing, stock bonus, or annuity plan shall be considered as satisfying the requirements of section 401(a) (3), (4), (5), and (6) for the period beginning with the date on which it was put into effect and ending with the 15th day of the third month following the close of the taxable year of the employer in which the plan was put into effect, if all the provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes with respect to the whole of such period. Thus, if an employer in 1954 adopts such a plan as of January 1, 1954, and makes a return on the basis of the calendar year, he will have until March 15, 1955, to amend his plan so as to make it satisfy the requirements of section 401(a) (3), (4), (5), and (6) for the calendar year 1954 provided that by March 15, 1955, all provisions of such plan necessary to satisfy such requirements are in effect and have been made retroactive for all purposes to January 1, 1954, the effective date of the plan. If an employer is on a fiscal year basis, for example, April 1 to March 31, and in 1954 adopts such a plan effective as of April 1, 1954, he will have until June 15, 1955, to