Point	Latitude	Longitude
7	24°29.20′N	81°17.30′W
8	24°22.30′N	81°43.17′W
9	24°28.00′N	81°43.17′W
10	24°28.70′N	81°43.50′W
11	24°29.80′N	81°43.17′W
12	24°33.10′N	81°35.15′W
13	24°33.60′N	81°26.00′W
14	24°38.20′N	81°07.00′W
15	24°43.20′N	80°53.20′W
16	24°46.10′N	80°46.15′W
17	24°51.10′N	80°37.10′W
18	24°57.50′N	80°27.50′W
19	25°09.90′N	80°16.20′W
20	25°24.00′N	80°09.10′W
21	25°31.50′N	80°07.00′W
22	25°39.70′N	80°06.85′W
23	25°45.00′N	80°06.10′W

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8954]

RIN 1545–AY36

Nondiscrimination Requirements for Certain Defined Contribution Retirement Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that permit certain defined contribution retirement plans to demonstrate compliance with the nondiscrimination requirements based on plan benefits rather than contributions. Under the final regulations, a defined contribution plan can test on a benefits basis if it provides broadly available allocation rates, age-based allocations, or passes a gateway requiring allocation rates for nonhighly compensated employees to be at least 5% of pay or at least one-third of the highest allocation rate for highly compensated employees. The regulations also permit qualified defined contribution and defined benefit plans that are tested together as a single, aggregated plan (and that are not primarily defined benefit or broadly available separate plans) to test on a benefits basis after passing a similar gateway, under which the allocation rate for nonhighly compensated employees need not exceed 7½% of pay. These final regulations affect employers that maintain qualified retirement plans and qualified retirement plan participants.

DATES: *Effective Date:* These regulations are effective June 29, 2001.

Applicability Date: These regulations apply for plan years beginning on or after January 1, 2002.

FOR FURTHER INFORMATION CONTACT: John T. Ricotta, 202–622–6060 or Linda S.F. Marshall, 202–622–6090 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 under section 401(a)(4) of the Internal Revenue Code of 1986 (Code).

Section 401(a)(4) provides that a plan or trust forming part of a stock bonus, pension, or profit-sharing plan of an employer shall not constitute a qualified plan under section 401(a) of the Code unless the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (HCEs) (within the meaning of section 414(q)). Whether a plan satisfies this requirement depends on the form of the plan and its effect in operation.

Section 415(b)(6)(A) provides that the computation of benefits under a defined contribution plan, for purposes of section 401(a)(4), shall not be made on a basis inconsistent with regulations prescribed by the Secretary. The legislative history of this provision explains that, in the case of target benefit and other defined contribution plans, ''regulations may establish reasonable earnings assumptions and other factors for these plans to prevent discrimination.'' Conf. Rep. No. 1280, 93d Cong., 2d Sess. 277 (1974).

Under the section 401(a)(4) regulations, a plan can demonstrate that either the contributions or the benefits provided under the plan are nondiscriminatory in amount. Defined contribution plans generally satisfy the regulations by demonstrating that contributions are nondiscriminatory in amount, through certain safe harbors provided for under the regulations or through general testing.

A defined contribution plan (other than an ESOP) may, however, satisfy the regulations on the basis of benefits by using cross-testing pursuant to rules provided in § 1.401(a)(4)–8 of the regulations. Under this cross-testing method, contributions are converted, using actuarial assumptions, to equivalent benefits payable at normal retirement age, and these equivalent benefits are tested in a manner similar to the testing of employer-provided benefits under a defined benefit plan.

In Notice 2000–14 (2000–10 I.R.B. 737), released February 24, 2000, the IRS and the Treasury Department initiated a review of issues related to use of the cross-testing method by so-called new comparability plans and requested public comments on this plan design from plan sponsors, participants and other interested parties. In general, new comparability plans are defined contribution plans that have built-in disparities between the allocation rates for classifications of participants consisting entirely or predominantly of HCEs and the allocation rates for other employees.

In a typical new comparability plan, HCEs receive high allocation rates, while nonhighly compensated employees (NHCEs), regardless of their age or years of service, receive comparatively low allocation rates. For example, HCEs in such a plan might receive allocations of 18 or 20% of compensation, while NHCEs might receive allocations of 3% of compensation. A similar plan design, sometimes known as a super-integrated plan, provides for an additional allocation rate that applies only to compensation in excess of a specified threshold, but the specified threshold (e.g., $100,000) or the additional allocation rate (e.g., 10%) is higher than the maximum threshold and rate allowed under the permitted disparity rules of section 401(l).

These new comparability and similar plans rely on the cross-testing method to demonstrate compliance with the nondiscrimination rules by comparing the actuarially projected value of the employer contributions for the younger NHCEs with the actuarial projections of the larger contributions (as a percentage of compensation) for the older HCEs. As a result, these plans are able generally to provide higher rates of employer contributions to HCEs, while NHCEs are not allowed to earn the higher allocation rates as they work additional years for the employer or grow older. Notwithstanding the analytical underpinnings of cross-testing, the IRS and Treasury Department became concerned that new comparability and similar plans were not consistent with the basic purpose of the nondiscrimination rules under section 401(a)(4).

After consideration of the comments received in response to Notice 2000–14, the IRS and Treasury issued proposed regulations on this subject (REG–114697–00), which were published in the **Federal Register** on October 6, 2000 (65 FR 59774). The proposed regulations

preserved the cross-testing rules of the section 401(a)(4) regulations, but prescribed a gateway condition for new comparability and similar plans to meet in order to be eligible to use cross-testing to satisfy the nondiscrimination rules on the basis of benefits. However, defined contribution plans that provide broadly available allocation rates, as defined in the proposed regulations, did not have to satisfy the gateway. The definition of broadly available allocation rates under the proposed regulations covered plans that provide different allocation rates to different, nondiscriminatory groups of employees. Under the proposed regulations, the definition also covered plans that base allocations or allocation rates on age or years of service, that, in contrast to new comparability plans, provide an opportunity for participants to ''grow into'' higher allocation rates as they age or accumulate additional service.

The proposed regulations also addressed a new comparability-type plan design that aggregates a defined benefit plan that benefits primarily HCEs with a defined contribution plan that benefits primarily NHCEs. This design would permit an employer to circumvent the minimum allocation gateway by aggregating (for purposes of the nondiscrimination rules) a new comparability or similar defined contribution plan with a defined benefit plan that provides only minimal benefits to NHCEs or covers only a relatively small number of NHCEs. In addition, a defined benefit plan that benefits primarily HCEs, and that is aggregated with a defined contribution plan for nondiscrimination testing, could produce results similar to a new comparability plan but with a potential for substantially more valuable benefits for HCEs. The proposed regulations provided a gateway for testing the aggregated plans on the basis of benefits that must be satisfied unless the aggregated defined contribution and defined benefit plan (the DB/DC plan) is primarily defined benefit in character (as defined in the proposed regulations), or unless each of the defined contribution and defined benefit portions of the DB/DC plan is a broadly available separate plan (as defined in the proposed regulations).

Written comments responding to the notice of proposed rulemaking were received, and a public hearing was held on January 25, 2001, at the request of one commentator. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

A. Overview

Like the proposed regulations, these final regulations permit defined contribution plans with either broadly available allocation rates or certain age-based allocation rates to test on a benefits basis (cross-test) in the same manner as under current law, and permit other defined contribution plans to cross-test once they pass a gateway that prescribes minimum allocation rates for NHCEs. Similarly, these final regulations retain the rule in the proposed regulations that permits a DB/DC plan to test on a benefits basis in the same manner as under current law if the DB/DC plan either is primarily defined benefit in character or consists of broadly available separate plans. Other DB/DC plans are permitted to test on a benefits basis once they pass a corresponding gateway prescribing minimum aggregate normal allocation rates for NHCEs.

B. Gateway for Cross-Testing of New Comparability and Similar Plans

These final regulations retain the rule in the proposed regulations that requires a defined contribution plan that does not provide broadly available allocation rates or certain age-based allocation rates (as these terms are defined in these final regulations) to satisfy a gateway in order to be eligible to use the cross-testing rules to meet the nondiscrimination requirements of section 401(a)(4). Under these final regulations, as under the proposed regulations, a plan satisfies this minimum allocation gateway if each NHCE in the plan has an allocation rate that is at least one third of the allocation rate of the HCE with the highest allocation rate, but a plan is deemed to satisfy the gateway if each NHCE receives an allocation of at least 5% of the NHCE's compensation (within the meaning of section 415(c)(3)).

Several commentators raised questions about the interaction of the requirements under the proposed regulations and other regulatory rules relating to testing for nondiscrimination. For example, some commentators asked what was intended by the gateway requirement that all NHCEs receive the minimum required allocation. Except as specifically provided, the regulatory definitions and rules that apply for purposes of section 401(a)(4) also apply for purposes of these regulations. For example, the term employee, as used in these regulations, is defined in § 1.401(a)(4)–12 as an employee (within the meaning of § 1.410(b)–9) who benefits as an employee under the plan for the plan year, and an NHCE is defined in § 1.401(a)(4)–12 as an employee who is not an HCE. Thus, an individual who does not otherwise benefit under the plan for the plan year is not an employee under these regulations, hence not an NHCE, and need not be given the minimum required allocation under the gateway. Similarly, the allocation rate referred to in the gateway is determined under § 1.401(a)(4)–2(c) as the allocations to an employee's account for a plan year, expressed either as a percentage of plan year compensation (which must be calculated using a definition of compensation that satisfies the requirements of section 414(s)) or as a dollar amount.

The general rules and regulatory definitions applicable under section 410(b) apply also for purposes of these regulations. For example, these regulations do not change the general rule prohibiting aggregation of a 401(k) plan or 401(m) plan with a plan providing nonelective contributions. Accordingly, matching contributions are not taken into account for purposes of the gateway. Similarly, pursuant to § 1.410(b)–6(b)(3), if a plan benefits employees who have not met the minimum age and service requirements of section 410(a)(1), the plan may be treated as two separate plans, one for those otherwise excludable employees and one for the other employees benefitting under the plan. Thus, if the plan is treated as two separate plans in this manner, cross-testing the portion of the plan benefitting the nonexcludable employees will not result in minimum required allocations under the gateway for the employees who have not met the section 410(a)(1) minimum age and service requirements.

One commentator suggested that the regulatory provision that permits a plan to satisfy the gateway requirement by providing an allocation of at least 5% of compensation within the meaning of section 415(c)(3) not require that the allocation be based on a full year's compensation in the case of an employee who participates in the plan for only a portion of the plan year. The final regulations modify this requirement as suggested. The final regulations allow a plan to satisfy the gateway by providing an allocation of at least 5% of compensation within the meaning of section 415(c)(3), limited to a period otherwise permissible under the timing rules applicable under the definition of plan year compensation, in the same manner as the general rules under the section 401(a)(4) regulations. The definition of plan year compensation permits use of amounts

paid only during the period of participation within the plan year.

Some commentators questioned whether it was necessary to require the use of compensation within the meaning of section 415(c)(3) for purposes of the 5% of compensation component of the minimum allocation gateway. One of these commentators argued that using compensation within the meaning of section 414(s) would be more appropriate. Two other commentators argued that, for this purpose, plans should be able to use a definition of compensation that would be a reasonable definition of compensation for purposes of section 414(s) without regard to whether the definition of compensation meets the nondiscrimination standard under the section 414(s) regulations.

After consideration of these comments, the requirement that section 415(c)(3) compensation be used for purposes of the 5% of compensation component of the minimum allocation gateway has been retained. For purposes of the ''one third'' component of the gateway, a definition of compensation that satisfies section 414(s) is an appropriate measure because this component is based on the ratio of HCE allocation rates to NHCE allocation rates. By contrast, the 5% of compensation component of the gateway does not reflect a comparison of NHCE allocations to HCE allocations, but is based on a particular level of NHCE allocations. Without the comparison between HCE and NHCE allocations, a rule permitting the use of a definition of compensation that satisfies section 414(s), but is less inclusive than total compensation, could lead to NHCE allocations that are significantly smaller than the minimum that is contemplated by the regulations. Therefore, it is appropriate to require the use of total compensation, as defined in section 415(c)(3), for the 5% allocation component of the gateway. Furthermore, permitting the use of a potentially discriminatory definition of compensation would be inconsistent with the nondiscrimination requirements in general, including the minimum allocation gateway.

C. Plans With Broadly Available Allocation Rates

Like the proposed regulations, these final regulations provide that a plan that has broadly available allocation rates need not satisfy the minimum allocation gateway. In order to be broadly available, each allocation rate under the plan must be currently available to a group of employees that satisfies section 410(b) (without regard to the average benefit percentage test). Thus, if, within one plan, an employer provides different allocation rates for nondiscriminatory groups of employees at different locations or different profit centers, the plan would not need to satisfy the minimum allocation gateway in order to use cross-testing.

For purposes of determining whether an allocation rate that was available only to employees who satisfied an age or service condition was currently available to a section 410(b) group, the proposed regulations allowed such a condition to be disregarded if certain standards were met. The final regulations retain this exception from the application of the minimum allocation gateway. However, this exception has been relocated and is now part of an expanded provision for plans with age-based allocations (see Plans with Age-Based Allocations portion of this preamble).

In response to comments, the final regulations also liberalize the determination of whether a plan has broadly available allocation rates. First, the final regulations permit two allocation rates to be aggregated in a manner similar to the rule that permits aggregation of certain benefits, rights or features. This rule permits excess NHCEs with a higher allocation rate to be used to support a lower allocation rate. For example, under this rule, if under a plan there are two groups of participants, one group that receives an allocation rate of 10% and another that receives an allocation rate of 3%, and if the group of employees who receive the 10% allocation rate satisfies section 410(b) (without regard to the average benefit percentage test), then the 10% rate and the 3% rate can be aggregated and treated as a single allocation rate for purposes of determining whether the plan has broadly available allocation rates. In addition, the final regulations provide that, in determining whether a plan provides broadly available allocation rates, differences in allocation rates resulting from any method of permitted disparity provided for under the section 401(l) regulations are disregarded.

D. Transition Allocations

Several commentators raised the concern that a defined contribution plan may fail the broadly available test because of grandfathered allocation rates provided to employees who formerly participated in a defined benefit plan or provided to a group of employees in connection with a merger, acquisition, or other similar transaction. In response to these comments, the final regulations permit an employee's allocation to be disregarded, to the extent the employee's allocation is a transition allocation (as defined in the regulations) for the plan year. Transition allocations which can be disregarded can be defined benefit replacement allocations, pre-existing replacement allocations, or pre-existing merger and acquisition allocations (as defined in the regulations).

In each case, the transition allocations must be provided to a closed group of employees and must be established under plan provisions. Once the allocations are established under the plan, they cannot be modified, except to reduce allocations for HCEs, or because of de minimis changes (such as a change in the definition of compensation to include section 132(f) elective reductions). A plan also does not violate this requirement because of an amendment that either adds or removes a provision applicable to all employees in the group eligible for the allocations under which each employee who is eligible for a transition allocation receives the greater of the transition allocation or another allocation for which the employee would otherwise be eligible. If the plan provides that all employees who are eligible for the transition allocation receive the greater of the transition allocation or an otherwise available allocation, the otherwise available allocation is considered currently available to all such employees, including employees for whom the transition allocation is greater.

These final regulations set forth basic conditions for defined benefit replacement allocations. These conditions provide a framework that is designed to ensure that these allocations are provided in a manner consistent with the general principles underlying the provisions for broadly available allocation rates under these regulations. The regulations then delegate authority to the Commissioner to prescribe rules for defined benefit replacement allocations in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin. Rev. Rul. 2001–30 (2001–29 I.R.B.), dated July 16, 2001, published in conjunction with these final regulations, prescribes specific conditions for defined benefit replacement allocations that relate to the basic conditions set forth in the regulations. This division of the medium of guidance is designed to provide ongoing flexibility to the IRS and Treasury to respond to changing circumstances, or additional information relating to defined benefit replacement allocations.

The basic conditions that allocations must satisfy in order to be defined benefit replacement allocations are as follows: (1) The allocations are provided to a group of employees who formerly benefitted under an established nondiscriminatory defined benefit plan of the employer or of a prior employer that provided age-based equivalent allocation rates; (2) the allocations for each employee were reasonably calculated, in a consistent manner, to replace the retirement benefits that the employee would have been provided under the defined benefit plan if the employee had continued to benefit under the defined benefit plan; (3) no employee who receives the allocation receives any other allocations under the plan for the plan year (except as provided in these regulations); and (4) the composition of the group of employees who receive the allocations is nondiscriminatory.

Rev. Rul. 2001–30 fleshes out these basic conditions for determining whether an allocation is a defined benefit replacement allocation. Under the revenue ruling, the defined benefit plan's benefit formula applicable to the group of employees must be one that generated equivalent normal allocation rates (determined without regard to changes in accrual rates attributable to changes in an employee's years of service) that increased from year to year as employees attained higher ages. Further, if the defined benefit plan was sponsored by the employer, the defined benefit plan satisfied sections 410(b) and 401(a)(4), without regard to section 410(b)(6)(C) and without aggregating with any other plan, for the plan year which immediately precedes the first plan year for which the allocations are provided. Finally, the defined benefit plan must be one that has been established and maintained without substantial change for at least the 5 years ending on the date benefit accruals under the defined benefit plan cease (with one year substituted for 5 years in the case of a defined benefit plan of a former employer).

In order to be defined benefit replacement allocations for the plan year, the allocations for each employee in the group must be reasonably calculated, in a consistent manner, to replace the employee's retirement benefits under the defined benefit plan based on the terms of the defined benefit plan (including the section 415(b)(1)(A) limit) as in effect immediately prior to the date accruals under the defined benefit plan cease. In addition, the group of employees who receive the allocations in a plan year must satisfy section 410(b) (determined without regard to the average benefit percentage test of § 1.410(b)–5).

Although the regulations and Rev. Rul. 2001–30 prescribe conditions for the defined benefit replacement allocations, they still leave employers with flexibility in structuring these benefits. For example, there is more than one way in which the allocations may reasonably be calculated, such as a level percentage of pay for each year or an amount that increases as the employee ages.

The final regulations provide special rules applicable to allocations that are either pre-existing replacement allocations or pre-existing merger and acquisition allocations. Allocations are pre-existing replacement allocations if the allocations are provided pursuant to a plan provision adopted before June 29, 2001, are provided to employees who formerly benefitted under a defined benefit plan and are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under the defined benefit plan and any other plan or arrangement of the employer if the employee had continued to benefit under such defined benefit plan and such other plan or arrangement. Allocations are pre-existing merger and acquisition allocations if the allocations were established in connection with a stock or asset acquisition, merger, or other similar transaction occurring prior to August 28, 2001, for a group of employees who were employed by the acquired trade or business prior to a specified date, provided that the class of employees eligible for the allocations is closed no later than two years after the transaction (or January 1, 2002, if earlier), the allocations are provided pursuant to a plan amendment adopted by the date the class was closed, and the allocations for each employee in the group are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under any plan of the employer if the new employer had continued to provide the retirement benefits that the prior employer was providing for employees of the trade or business.

E. Plans With Age-Based Allocations

These final regulations provide a separate exception from the application of the minimum allocation gateway for certain plans with age-based allocation rates. This provision incorporates the exception under the proposed regulations for plans with gradual age or service schedules, and expands the exception to include plans that provide for allocation rates based on a uniform target benefit allocation.

A plan has a gradual age or service schedule if the schedule of allocation rates under the plan's formula is available to all employees in the plan and provides for allocation rates that increase smoothly at regular intervals. The rules applicable to the schedule of allocation rates are designed to be sufficiently flexible to accommodate a wide variety of age- or service-based plans (including age-weighted profit-sharing plans that provide for allocations resulting in the same equivalent accrual rate for all employees). The final regulations clarify that a plan projecting future age or service may not use imputed disparity in determining whether the allocation rates under the schedule increase smoothly at regular intervals. In response to comments, the final regulations also accommodate smoothly increasing schedules of allocation rates that are based on the sum of age and years of service. In addition, to conform with the rules for computation of service under § 1.401(a)(4)–12, references to service have been changed to years of service.

The requirement that the allocation rates under a schedule increase smoothly at regular intervals provides important protection for employees, because this requirement limits the exception from the minimum allocation gateway to plans in which NHCEs actually receive the benefit of higher rates as they attain higher ages or complete additional years of service. Some commentators expressed concern that employers could be forced to reduce allocations to younger or shorter-service NHCEs in order to satisfy the conditions for allocation rates that increase smoothly at regular intervals. In response to these comments, the final regulations provide that a plan's schedule of allocation rates does not fail to increase smoothly at regular intervals merely because a specified minimum uniform allocation rate is provided for all employees or because the minimum benefit described in section 416(c)(2) is provided for all non-key employees (either because the plan is top heavy or without regard to whether the plan is top heavy) if one of two alternative conditions is satisfied. These two alternative conditions are intended to limit the potential use of a minimum allocation to provide a schedule of rates that delivers allocations similar to those under a new comparability plan (i.e., a flat allocation rate applicable for all employees below a certain age, followed by a sharply increasing schedule of rates that effectively benefits only HCEs)

without satisfying the minimum allocation gateway.

A plan satisfies the first alternative condition if the allocation rates under the plan that exceed the specified minimum rate could form part of a schedule of allocation rates that increase smoothly at regular intervals (as defined in these regulations) in which the lowest allocation rate is at least 1% of plan year compensation. The second alternative condition, available for a plan using an age-based schedule, allows the use of a minimum allocation rate if, for each age band above the minimum allocation rate, the allocation rate applicable for that band is less than or equal to the allocation rate that would yield an equivalent accrual rate at the highest age in the band that is the same as the equivalent accrual rate determined for the oldest hypothetical employee who would receive just the minimum allocation rate. Thus, under this condition, the allocation rates above the minimum allocation rate do not rise more steeply than expected under an age-weighted profit-sharing plan generally intended to provide the same accrual rate at all ages.

The exception to the minimum allocation gateway for plans with age-based allocation rates also applies to certain uniform target benefit plans that do not comply with the safe-harbor testing method provided in § 1.401(a)(4)–8(b)(3).[1] A plan has allocation rates based on a uniform target benefit allocation if it would comply with the requirements for a safe harbor target benefit plan in § 1.401(a)(4)–8(b)(3) except that the interest rate for determining the actuarial present value of the stated plan benefit and the theoretical reserve is lower than a standard interest rate, the stated benefit is calculated assuming compensation increases, or the plan computes the current year contribution using the actual account balance instead of the theoretical reserve.

F. Application to Defined Contribution Plans That Are Combined With Defined Benefit Plans (DB/DC Plans)

These regulations prescribe rules for testing defined contribution plans that are aggregated with defined benefit plans for purposes of sections 401(a)(4) and 410(b). These rules apply in situations in which the employer aggregates the plans because one of the plans does not satisfy sections 401(a)(4) and 410(b) standing alone. These rules do not apply to safe harbor floor-offset arrangements described in § 1.401(a)(4)–8(d), or to the situation in which plans are aggregated solely for purposes of satisfying the average benefit percentage test of § 1.410(b)–5.

These regulations retain the rule of the proposed regulations that the combination of a defined contribution plan and a defined benefit plan may demonstrate nondiscrimination on the basis of benefits if the combined plan (the DB/DC plan) is primarily defined benefit in character, consists of broadly available separate plans (as these terms are defined in the regulations), or satisfies a minimum aggregate allocation gateway requirement that is generally similar to the minimum allocation gateway for defined contribution plans that are not combined with a defined benefit plan.

1. Gateway for Benefits Testing of Combined Plans

In order to apply this minimum aggregate allocation gateway, the employee's aggregate normal allocation rate is determined by adding the employee's allocation rate under the defined contribution plan to the employee's equivalent allocation rate under the defined benefit plan. This aggregation allows an employer that provides NHCEs with both a defined contribution and a defined benefit plan to take both plans into account in determining whether the minimum aggregate allocation gateway is met.

Under the gateway, if the aggregate normal allocation rate of the HCE with the highest aggregate normal allocation rate under the plan (HCE rate) is less than 15%, the aggregate normal allocation rate for all NHCEs must be at least one-third of the HCE rate. If the HCE rate is between 15% and 25%, the aggregate normal allocation rate for all NHCEs must be at least 5%. If the HCE rate exceeds 25%, then the aggregate normal allocation rate for each NHCE must be at least 5% plus one percentage point for each 5-percentage-point increment (or portion thereof) by which the HCE rate exceeds 25% (*e.g.,* the NHCE minimum is 6% for an HCE rate that exceeds 25% but not 30%, and 7% for an HCE rate that exceeds 30% but not 35%).

Several commentators expressed a concern that the minimum aggregate allocation gateway in the proposed regulations could require contributions for NHCEs that would make DB/DC plans too expensive for employers in certain circumstances. This could occur in cases where one HCE had a very high equivalent allocation rate on account of age or some other factor, and could prompt such an employer to redesign its plans in ways that could disadvantage NHCEs. In response to these comments, these final regulations provide that a plan is deemed to satisfy this minimum aggregate allocation gateway if the aggregate normal allocation rate for each NHCE is at least 7½% of compensation within the meaning of section 415(c)(3), determined over a period otherwise permissible under the timing rules applicable under the definition of plan year compensation.

These regulations retain the rule that, in determining the equivalent allocation rate for an NHCE under a defined benefit plan, a plan is permitted to treat each NHCE who benefits under the defined benefit plan as having an equivalent allocation rate equal to the average of the equivalent allocation rates under the defined benefit plan for all NHCEs benefitting under that plan. This averaging rule recognizes the grow-in feature inherent in traditional defined benefit plans (*i.e.,* the defined benefit plan provides higher equivalent allocation rates at higher ages).

2. Primarily Defined Benefit in Character

Like the proposed regulations, these final regulations provide that a DB/DC plan that is primarily defined benefit in character is not subject to the gateway requirement and may continue to be tested for nondiscrimination on the basis of benefits as under former law. A DB/DC plan is primarily defined benefit in character if, for more than 50% of the NHCEs benefitting under the plan, the normal accrual rate attributable to benefits provided under defined benefit plans for the NHCE exceeds the equivalent accrual rate attributable to contributions under defined contribution plans for the NHCE. For example, a DB/DC plan is primarily defined benefit in character where the defined contribution plan covers only salaried employees, the defined benefit plan covers only hourly employees, and more than half of the NHCEs participating in the DB/DC plan are hourly employees participating only in the defined benefit plan.

Some comments suggested a loosening of the standard as to when a DB/DC plan is primarily defined benefit in character, but no changes have been made. The Treasury and IRS believe that the determination of whether a DB/DC plan is primarily defined benefit in character should be based on the relative size of the defined benefit accruals and the defined contribution allocations for individual employees, as reflected in the actual benefits testing

[1] No exception to the minimum allocation gateway is needed for target benefit plans that comply with the safe-harbor testing provisions of § 1.401(a)(4)–8(b)(3), because they are deemed to satisfy section 401(a)(4) with respect to an equivalent amount of benefits.

that is being done under section 401(a)(4). In particular, the actuarial assumptions used to determine whether a DB/DC plan is primarily defined benefit in character must be the same assumptions that are used to apply the cross-testing rules.

3. Broadly Available Separate Plans

Like the proposed regulations, these final regulations provide that a DB/DC plan that consists of broadly available separate plans may continue to be tested for nondiscrimination on the basis of benefits as under current law, even if it does not satisfy the gateway requirement. A DB/DC plan consists of broadly available separate plans if the defined contribution plan and the defined benefit plan, tested separately, would each satisfy the requirements of section 410(b) and the nondiscrimination in amount requirement of § 1.401(a)(4)–1(b)(2), assuming satisfaction of the average benefit percentage test of § 1.410(b)–5. Thus, the defined contribution plan must separately satisfy the nondiscrimination requirements (taking into account these regulations as applicable), but for this purpose assuming satisfaction of the average benefit percentage test. Similarly, the defined benefit plan must separately satisfy the nondiscrimination requirements, assuming for this purpose satisfaction of the average benefit percentage test. In conducting the required separate testing, all plans of a single type (defined contribution or defined benefit) within the DB/DC plan are aggregated, but those plans are tested without regard to plans of the other type.

This alternative is useful, for example, where an employer maintains a defined contribution plan that provides a uniform allocation rate for all covered employees at one business unit and a safe harbor defined benefit plan for all covered employees at another unit, and where the group of employees covered by each of those plans is a group that satisfies the nondiscriminatory classification requirement of section 410(b). Because the employer provides broadly available separate plans, it may continue to aggregate the plans and test for nondiscrimination on the basis of benefits, as an alternative to using the qualified separate line of business rules or demonstrating satisfaction of the average benefit percentage test.

G. Use of Component Plans

As under the proposed regulations, the rules set forth in these final regulations cannot be satisfied using component plans under the restructuring rules. Although some commentators requested that restructuring be permitted for this purpose, the IRS and Treasury have determined that such use of component plans would be inconsistent with the purpose of these regulations.

Effective Date

These regulations apply for plan years beginning on or after January 1, 2002.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are John T. Ricotta and Linda S. F. Marshall of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. In § 1.401(a)(4)–0, the entry for § 1.401(a)(4)–8(b)(1), is revised to read as follows:

§ 1.401(a)(4)–0 Table of contents.

* * * * *

§ 1.401(a)(4)–8 Cross-testing.

* * * * *

*(b) * * **

(1) General rule and gateway.

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Par. 3. In § 1.401(a)(4)–8, paragraph (b)(1) is revised to read as follows:

§ 1.401(a)(4)–8 Cross-testing.

* * * * *

(b) *Nondiscrimination in amount of benefits provided under a defined contribution plan*—(1) *General rule and gateway*—(i) *General rule.* Equivalent benefits under a defined contribution plan (other than an ESOP) are nondiscriminatory in amount for a plan year if—

(A) The plan would satisfy § 1.401(a)(4)–2(c)(1) for the plan year if an equivalent accrual rate, as determined under paragraph (b)(2) of this section, were substituted for each employee's allocation rate in the determination of rate groups; and

(B) For plan years beginning on or after January 1, 2002, the plan satisfies one of the following conditions—

(*1*) The plan has broadly available allocation rates (within the meaning of paragraph (b)(1)(iii) of this section) for the plan year;

(*2*) The plan has age-based allocation rates that are based on either a gradual age or service schedule (within the meaning of paragraph (b)(1)(iv) of this section) or a uniform target benefit allocation (within the meaning of paragraph (b)(1)(v) of this section) for the plan year; or

(*3*) The plan satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section for the plan year.

(ii) *Allocations after testing age.* A plan does not fail to satisfy paragraph (b)(1)(i)(A) of this section merely because allocations are made at the same rate for employees who are older than their testing age (determined without regard to the current-age rule in paragraph (4) of the definition of *testing age* in § 1.401(a)(4)–12) as they are made for employees who are at that age.

(iii) *Broadly available allocation rates*—(A) *In general.* A plan has broadly available allocation rates for the plan year if each allocation rate under the plan is currently available during the plan year (within the meaning of § 1.401(a)(4)–4(b)(2)), to a group of employees that satisfies section 410(b) (without regard to the average benefit percentage test of § 1.410(b)–5). For this purpose, if two allocation rates could be permissively aggregated under § 1.401(a)(4)–4(d)(4), assuming the allocation rates were treated as benefits, rights or features, they may be aggregated and treated as a single allocation rate. In addition, the disregard of age and service conditions described in § 1.401(a)(4)–4(b)(2)(ii)(A)

does not apply for purposes of this paragraph (b)(1)(iii)(A).

(B) *Certain transition allocations.* In determining whether a plan has broadly available allocation rates for the plan year within the meaning of paragraph (b)(1)(iii)(A) of this section, an employee's allocation may be disregarded to the extent that the allocation is a transition allocation for the plan year. In order for an allocation to be a transition allocation, the allocation must comply with the requirements of paragraph (b)(1)(iii)(C) of this section and must be either—

(*1*) A defined benefit replacement allocation within the meaning of paragraph (b)(1)(iii)(D) of this section; or

(*2*) A pre-existing replacement allocation or pre-existing merger and acquisition allocation, within the meaning of paragraph (b)(1)(iii)(E) of this section.

(C) *Plan provisions relating to transition allocations*—(*1*) *In general.* Plan provisions providing for transition allocations for the plan year must specify both the group of employees who are eligible for the transition allocations and the amount of the transition allocations.

(*2*) *Limited plan amendments.* Allocations are not transition allocations within the meaning of paragraph (b)(1)(iii)(B) of this section for the plan year if the plan provisions relating to the allocations are amended after the date those plan provisions are both adopted and effective. The preceding sentence in this paragraph (b)(1)(iii)(C)(*2*) does not apply to a plan amendment that reduces transition allocations to HCEs, makes de minimis changes in the calculation of the transition allocations (such as a change in the definition of compensation to include section 132(f) elective reductions), or adds or removes a provision permitted under paragraph (b)(1)(iii)(C)(*3*) of this section.

(*3*) *Certain permitted plan provisions.* An allocation does not fail to be a transition allocation within the meaning of paragraph (b)(1)(iii)(B) of this section merely because the plan provides that each employee who is eligible for a transition allocation receives the greater of such allocation and the allocation for which the employee would otherwise be eligible under the plan. In a plan that contains such a provision, for purposes of determining whether the plan has broadly available allocation rates within the meaning of paragraph (b)(1)(iii)(A) of this section, the allocation for which an employee would otherwise be eligible is considered currently available to the employee, even if the employee's transition allocation is greater.

(D) *Defined benefit replacement allocation.* An allocation is a defined benefit replacement allocation for the plan year if it is provided in accordance with guidance prescribed by the Commissioner published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter) and satisfies the following conditions—

(*1*) The allocations are provided to a group of employees who formerly benefitted under an established nondiscriminatory defined benefit plan of the employer or of a prior employer that provided age-based equivalent allocation rates;

(*2*) The allocations for each employee in the group were reasonably calculated, in a consistent manner, to replace the retirement benefits that the employee would have been provided under the defined benefit plan if the employee had continued to benefit under the defined benefit plan;

(*3*) Except as provided in paragraph (b)(1)(iii)(C) of this section, no employee who receives the allocation receives any other allocations under the plan for the plan year; and

(*4*) The composition of the group of employees who receive the allocations is nondiscriminatory.

(E) *Pre-existing transition allocations—(1) Pre-existing replacement allocations.* An allocation is a pre-existing replacement allocation for the plan year if the allocation satisfies the following conditions—

(*i*) The allocations are provided pursuant to a plan provision adopted before June 29, 2001;

(*ii*) The allocations are provided to employees who formerly benefitted under a defined benefit plan of the employer; and

(*iii*) The allocations for each employee in the group are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under the defined benefit plan and any other plan or arrangement of the employer if the employee had continued to benefit under such defined benefit plan and such other plan or arrangement.

(*2*) *Pre-existing merger and acquisition allocations.* An allocation is a pre-existing merger and acquisition allocation for the plan year if the allocation satisfies the following conditions—

(*i*) The allocations are provided solely to employees of a trade or business that has been acquired by the employer in a stock or asset acquisition, merger, or other similar transaction occurring prior to August 28, 2001, involving a change in the employer of the employees of the trade or business;

(*ii*) The allocations are provided only to employees who were employed by the acquired trade or business before a specified date that is no later than two years after the transaction (or January 1, 2002, if earlier);

(*iii*) The allocations are provided pursuant a plan provision adopted no later than the specified date; and

(*iv*) The allocations for each employee in the group are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under any plan of the employer if the new employer had continued to provide the retirement benefits that the prior employer was providing for employees of the trade or business.

(F) *Successor employers.* An employer that accepts a transfer of assets (within the meaning of section 414(l)) from the plan of a prior employer may continue to treat any transition allocations provided under that plan as transition allocations under paragraph (b)(1)(iii)(B) of this section, provided that the successor employer continues to satisfy the applicable requirements set forth in paragraphs (b)(1)(iii)(C) through (E) of this section for the plan year.

(iv) *Gradual age or service schedule*—(A) *In general.* A plan has a gradual age or service schedule for the plan year if the allocation formula for all employees under the plan provides for a single schedule of allocation rates under which—

(*1*) The schedule defines a series of bands based solely on age, years of service, or the number of points representing the sum of age and years of service (age and service points), under which the same allocation rate applies to all employees whose age, years of service, or age and service points are within each band; and

(*2*) The allocation rates under the schedule increase smoothly at regular intervals, within the meaning of paragraphs (b)(1)(iv)(B) and (C) of this section.

(B) *Smoothly increasing schedule of allocation rates.* A schedule of allocation rates increases smoothly if the allocation rate for each band within the schedule is greater than the allocation rate for the immediately preceding band (i.e., the band with the next lower number of years of age, years of service, or age and service points) but by no more than 5 percentage points. However, a schedule of allocation rates will not be treated as increasing smoothly if the ratio of the allocation rate for any band to the rate for the immediately preceding band is more than 2.0 or if it exceeds the ratio of

allocation rates between the two immediately preceding bands.

(C) *Regular intervals.* A schedule of allocation rates has regular intervals of age, years of service or age and service points, if each band, other than the band associated with the highest age, years of service, or age and service points, is the same length. For this purpose, if the schedule is based on age, the first band is deemed to be of the same length as the other bands if it ends at or before age 25. If the first age band ends after age 25, then, in determining whether the length of the first band is the same as the length of other bands, the starting age for the first age band is permitted to be treated as age 25 or any age earlier than 25. For a schedule of allocation rates based on age and service points, the rules of the preceding two sentences are applied by substituting 25 age and service points for age 25. For a schedule of allocation rates based on service, the starting service for the first service band is permitted to be treated as one year of service or any lesser amount of service.

(D) *Minimum allocation rates permitted.* A schedule of allocation rates under a plan does not fail to increase smoothly at regular intervals, within the meaning of paragraphs (b)(1)(iv)(B) and (C) of this section, merely because a minimum uniform allocation rate is provided for all employees or the minimum benefit described in section 416(c)(2) is provided for all non-key employees (either because the plan is top heavy or without regard to whether the plan is top heavy) if the schedule satisfies one of the following conditions—

(*1*) The allocation rates under the plan that are greater than the minimum allocation rate can be included in a hypothetical schedule of allocation rates that increases smoothly at regular intervals, within the meaning of paragraphs (b)(1)(iv)(B) and (C) of this section, where the hypothetical schedule has a lowest allocation rate no lower than 1% of plan year compensation; or

(*2*) For a plan using a schedule of allocation rates based on age, for each age band in the schedule that provides an allocation rate greater than the minimum allocation rate, there could be an employee in that age band with an equivalent accrual rate that is less than or equal to the equivalent accrual rate that would apply to an employee whose age is the highest age for which the allocation rate equals the minimum allocation rate.

(v) *Uniform target benefit allocations.* A plan has allocation rates that are based on a uniform target benefit allocation for the plan year if the plan fails to satisfy the requirements for the safe harbor testing method in paragraph (b)(3) of this section merely because the determination of the allocations under the plan differs from the allocations determined under that safe harbor testing method for any of the following reasons—

(A) The interest rate used for determining the actuarial present value of the stated plan benefit and the theoretical reserve is lower than a standard interest rate;

(B) The stated benefit is calculated assuming compensation increases at a specified rate; or

(C) The plan computes the current year contribution using the actual account balance instead of the theoretical reserve.

(vi) *Minimum allocation gateway*—(A) *General rule.* A plan satisfies the minimum allocation gateway of this paragraph (b)(1)(vi) if each NHCE has an allocation rate that is at least one third of the allocation rate of the HCE with the highest allocation rate.

(B) *Deemed satisfaction.* A plan is deemed to satisfy the minimum allocation gateway of this paragraph (b)(1)(vi) if each NHCE receives an allocation of at least 5% of the NHCE's compensation within the meaning of section 415(c)(3), measured over a period of time permitted under the definition of plan year compensation.

(vii) *Determination of allocation rate.* For purposes of paragraph (b)(1)(i)(B) of this section, allocations and allocation rates are determined under § 1.401(a)(4)–2(c)(2), but without taking into account the imputation of permitted disparity under § 1.401(a)(4)–7. However, in determining whether the plan has broadly available allocation rates as provided in paragraph (b)(1)(iii) of this section, differences in allocation rates attributable solely to the use of permitted disparity described in § 1.401(l)–2 are disregarded.

(viii) *Examples.* The following examples illustrate the rules in this paragraph (b)(1):

Example 1. (i) Plan M, a defined contribution plan without a minimum service requirement, provides an allocation formula under which allocations are provided to all employees according to the following schedule:

Completed years of service	Allocation rate (in percent)	Ratio of allocation rate for band to allocation rate for immediately preceding band
0–5	3.0	([1])
6–10	4.5	1.50
11–15	6.5	1.44
16–20	8.5	1.31
21–25	10.0	1.18
26 or more	11.5	1.15

[1] Not applicable.

(ii) Plan M provides that allocation rates for all employees are determined using a single schedule based solely on service, as described in paragraph (b)(1)(iv)(A)(*1*) of this section. Therefore, if the allocation rates under the schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section, then the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iii) The schedule of allocation rates under Plan M does not increase by more than 5 percentage points between adjacent bands and the ratio of the allocation rate for any band to the allocation rate for the immediately preceding band is never more than 2.0 and does not increase. Therefore, the allocation rates increase smoothly as described in paragraph (b)(1)(iv)(B) of this section. In addition, the bands (other than the highest band) are all 5 years long, so the increases occur at regular intervals as described in paragraph (b)(1)(iv)(C) of this section. Thus, the allocation rates under the plan's schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section. Accordingly, the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iv) Under paragraph (b)(1)(i) of this section, Plan M satisfies the nondiscrimination in amount requirement of § 1.401(a)(4)-1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section, regardless of whether it satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section.

Example 2. (i) The facts are the same as in *Example 1,* except that the 4.5% allocation rate applies for all employees with 10 years of service or less.

(ii) Plan M provides that allocation rates for all employees are determined using a single schedule based solely on service, as described in paragraph (b)(1)(iv)(A)(*1*) of this section. Therefore, if the allocation rates under the schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section, then the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iii) The bands (other than the highest band) in the schedule are not all the same length, since the first band is 10 years long while other bands are 5 years long. Thus, the schedule does not have regular intervals as described in paragraph (b)(1)(iv)(C) of this section. However, under paragraph (b)(1)(iv)(D) of this section, the schedule of

allocation rates does not fail to increase smoothly at regular intervals merely because the minimum allocation rate of 4.5% results in a first band that is longer than the other bands, if either of the conditions of paragraph (b)(1)(iv)(D)(*1*) or (*2*) of this section is satisfied.

(iv) In this case, the schedule of allocation rates satisfies the condition in paragraph (b)(1)(iv)(D)(*1*) of this section because the allocation rates under the plan that are greater than the 4.5% minimum allocation rate can be included in the following hypothetical schedule of allocation rates that increases smoothly at regular intervals and has a lowest allocation rate of at least 1% of plan year compensation:

Completed years of service	Allocation rate (in percent)	Ratio of allocation rate for band to allocation rate for immediately preceding band
0–5	2.5	(1)
6–10	4.5	1.80
11–15	6.5	1.44
16–20	8.5	1.31
21–25	10.0	1.18
26 or more	11.5	1.15

[1] Not applicable.

(v) Accordingly, the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section. Under paragraph (b)(1)(i) of this section, Plan M satisfies the nondiscrimination in amount requirement of § 1.401(a)(4)–1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section, regardless of whether it satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section.

Example 3. (i) Plan N, a defined contribution plan, provides an allocation formula under which allocations are provided to all employees according to the following schedule:

Age	Allocation rate (in percent)	Ratio of allocation rate for band to allocation rate for immediately preceding band
Under 25	3.0	(1)
25–34	6.0	2.00
35–44	9.0	1.50
45–54	12.0	1.33
55–64	16.0	1.33
65 or older	21.0	1.31

[1] Not applicable.

(ii) Plan N provides that allocation rates for all employees are determined using a single schedule based solely on age, as described in paragraph (b)(1)(iv)(A)(*1*) of this section. Therefore, if the allocation rates under the schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section, then the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iii) The schedule of allocation rates under Plan N does not increase by more than 5 percentage points between adjacent bands and the ratio of the allocation rate for any band to the allocation rate for the immediately preceding band is never more than 2.0 and does not increase. Therefore, the allocation rates increase smoothly as described in paragraph (b)(1)(iv)(B) of this section. In addition, the bands (other than the highest band and the first band, which is deemed to be the same length as the other bands because it ends prior to age 25) are all 5 years long, so the increases occur at regular intervals as described in paragraph (b)(1)(iv)(C) of this section. Thus, the allocation rates under the plan's schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section. Accordingly, the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iv) Under paragraph (b)(1)(i) of this section, Plan N satisfies the nondiscrimination in amount requirement of § 1.401(a)(4)–1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section, regardless of whether it satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section.

Example 4. (i) Plan O, a defined contribution plan, provides an allocation formula under which allocations are provided to all employees according to the following schedule:

Age	Allocation rate (in percent)	Ratio of allocation rate for band to allocation rate for immediately preceding band
Under 40	3	(1)
40–44	6	2.00
45–49	9	1.50
50–54	12	1.33
55–59	16	1.33
60–64	20	1.25
65 or older	25	1.25

[1] Not applicable.

(ii) Plan O provides that allocation rates for all employees are determined using a single schedule based solely on age, as described in paragraph (b)(1)(iv)(A)(*1*) of this section. Therefore, if the allocation rates under the schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section, then the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iii) The bands (other than the highest band) in the schedule are not all the same length, since the first band is treated as 15 years long while other bands are 5 years long. Thus, the schedule does not have regular intervals as described in paragraph (b)(1)(iv)(C) of this section. However, under paragraph (b)(1)(iv)(D) of this section, the schedule of allocation rates does not fail to increase smoothly at regular intervals merely because the minimum allocation rate of 3% results in a first band that is longer than the other bands, if either of the conditions of paragraph (b)(1)(iv)(D)(*1*) or (*2*) of this section is satisfied.

(iv) In this case, in order to define a hypothetical schedule that could include the allocation rates in the actual schedule of allocation rates, each of the bands below age 40 would have to be 5 years long (or be treated as 5 years long). Accordingly, the hypothetical schedule would have to provide for a band for employees under age 30, a band for employees in the range 30–34 and a band for employees age 35–39.

(v) The ratio of the allocation rate for the age 40–44 band to the next lower band is 2.0. Accordingly, in order for the applicable allocations rates under this hypothetical schedule to increase smoothly, the ratio of the allocation rate for each band in the hypothetical schedule below age 40 to the allocation rate for the immediately preceding band would have to be 2.0. Thus, the allocation rate for the hypothetical band applicable for employees under age 30 would be .75%, the allocation rate for the hypothetical band for employees in the range 30–34 would be 1.5% and the allocation rate for employees in the range 35–39 would be 3%.

(vi) Because the lowest allocation rate under any possible hypothetical schedule is less than 1% of plan year compensation, Plan O will be treated as satisfying the requirements of paragraphs (b)(1)(iv)(B) and (C) of this section only if the schedule of allocation rates satisfies the steepness condition described in paragraph (b)(1)(iv)(D)(*2*) of this section. In this case, the steepness condition is not satisfied because the equivalent accrual rate for an employee age 39 is 2.81%, but there is no hypothetical employee in the band for ages 40–44 with an equal or lower equivalent accrual rate (since the lowest equivalent accrual rate for hypothetical employees within this band is 3.74% at age 44).

(vii) Since the schedule of allocation rates under the plan does not increase smoothly at regular intervals, Plan O's schedule of allocation rates is not a gradual age or service schedule. Further, Plan O does not provide uniform target benefit allocations. Therefore, under paragraph (b)(1)(i) of this section, Plan O cannot satisfy the nondiscrimination in amount requirement of § 1.401(a)(4)–1(b)(2) for the plan year on the basis of benefits unless either Plan O provides for broadly available allocation rates for the plan year as described in paragraph (b)(1)(iii) of this section (i.e., the allocation rate at each age is provided to a group of employees that satisfies section 410(b) without regard to the average benefit percentage test), or Plan O satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section for the plan year.

Example 5. (i) Plan P is a profit-sharing plan maintained by Employer A that covers all of Employer A's employees, consisting of two HCEs, X and Y, and 7 NHCEs. Employee X's compensation is $170,000 and Employee

Y's compensation is $150,000. The allocation for Employees X and Y is $30,000 each, resulting in an allocation rate of 17.65% for Employee X and 20% for Employee Y. Under Plan P, each NHCE receives an allocation of 5% of compensation within the meaning of section 415(c)(3), measured over a period of time permitted under the definition of plan year compensation.

(ii) Because the allocation rate for X is not currently available to any NHCE, Plan P does not have broadly available allocation rates within the meaning of paragraph (b)(1)(iii) of this section. Furthermore, Plan P does not provide for age based-allocation rates within the meaning of paragraph (b)(1)(iv) or (v) of this section. Thus, under paragraph (b)(1)(i) of this section, Plan P can satisfy the nondiscrimination in amount requirement of § 1.401(a)(4)–1(b)(2) for the plan year on the basis of benefits only if Plan P satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section for the plan year.

(iii) The highest allocation rate for any HCE under Plan P is 20%. Accordingly, Plan P would satisfy the minimum allocation gateway of paragraph (b)(1)(vi) of this section if all NHCEs have an allocation rate of at least 6.67%, or if all NHCEs receive an allocation of at least 5% of compensation within the meaning of section 415(c)(3) (measured over a period of time permitted under the definition of plan year compensation).

(iv) Under Plan P, each NHCE receives an allocation of 5% of compensation within the meaning of section 415(c)(3) (measured over a period of time permitted under the definition of plan year compensation). Accordingly, Plan P satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section.

(v) Under paragraph (b)(1)(i) of this section, Plan P satisfies the nondiscrimination in amount requirement of § 1.401(a)(4)–1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section.

* * * * *

Par. 4. Section 1.401(a)(4)–9 is amended by adding paragraph (b)(2)(v) and revising paragraph (c)(3)(ii) to read as follows:

§ 1.401(a)(4)–9 Plan aggregation and restructuring.

* * * * *

(b) * * *

(2) * * *

(v) *Eligibility for testing on a benefits basis*—(A) *General rule.* For plan years beginning on or after January 1, 2002, unless, for the plan year, a DB/DC plan is primarily defined benefit in character (within the meaning of paragraph (b)(2)(v)(B) of this section) or consists of broadly available separate plans (within the meaning of paragraph (b)(2)(v)(C) of this section), the DB/DC plan must satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section for the plan year in order to be permitted to demonstrate satisfaction of the nondiscrimination in amount requirement of § 1.401(a)(4)–1(b)(2) on the basis of benefits.

(B) *Primarily defined benefit in character.* A DB/DC plan is primarily defined benefit in character if, for more than 50% of the NHCEs benefitting under the plan, the normal accrual rate for the NHCE attributable to benefits provided under defined benefit plans that are part of the DB/DC plan exceeds the equivalent accrual rate for the NHCE attributable to contributions under defined contribution plans that are part of the DB/DC plan.

(C) *Broadly available separate plans.* A DB/DC plan consists of broadly available separate plans if the defined contribution plan and the defined benefit plan that are part of the DB/DC plan each would satisfy the requirements of section 410(b) and the nondiscrimination in amount requirement of § 1.401(a)(4)–1(b)(2) if each plan were tested separately and assuming that the average benefit percentage test of § 1.410(b)–5 were satisfied. For this purpose, all defined contribution plans that are part of the DB/DC plan are treated as a single defined contribution plan and all defined benefit plans that are part of the DB/DC plan are treated as a single defined benefit plan. In addition, if permitted disparity is used for an employee for purposes of satisfying the separate testing requirement of this paragraph (b)(2)(v)(C) for plans of one type, it may not be used in satisfying the separate testing requirement for plans of the other type for the employee.

(D) *Minimum aggregate allocation gateway*—(1) *General rule.* A DB/DC plan satisfies the minimum aggregate allocation gateway if each NHCE has an aggregate normal allocation rate that is at least one third of the aggregate normal allocation rate of the HCE with the highest such rate (HCE rate), or, if less, 5% of the NHCE's compensation, provided that the HCE rate does not exceed 25% of compensation. If the HCE rate exceeds 25% of compensation, then the aggregate normal allocation rate for each NHCE must be at least 5% increased by one percentage point for each 5-percentage-point increment (or portion thereof) by which the HCE rate exceeds 25% (e.g., the NHCE minimum is 6% for an HCE rate that exceeds 25% but not 30%, and 7% for an HCE rate that exceeds 30% but not 35%).

(2) Deemed satisfaction. A plan is deemed to satisfy the minimum aggregate allocation gateway of this paragraph (b)(2)(v)(D) if the aggregate normal allocation rate for each NHCE is at least 7½% of the NHCE's compensation within the meaning of section 415(c)(3), measured over a period of time permitted under the definition of plan year compensation.

(3) Averaging of equivalent allocation rates for NHCEs. For purposes of this paragraph (b)(2)(v)(D), a plan is permitted to treat each NHCE who benefits under the defined benefit plan as having an equivalent normal allocation rate equal to the average of the equivalent normal allocation rates under the defined benefit plan for all NHCEs benefitting under that plan.

(E) *Determination of rates.* For purposes of this paragraph (b)(2)(v), the normal accrual rate and the equivalent normal allocation rate attributable to defined benefit plans, the equivalent accrual rate attributable to defined contribution plans, and the aggregate normal allocation rate are determined under paragraph (b)(2)(ii) of this section, but without taking into account the imputation of permitted disparity under § 1.401(a)(4)–7, except as otherwise permitted under paragraph (b)(2)(v)(C) of this section.

(F) *Examples.* The following examples illustrate the application of this paragraph (b)(2)(v):

Example 1. (i) Employer A maintains Plan M, a defined benefit plan, and Plan N, a defined contribution plan. All HCEs of Employer A are covered by Plan M (at a 1% accrual rate), but are not covered by Plan N. All NHCEs of Employer A are covered by Plan N (at a 3% allocation rate), but are not covered by Plan M. Because Plan M does not satisfy section 410(b) standing alone, Plans M and N are aggregated for purposes of satisfying sections 410(b) and 401(a)(4).

(ii) Because none of the NHCEs participate in the defined benefit plan, the aggregated DB/DC plan is not primarily defined benefit in character within the meaning of paragraph (b)(2)(v)(B) of this section nor does it consist of broadly available separate plans within the meaning of paragraph (b)(2)(v)(C) of this section. Accordingly, the aggregated Plan M and Plan N must satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section in order be permitted to demonstrate satisfaction of the nondiscrimination in amount requirement of § 1.401(a)(4)–1(b)(2) on the basis of benefits.

Example 2. (i) Employer B maintains Plan O, a defined benefit plan, and Plan P, a defined contribution plan. All of the six employees of Employer B are covered under both Plan O and Plan P. Under Plan O, all employees have a uniform normal accrual rate of 1% of compensation. Under Plan P, Employees A and B, who are HCEs, receive an allocation rate of 15%, and participants C, D, E and F, who are NHCEs, receive an allocation rate of 3%. Employer B aggregates Plans O and P for purposes of satisfying sections 410(b) and 401(a)(4). The equivalent normal allocation and normal accrual rates under Plans O and P are as follows:

Employee	Equivalent normal allocation rates for the 1% accural under plan O (defined benefit plan) (in percent)	Equivalent normal accural rates for the 15%/3% allocation under plan P (defined contribution plan) (in percent)
HCE A (age 55)	3.93	3.82
HCE B (age 50)	2.61	5.74
C (age 60)	5.91	.51
D (age 45)	1.74	1.73
E (age 35)	.77	3.90
F (age 25)	.34	8.82

(ii) Although all of the NHCEs benefit under Plan O (the defined benefit plan), the aggregated DB/DC plan is not primarily defined benefit in character because the normal accrual rate attributable to defined benefit plans (which is 1% for each of the NHCEs) is greater than the equivalent accrual rate under defined contribution plans only for Employee C. In addition, because the 15% allocation rate is available only to HCEs, the defined contribution plan cannot satisfy the requirements of § 1.401(a)(4)–2 and does not have broadly available allocation rates within the meaning of § 1.401(a)(4)–8(b)(1)(iii). Further, the defined contribution plan does not satisfy the minimum allocation gateway of § 1.401(a)(4)–8(b)(1)(vi) (3% is less than 1/3 of the 15% HCE rate). Therefore, the defined contribution plan within the DB/DC plan cannot separately satisfy § 1.401(a)(4)–1(b)(2) and does not constitute a broadly available separate plan within the meaning of paragraph (b)(2)(v)(C) of this section. Accordingly, the aggregated plans are permitted to demonstrate satisfaction of the nondiscrimination in amounts requirement of § 1.401(a)(4)–1(b)(2) on the basis of benefits only if the aggregated plans satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section.

(iii) Employee A has an aggregate normal allocation rate of 18.93% under the aggregated plans (3.93% from Plan O plus 15% from Plan P), which is the highest aggregate normal allocation rate for any HCE under the plans. Employee F has an aggregate normal allocation rate of 3.34% under the aggregated plans (.34% from Plan O plus 3% from Plan P) which is less than the 5% aggregate normal allocation rate that Employee F would be required to have to satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section.

(iv) However, for purposes of satisfying the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section, Employer B is permitted to treat each NHCE who benefits under Plan O (the defined benefit plan) as having an equivalent allocation rate equal to the average of the equivalent allocation rates under Plan O for all NHCEs benefitting under that plan. The average of the equivalent allocation rates for all of the NHCEs under Plan O is 2.19% (the sum of 5.91%, 1.74%, .77%, and .34%, divided by 4). Accordingly, Employer B is permitted to treat all of the NHCEs as having an equivalent allocation rate attributable to Plan O equal to 2.19%. Thus, all of the NHCEs can be treated as having an aggregate normal allocation rate of 5.19% for this purpose (3% from the defined contribution plan and 2.19% from the defined benefit plan) and the aggregated DB/DC plan satisfies the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section.

* * * * *

(c) * * *

(3) * * *

(ii) *Restructuring not available for certain testing purposes.* The safe harbor in § 1.401(a)(4)–2(b)(3) for plans with uniform points allocation formulas is not available in testing (and thus cannot be satisfied by) contributions under a component plan. Similarly, component plans cannot be used for purposes of determining whether a plan provides broadly available allocation rates (as defined in § 1.401(a)(4)–8(b)(1)(iii)), determining whether a plan has a gradual age or service schedule (as defined in § 1.401(a)(4)–8(b)(1)(iv)), determining whether a plan has allocation rates that are based on a uniform target benefit allocation (as defined in § 1.401(a)(4)–8(b)(1)(v)), or determining whether a plan is primarily defined benefit in character or consists of broadly available separate plans (as defined in paragraphs (b)(2)(v)(B) and (C) of this section). In addition, the minimum allocation gateway of § 1.401(a)(4)–8(b)(1)(vi) and the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section cannot be satisfied on the basis of component plans. See §§ 1.401(k)–1(b)(3)(iii) and 1.401(m)–1(b)(3)(iii) for rules regarding the inapplicability of restructuring to section 401(k) plans and section 401(m) plans.

* * * * *

Par. 5. Section 1.401(a)(4)–12 is amended by adding a sentence to the end of the definition of *Standard mortality table* to read as follows:

§ 1.401(a)(4)–12 Definitions.

* * * * *

Standard mortality table. * * * The applicable mortality table under section 417(e)(3)(A)(ii)(I) is also a standard mortality table.

* * * * *

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

Approved: June 21, 2001.

Mark A. Weinberger,

Assistant Secretary of the Treasury.

[FR Doc. 01–16326 Filed 6–28–01; 8:45 am]

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DEPARTMENT OF COMMERCE

Technology Administration

37 CFR Part 404

[Docket No. 010111012–1012–01]

RIN 0692–AA17

Licensing of Government Owned Inventions

AGENCY: Technology Administration, Commerce.

ACTION: Final rule.

SUMMARY: This final rule incorporates a recently enacted change to 35 U.S.C. 209 with respect to the granting of exclusive patent licenses by Federal agencies. Federal agencies are now authorized to provide the public no less than 15 days to file an objection to the proposed license. Under the present regulation in 37 CFR part 404, the notice period is 60 days although no specific time period was required by statute. This statutory change is being implemented to address the concern that the granting of exclusive licenses was being unnecessarily delayed by the 60-day notice period.

DATES: This rule is effective June 29, 2001.

FOR FURTHER INFORMATION CONTACT: Mr. John Raubitschek, Patent Counsel, at telephone: (202) 482–8010.

SUPPLEMENTARY INFORMATION: In section 4(e) of Public Law 106–404, the Technology Transfer Commercialization Act of 2000, signed by the President on November 1, 2000, agencies are now required to give the public notice of at least 15 days before granting an exclusive or partially exclusive license on a federally owned invention. This is reflected in revisions to 37 CFR 404.7(a)(1)(i) and (b)(1)(i). One of the reasons for the minimum notice was a concern that the granting of exclusive licenses was being unnecessarily delayed by the 60 day notice period prescribed by the current regulations. Although agencies may now issue shorter notices, they are expected to balance the need for promptness against the statutory purpose of ensuring that Government inventions are used to benefit the public.

Public Law 106–404 makes other changes to 35 U.S.C. 209 which will be separately addressed in a proposed rule.

In addition, the rule now cites 35 U.S.C. 208, instead of 35 U.S.C. 206, as the correct authority for the Department of Commerce over the patent licensing regulation. The rule also cites section 3(d)(3) of DOO 10–18, instead of section