

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(a)(4)-1: Nondiscrimination requirements of § 401(a)(4)
(Also, §§ 410, 416; 1.410(b)-6, 1.416-1.)

Nondiscrimination and coverage; rollover. The nondiscrimination, actual deferral percentage, and actual contribution percentage tests of a qualified plan are not affected by a qualified rollover to that plan prior to the individual who makes the rollover meeting the plan's age and service requirements. In addition, the rollover will not trigger the minimum nonintegrated benefit or minimum nonintegrated contribution requirements of section 416(c) of the Code.

Rev. Rul. 96-48

ISSUES

(1) If, under a qualified retirement plan, employees who have not satisfied the minimum age and service requirements for participation for a plan year are permitted to make "rollover contributions" to the plan's trust, to what extent are such employees taken into account for purposes of the minimum coverage requirements of § 410(b) of the Internal Revenue Code and the nondiscrimination requirements of §§ 401(a)(4), 401(k)(3), and 401(m)(2)?

(2) Are the employees described in Issue 1 participants for purposes of the minimum contribution and benefit requirements of § 416(c)?

FACTS

Employer X maintains Plan A, a profit-sharing plan qualified under § 401(a) that includes a qualified cash or deferred arrangement, as defined in § 1.401(k)-1(a)(4)(i) of the Income Tax Regulations, and that provides for matching contributions and nonelective contributions. Plan A does not accept after-tax employee contributions. Employer X consists of Division M and Division N. Employees of Division M are eligible to participate in Plan A, i.e., to make salary deferral contributions and receive allocations of matching and nonelective contributions, when they have completed one year of service with Employer X. Employees of Division M who have satisfied Plan A's minimum one year of service requirement are also permitted to make rollover contributions to Plan A's trust. Effective January 1,

1997, Plan A is amended to permit all employees of Division M, including employees who have not completed one year of service, to make rollover contributions to Plan A's trust at any time following commencement of employment. Plan A defines a rollover contribution as a rollover contribution under § 402(c), 403(a)(4), or 408(d)(3)(A)(ii), or a direct rollover under § 401(a)(31).

LAW AND ANALYSIS (ISSUE 1)

MINIMUM COVERAGE REQUIREMENTS OF § 410(b)

Section 410(b) describes minimum coverage requirements that a plan must satisfy in order to be qualified under § 401(a). Under § 1.410(b)-7(c)(1), a plan that consists of (1) elective contributions under a section 401(k) plan (as defined in § 1.410(b)-9), (2) employee and matching contributions under a section 401(m) plan (as defined in § 1.410(b)-9), and (3) nonelective contributions (which are contributions that are neither elective, employee, nor matching contributions) is treated as three separate plans, each of which must separately satisfy the requirements of § 410(b). Under § 1.410(b)-6(b), if a plan applies minimum age and service eligibility conditions permissible under § 410(a)(1) (including any entry date conditions under § 410(b)(4)(C)) and excludes all employees who do not meet those conditions from benefiting under the plan, then all employees who fail to satisfy those conditions are excludable employees for purposes of determining whether the plan satisfies § 410(b).

With respect to the portion of Plan A that is a section 401(k) plan, § 1.410(b)-3(a)(2)(i) provides that an employee is treated as benefiting under the plan for a plan year if and only if the employee is an eligible employee under the plan for the plan year, as defined in § 1.401(k)-1(g)(4). In general, under § 1.401(k)-1(g)(4), an employee is an eligible employee only if the employee is directly or indirectly eligible to make a cash or deferred election under the plan for all or a portion of the plan year.

Section 1.401(k)-1(a)(3)(i) defines a cash or deferred election as any election by an employee to have the employer either provide an amount to the employee in cash or another taxable benefit that is not currently available, or contribute an amount to a trust, or provide

an accrual or other benefit, under a plan deferring the receipt of compensation. An election to make a rollover contribution under Plan A is not a cash or deferred election. Consequently, the employees who are not eligible to make salary deferral contributions for a plan year because they have not met Plan A's minimum one year of service requirement are not eligible employees within the meaning of § 1.401(k)-1(g)(4) and are not treated as benefiting under the portion of Plan A that is a section 401(k) plan even though they are eligible to make rollover contributions under Plan A.

With respect to the portion of Plan A that is a section 401(m) plan, § 1.410(b)-3(a)(2)(i) provides that an employee is treated as benefiting under the plan for a plan year if and only if the employee is an eligible employee under the plan for the plan year, as defined in § 1.401(m)-1(f)(4). In general, under § 1.401(m)-1(f)(4), an employee is an eligible employee only if the employee is directly or indirectly eligible to make an employee contribution or to receive an allocation of matching contributions under the plan for the plan year.

Section 1.401(m)-1(f)(6) defines employee contribution to mean any mandatory or voluntary contribution to the plan that is treated at the time of contribution as an after-tax employee contribution. The rollover contributions that are permitted under Plan A are not after-tax contributions and therefore are not employee contributions for purposes of § 401(m). Consequently, the employees who are not eligible to receive allocations of matching contributions for a plan year because they have not met Plan A's minimum one year of service requirement are not eligible employees within the meaning of § 1.401(m)-1(f)(4) and are not treated as benefiting under the portion of Plan A that is a section 401(m) plan even though they are eligible to make rollover contributions under Plan A.

With respect to the portion of Plan A that is treated as a separate plan consisting of nonelective contributions, § 1.410(b)-3(a)(1) provides that an employee is treated as benefiting under the plan for a plan year if and only if the employee receives an allocation for the plan year that is taken into account under § 1.401(a)(4)-2(c)(2)(ii) in determining whether the plan satisfies the

nondiscriminatory amount requirement of § 1.401(a)(4)–1(b)(2). As provided in § 1.401(a)(4)–11(b)(1), rollover contributions are not taken into account in determining whether a plan satisfies the nondiscriminatory amount requirement of § 1.401(a)(4)–1(b)(2). Consequently, the employees who do not receive allocations of nonelective contributions for a plan year because they have not satisfied Plan A's minimum one year of service requirement are not treated as benefiting under the portion of Plan A that is treated as a separate plan consisting of nonelective contributions even though they make (or are eligible to make) rollover contributions under Plan A.

Thus, the employees who have not met Plan A's minimum one year of service requirement for participation for a plan year are not treated as benefiting under any of the three portions of Plan A that must separately satisfy the requirements of § 410(b) even though such employees make (or are eligible to make) rollover contributions under Plan A. Therefore, under § 1.410(b)–6(b), these employees are excludable employees for purposes of applying the requirements of § 410(b) to Plan A.

NONDISCRIMINATION REQUIREMENTS OF §§ 401(a)(4), 401(k)(3), AND 401(m)(2)

In order to be qualified under § 401(a), a plan must satisfy the nondiscrimination requirements of § 401(a)(4). Among these requirements are the nondiscriminatory amount of contributions or benefits requirement of § 1.401(a)(4)–1(b)(2) and the nondiscriminatory availability of benefits, rights, and features requirement of § 1.401(a)(4)–1(b)(3).

As provided in § 1.401(a)(4)–1(b)(2)(ii)(B), the nondiscriminatory amount requirement that applies to a section 401(k) plan is the actual deferral percentage (ADP) test in § 401(k)(3). The nondiscriminatory amount requirement that applies to a section 401(m) plan is the actual contribution percentage (ACP) test in § 401(m)(2). Under § 1.401(k)–1(b)(2), only eligible employees are taken into account in the ADP test. Likewise, under § 1.401(m)–1(b)(1), only eligible employees are taken into account in the ACP test. As noted above, the employees who are eligible to make rollover contributions, but not to make salary deferral contributions or to receive matching contributions, under Plan A are not eligible

employees with respect to the portion of Plan A that is a section 401(k) plan or the portion of Plan A that is a section 401(m) plan. Thus, these employees are not included in either the ADP test or the ACP test.

In general, only employees within the meaning of § 1.401(a)(4)–12 (“benefiting employees”) are tested in applying the nondiscrimination requirements of § 401(a)(4) to a plan. Under § 1.401(a)(4)–12, an employee is a benefiting employee for a given plan year for purposes of the nondiscrimination requirements of § 401(a)(4) if and only if the employee benefits under the plan for the plan year within the meaning of § 1.410(b)–3. As noted above, employees do not benefit under a plan within the meaning of § 1.410(b)–3 merely because they make (or are eligible to make) rollover contributions under the plan, since such contributions are not taken into account in determining whether a plan satisfies the nondiscriminatory amount requirement of § 1.401(a)(4)–1(b)(2). Thus, employees who make (or are eligible to make) rollover contributions under Plan A, but who do not receive allocations of nonelective contributions for a plan year, are not tested in applying the nondiscriminatory amount of contributions or benefits requirement to the portion of Plan A that is treated as a separate plan consisting of nonelective contributions.

The right to make a rollover contribution is an “other right or feature” under § 1.401(a)(4)–4(e)(3)(iii)(I) that must satisfy the nondiscriminatory availability of benefits, rights, and features requirement of § 1.401(a)(4)–1(b)(3). Under § 1.401(a)(4)–4, the tests of whether a benefit, right, or feature is made available in a nondiscriminatory manner are generally applied to benefiting employees. However, § 1.401(a)(4)–4(d)(2) also requires a plan to satisfy a separate test with respect to benefits, rights, and features provided to nonexcludable employees with accrued benefits who are not currently benefiting under the plan (frozen participants). As noted above, employees are not benefiting employees merely because they make (or are eligible to make) rollover contributions under a plan. In addition, the employees who make (or are eligible to make) rollover contributions under Plan A, but who have not met Plan A's minimum one year of service requirement for participation for a plan year, are not frozen participants. Thus, with respect to employees who are not benefiting em-

ployees under Plan A for a plan year and who are not frozen participants, the regulations under § 401(a)(4) do not provide guidance for determining whether a benefit, right, or feature available to such employees, such as the right to make rollover contributions, satisfies the nondiscriminatory availability of benefits, rights, and features requirement of § 1.401(a)(4)–1(b)(3).

Section 1.401(a)(4)–1(d) provides that the Commissioner may, in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin, provide any additional guidance that may be necessary or appropriate in applying the nondiscrimination requirements of § 401(a)(4), including additional safe harbors and alternative methods and procedures for satisfying those requirements. Pursuant to this authority, the following rule is provided.

A plan must separately satisfy the nondiscriminatory availability requirement of § 1.401(a)(4)–1(b)(3) with respect to each benefit, right, or feature that is made available under the plan to employees who do not benefit under the plan for a plan year within the meaning of § 1.410(b)–3 and who are not frozen participants within the meaning of § 1.401(a)(4)–4(d)(2). (Such employees are hereinafter referred to as “limited participants”.) A plan will separately satisfy this requirement if the benefit, right, or feature is made available to limited participants in a manner that, under all of the relevant facts and circumstances, does not discriminate significantly in favor of nonexcludable employees who are highly compensated employees within the meaning of § 414(q). For purposes of satisfying this requirement, whether an employee is treated as an excludable employee is determined under § 1.410(b)–6 based on any minimum age and service requirements that are applied under the plan as a condition on the availability of the benefit, right, or feature.

If either of the following two safe harbors is satisfied, a benefit, right, or feature will be treated as made available in a manner that does not discriminate significantly in favor of nonexcludable employees who are highly compensated employees. The first safe harbor will automatically be satisfied if the plan, within the meaning of § 1.401(a)(4)–12, meets the following requirements. The limited participants to whom the benefit, right, or feature is currently available, within the meaning of § 1.401(a)(4)–4(b), are all those, and only those,

employees who are excluded from participation solely on account of failure to satisfy the plan's minimum age and service requirements, and the benefit, right, or feature also satisfies the effective availability requirement of § 1.401(a)(4)–4(c). Thus, a plan would automatically satisfy this safe harbor if it allowed rollovers by all employees who will participate once they satisfy the plan's minimum age and service rules (and not by any other employees who are excluded from participation in the plan). A plan will not fail to satisfy this design-based safe harbor merely because it limits the availability of the benefit, right, or feature to those employees who have satisfied any lesser uniform minimum age and service requirements. The second safe harbor will be satisfied if the benefit, right, or feature is one that will satisfy § 1.401(a)(4)–4(b) and (c) either (1) when the benefit, right, or feature is treated as available only to employees who are limited participants (i.e., as if it were not available to other employees to whom the benefit, right, or feature is, in fact, available) or (2) when the benefit, right, or feature is treated as available to both limited participants and all other employees to whom the benefit, right, or feature is, in fact, available under the plan.

Applying this rule to Plan A, the right of employees who have not satisfied Plan A's minimum one year of service requirement for participation for a plan year to make rollover contributions must separately satisfy the nondiscriminatory availability requirement of § 1.401(a)–(4)–1(b)(3). The limited participants to whom the right to make rollover contributions under Plan A is currently available, within the meaning of § 1.401(a)–(4)–4(b), are all those, and only those, employees who are excluded from participation solely on account of failure to satisfy the plan's minimum one year of service requirement, and, absent other relevant facts and circumstances, the right of such limited participants to make rollover contributions also satisfies the effective availability requirement of § 1.401(a)(4)–4(c). (The right to make rollover contributions does not fail to be currently and effectively available to an employee merely because the employee does not have an amount that is eligible to be rolled over.) Plan A thus satisfies the requirements of the design-based safe harbor described above. Plan A is therefore treated as separately satisfying the nondiscriminatory availability re-

quirement of § 1.401(a)(4)–1(b)(3) with respect to the right of employees who have not satisfied Plan A's minimum one year of service requirement for participation for a plan year to make rollover contributions.

HOLDINGS (ISSUE 1)

1. Plan A is not precluded from treating as excludable, for purposes of § 410(b), all employees who have not completed one year of service (as required by the plan for participation) merely because Plan A permits rollover contributions to be made by such employees.

2. Employees who are eligible to make rollover contributions, but who have not satisfied Plan A's minimum one year of service requirement for participation for a plan year, are not taken into account in applying the ADP test in § 401(k)(3) to the portion of Plan A that is a section 401(k) plan, the ACP test in § 401(m)(2) to the portion of Plan A that is a section 401(m) plan, or the nondiscrimination in amount of contributions or benefits requirement under § 401(a)(4) to the portion of Plan A that consists of nonelective contributions.

3. Plan A must separately satisfy the nondiscriminatory availability requirement of § 1.401(a)(4)–1(b)(3) with respect to the right of employees who have not satisfied the minimum one year of service requirement for participation for a plan year to make rollover contributions to the plan. Plan A is treated as separately satisfying this requirement because it satisfies the requirements of the design-based safe harbor described in this revenue ruling.

LAW AND ANALYSIS (ISSUE 2)

Section 416(c) generally requires each non-key employee who is a participant in a defined benefit or defined contribution plan to accrue a minimum benefit or receive a minimum contribution under the plan in any year the plan is top-heavy. Section 1.416–1, Q&A M–4 and Q&A M–10, describes which employees must receive the top-heavy minimums. In general, each non-key employee who is a participant in a top-heavy plan must receive the minimum if, in the case of a defined contribution plan, the participant has not separated from service by the end of the plan year, or, in the case of a defined benefit plan, the participant has at least 1,000 hours of service for the accrual

computation period. Non-key employees may not fail to receive the top-heavy minimum by virtue of being excluded from participation because their compensation is less than a stated amount or because of failure to make mandatory employee contributions or elective contributions.

Employees who have not satisfied the minimum age and service requirements for plan participation for a plan year are not participants for purposes of § 416(c) merely because they make (or are eligible to make) rollover contributions under a plan. Such employees, therefore, are not required to accrue minimum benefits or receive minimum allocations for years in which a plan is top-heavy.

HOLDING (ISSUE 2)

For purposes of the minimum contribution and benefit requirements of § 416(c), employees are not participants for a plan year merely because they make (or are eligible to make) rollover contributions under Plan A.

DRAFTING INFORMATION

The principal author of this revenue ruling is James Flannery of the Employee Plans Division. For further information regarding this revenue ruling, please contact the Employee Plans Division's taxpayer assistance telephone service between the hours of 1:30 p.m. and 4 p.m. Eastern Time, Monday through Thursday, by calling (202) 622–6074/6075, or Mr. Flannery on (202) 622–6214. (These telephone numbers are not toll-free numbers.)