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## PURPOSE

This transmits complete reprint with changes for IRM 4.72.3, Employee Plans Technical Guidance, Employee Contributions and Matching Contributions.

## BACKGROUND

IRM text pertaining to IRM 7.7.1, Chapter 3 (formerly, IRM 7(10)54:450) has been reorganized and renumbered as IRM 4.72.3. This IRM material reflects the new simplified format and style.

## NATURE OF CHANGES

This IRM text provides guidance for examiners on plans providing for employee contributions or matching contributions for plan years beginning after December 31, 1996. This transmittal reissues existing procedures, updates the text for law changes, and reorganizes the material. This material replaces and obsoletes text currently contained in the following IRM sections: IRM 7.7.1, Chapter 3 (formerly, IRM 7(10)54:450), using the same catalog number.

## INTENDED AUDIENCE

TEGE (Employee Plans)

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4.72.3.1 (03-01-2002)

**Overview of Section 3**

- (1) The information contained in this section 3 is designed primarily to assist EP examiners in identifying relevant issues relating to plans that provide for employee contributions or matching contributions (a “section 401(m) plan”) for plan years beginning after December 31, 1996.
- (2) Most plans covered by this section will also contain a cash or deferred arrangement (CODA). In such case, IRM section 4.72.2 (relating to CODAs) should be used along with this section. For ease of use, this section 3 has a similar structure to the CODA section, sometimes resulting in duplicative material. Also, most CODA-related guidance issued by the Service will include guidance relevant to section 401(m) plans, so this section 3 will often reference guidance that is directed mainly at CODAs.
- (3) This section 3 reflects statutory changes made by the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103-353 (USERRA), the Small Business Job Protection Act of 1996, Pub. L. 104-188 (SBJPA), the Taxpayer Relief Act of 1997, Pub. L. 105-34 (TRA), the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206 (RRA) and all guidance issued by the Service prior to 2001. In addition this section also reflects a retroactive change made by the Community Renewal Tax Relief Act of 2000, Pub. L. 106-554 (CRA), to the definition of compensation.

4.72.3.2 (03-01-2002)

**Recent Changes to Section 401(m) Plans**

- (1) The statutes listed above in IRM 4.72.3.1 made the changes listed in (2), (3), (4) and (5) below.
- (2) Effective in 1997:
  - a. IRC sections 401(k)(11) and 401(m)(10) were added by section 1422 of SBJPA (as amended by section 1601(d) of TRA) to permit SIMPLE section 401(k) plans.
  - b. IRC sections 401(k) and 401(m) were amended by section 1433(c), (d) and (e) of SBJPA to allow testing HCEs’ ADP and ACP against prior year’s NHCEs’ ADP and ACP and to change the method of correcting failed tests.
  - c. IRC section 414(q) was amended by section 1431 of SBJPA to repeal the family aggregation rules and simplify the definition of HCE.
- (3) Effective in 1998:
  - a. IRC section 402(g)(9) was added by section 1501 of TRA to provide that matching contributions for self-employed individuals are not to be treated as elective deferrals.
  - b. IRC section 415(c)(3) was amended by section 1434 of SBJPA to provide that the definition of compensation includes elective deferrals and deferrals made under section 125 and section 457 plans.

- c. IRC section 415(c)(3) was further amended by section 314(e) of CRA to add IRC section 132(f)(4) elective amounts to the definition of compensation, effective for years beginning after 1997. See Notice 2001-37, 2001-25 I.R.B. 1340.
- (4) Effective in 1999:
- a. IRC sections 401(k)(12) and 401(m)(11) were added by section 1433(a) and (b) of SBJPA to provide safe-harbor methods for satisfying the nondiscrimination tests of sections 401(k) and 401(m).
  - b. IRC sections 401(k)(3)(F) and 401(m)(5)(C) were added by section 1459 of SBJPA to permit the ADP and ACP tests to be applied by excluding NHCEs who have not met the minimum age and service requirements of section 410 in certain cases.
- (5) In addition to the above, USERRA, codified at 38 U.S.C. sections 4301-4333, revised and restated the Federal law protecting the reemployment rights of an employee following an absence because of military service. Among the protected rights is the right to receive certain pension, profit-sharing and similar benefits that would have been received but for the employee's absence during military service, now codified at IRC section 414(u), which was added to the Code by section 1704(n) of SBJPA. IRC section 414(u) provides that employees are entitled to make catch-up elective deferrals and receive any matching contributions on those deferrals for an absence due to military service. IRC section 414(u) is effective as of December 12, 1994, but a plan has to the end of the SBJPA remedial amendment period to amend for IRC section 414(u). For a summary of the requirements of USERRA and IRC section 414(u), see Rev. Proc. 96-49, 1996-2 CB 369.
- (6) In addition to the statutory changes, the Service released the following guidance on CODAs (and section 401(m) plans) in the last few years:
- a. Notice 97-2, 1997-1 C.B. 348, dealing with the methodology of prior year testing and correction.
  - b. Rev. Proc. 97-9, 1997-1 C.B. 624, relating to SIMPLE 401(k) plans and providing a model amendment.
  - c. Notice 98-1, 1998-1 C.B. 327, providing guidance on prior year testing.
  - d. Notice 98-52, 1998-2 C.B. 632, and Notice 2000-3, 2000-4 I.R.B. 413, providing guidance on safe harbor plans.
  - e. Notice 99-5, 1999-3 I.R.B. 10, and Notice 2000-32, 2000-26 I.R.B. 1274, providing guidance on ineligible rollover distributions.
  - f. Rev. Rul. 2000-8, 2000-7 I.R.B. 617, dealing with automatic enrollment ("negative elections") features.
  - g. Rev. Rul. 2000-27, 2000-27 I.R.B. 1016, providing guidance on when a separation from service has occurred.
- (7) Due to all these recent changes, the regulations under IRC section 401(m) do not reflect current law. However, they are still valid to the extent they are not inconsistent with the items listed in (2) through (6) above.

4.72.3.3 (03-01-2002)

**Common  
Abbreviations**

- (1) For brevity, this text uses some common abbreviations for frequently used terms. Such terms are briefly defined in this IRM 4.72.3.3, but will be discussed in greater detail in the relevant parts of this section 3 and IRM 4.72.2.
- (2) “ECs,” or “elective contributions,” are the contributions made to a plan pursuant to an employee’s CODA election. Elective contributions can be treated as matching contributions and used in the ACP test provided the ADP test is first satisfied using all elective contributions and continues to be satisfied after exclusion of those elective contributions used in the ACP test
- (3) “Employee contributions,” sometimes referred to as “after-tax” employee contributions, are plan contributions from employees, either mandatory (meaning they are required in order to receive some benefit from the employer, such as matching contributions) or voluntary, that are allocated to a separate account. These contributions are treated at the time of contribution as after-tax employee contributions. The term does not include loan repayments, repayments for the buy-back of cashed-out benefits (see IRC section 411(a)(7)(C)), or amounts that are transferred from another plan.
- (4) “Matching contributions” are employer contributions made to a defined contribution plan on account of an employee’s employee contributions or elective contributions. The term also includes forfeitures allocated on the basis of matching contributions, employee contributions or elective contributions. The term does not include contributions used to satisfy the top-heavy minimum contribution requirement under IRC section 416.
- (5) “ADR,” or “actual deferral ratio,” is an employee’s ECs (and amounts treated as ECs) for a plan year divided by the employee’s compensation for the plan year.
- (6) “ADP,” or “actual deferral percentage,” is the average of the ADRs for the relevant group of employees. It is used in discussions about the ADP test, an antidiscrimination test contained in IRC section 401(k)(3)(A)(ii).
- (7) “ACR,” or “actual contribution ratio,” is the sum of an employee’s employee contributions and matching contributions (and amounts treated as matching contributions) for a plan year divided by the employee’s compensation for the plan year.
- (8) “ACP,” or “actual contribution percentage,” is the average of the ACRs for the relevant group of employees. It is used in discussions about the ACP test, an antidiscrimination test contained in IRC section 401(m)(2)(A).
- (9) “QNECs” (sometimes “QNCs”), or “qualified nonelective contributions,” are special employer contributions that are not subject to a CODA election. They are always fully vested and are subject to certain distribution restrictions. They may be treated as ECs or matching contributions in the ADP test or ACP test, respectively.

- (10) “QMACs,” or “qualified matching contributions,” are employer matching contributions that are always fully vested and are subject to certain distribution restrictions. They are counted in the ACP test unless they are treated as ECs, in which case they are counted in the ADP test. If the only matching contributions under a plan containing a CODA were QMACs, and no employee contributions were permitted, the plan need not perform the ACP test, only the ADP test.

4.72.3.4 (03-01-2002)  
**Summary of  
Section 401(m)  
Plan  
Requirements**

- (1) If a plan provides for employee contributions or matching contributions, it must satisfy the requirements of IRC section 401(m), in addition to the other requirements under IRC section 401(a). In this text such a plan is referred to as a “section 401(m) plan,” whether or not any other types of contributions are provided for in the plan; but in the regulations, a “section 401(m) plan” means only the portion of a plan that consists of employee and matching contributions.
- (2) Essentially, the only requirement imposed by IRC section 401(m) is the ACP test, which applies to the amount of employee and matching contributions.
- (3) Under Regs. 1.410(b)-7(c) the portion of a plan consisting of employee and matching contributions must separately satisfy the IRC section 410(b) coverage requirements.
- (4) Note that employee contributions and attributable earnings must be nonforfeitable at all times, whereas matching contributions (other than QMACs) may be subject to a vesting schedule. But vested matching contributions, including QMACs, may be forfeited under the plan if the contributions to which they relate are treated as excess deferrals (deferrals in excess of the IRC section 402(g) limit), excess contributions (deferrals over the ADP test limit) or excess aggregate contributions (amounts in excess of the ACP test limit). See IRC sections 401(k)(8)(E) and 411(a)(3)(G).

4.72.3.5 (03-01-2002)  
**Coverage and  
Participation**

- (1) The portion of the plan consisting of employee and matching contributions, by itself, must satisfy one of the coverage tests under IRC section 410(b), either the ratio percentage test or the average benefits test. To satisfy the ratio percentage test, such portion may be aggregated with a similar portion in the same or another plan if it has the same plan year, uses the same testing method (prior year or current year) and may be permissively aggregated under the IRC section 410(b) regulations.
- (2) Each employee who is eligible to make an employee contribution or receive a matching contribution (an “eligible employee”) is treated as “benefiting,” (i.e., covered), regardless of whether the employee elects to make employee contributions or have deferrals made on his or her behalf (and, potentially, receive matching contributions on these amounts). The term “eligible employee” also includes certain employees who are



temporarily prohibited under the plan from making contributions, such as a suspension following a hardship distribution. See the discussion later under “ACP Test.”

- (3) Reg. 1.401(a)(4)–11(g)(3) provides that section 401(k) and section 401(m) plans may be retroactively amended to extend eligibility to employees for coverage purposes within 10 1/2 months after the plan year in which there is a coverage problem. Under this regulation, if a plan needs to add some nonhighly compensated employees to satisfy IRC section 410(b), the employer must make a QNEC contribution to each of the added employees equal to the average of the ACRs of the nonhighly compensated employees who were eligible. This retroactive correction feature cannot be used to correct other defects, such as a failure to satisfy the ACP test.
- (4) Employees covered by a collective bargaining agreement must be disaggregated from employees not covered by a collective bargaining agreement for purposes of the ACP test. Separate collective bargaining units within the same plan may be disaggregated, but are not required to be, for purposes of the ACP test. The combination of bargaining units used for testing must be reasonable and reasonably consistent from year to year. Equivalent rules apply to multi-employer plans.
- (5) An ESOP must be disaggregated from non-ESOP portions of the same plan. Even if an employer maintains portions of plans subject to the ACP test in both an ESOP and another plan and an HCE participates in both, the portions are not aggregated.

4.72.3.5.1 (03-01-2002)  
**Examination Tip**

- (1) Verify the portion of the plan that is subject to IRC section 401(m) satisfies the coverage requirements of IRC section 410(b).

4.72.3.6 (03-01-2002)  
**Nondiscrimination**

- (1) Under IRC section 401(m)(2), an employer maintaining a section 401(m) plan must annually compare the employee and matching contributions of eligible highly compensated employees (“HCEs”) with those made by eligible nonhighly compensated employees (“NHCEs”) and, if certain limits are exceeded by the HCEs, must take corrective action to bring the plan within the limits. This testing for nondiscrimination (the ACP test) is the exclusive nondiscrimination test for amounts of employee and matching contributions contributed to a plan, that is, this test is used instead of any amounts test under IRC section 401(a)(4). QNECs and elective contributions that are treated as matching contributions are also counted in the ACP test.
- (2) Employee and matching contributions under a collectively bargained plan are treated as satisfying IRC section 401(m).
- (3) There are two alternatives a plan may use instead of the ACP test and its correction mechanisms:

- a. For plan years beginning after December 31, 1996, employers could adopt SIMPLE 401(k) plans, modeled after SIMPLE IRA plans described in IRC section 408(p). See IRC sections 401(k)(11) and 401(m)(10).
  - b. For plan years beginning after December 31, 1998, employers could adopt safe harbor 401(k) plans described in IRC sections 401(k)(12) and 401(m)(11).
- (4) Although a section 401(m) plan must satisfy the ACP test (or be deemed to satisfy the ACP test because it is part of a SIMPLE 401(k) plan or a safe harbor 401(k) plan) with respect to the amount of employee and matching contributions, the right to make each level of employee contributions and the right to each level of matching contributions is a benefit, right or feature that must satisfy the nondiscriminatory availability requirement of Regs. 1.401(a)(4)-4(e)(3).
  - (5) A plan that fails the ACP test does not meet the requirements for a qualified plan under IRC section 401(a).
  - (6) In addition to the ACP test, if an employer has one or more HCEs who are eligible under both a CODA of the employer that is subject to the ADP test and a plan of the employer that is subject to the ACP test, then the employer must perform an additional nondiscrimination test designed to limit the multiple use of the “2 plus or 2 times” prong of the ADP and ACP tests. This test is often referred to as the “multiple use test.” See “Multiple Use Test” later.
  - (7) A section 401(m) plan must state that the ACP test will be satisfied and the employer is required to maintain records necessary to demonstrate compliance with the ACP test, including the extent to which QNECs and elective contributions are taken into account.

## 4.72.3.6.1 (03-01-2002)

**ACP Test**

- (1) Under the ACP test, set forth at IRC section 401(m)(2)(A), the ACP of the eligible HCEs cannot exceed the greater of:
  - a. 1.25 x the ACP of the eligible NHCEs, or
  - b. the lesser of 2 + the ACP of the eligible NHCEs or 2 X the ACP of the eligible NHCEs.
- (2) The ACP for a group (either HCE or NHCE) is the average of the individual ACRs of the particular group. An eligible employee’s ACR is the sum of the employee and matching contributions and QNECs and elective contributions that are treated as matching contributions allocated to the employee’s account in the plan divided by the employee’s compensation. ACRs and ACPs, expressed as a percentage, must be rounded to the nearest one-hundredth of a percent. If the only eligible employees under the plan are HCEs, the plan automatically passes the ACP test.
- (3) Only “eligible employees” are included in the ACP test. (“Eligible employees” are also counted as “benefiting” for purposes of satisfying the IRC section 410(b) coverage requirements.) An “eligible employee” is one

who is eligible under the plan to make an employee contribution or to receive an allocation of matching contributions, whether or not the employee actually makes any employee contributions or receives any matching contributions. If an eligible employee chooses not to make employee contributions, and no matching contributions (or elective contributions or QNECs treated as matching contributions) are allocated to the employee's accounts, the employee must be included in the ACP test with an ACR of zero. The term also includes an employee who:

- a. must perform purely ministerial or mechanical acts in order to make an employee contribution or receive an allocation of matching contributions,
  - b. has been suspended from making employee contributions under the plan (e.g., for having taken a hardship distribution), or
  - c. may not make additional employee contributions or receive additional employer contributions because of the limits imposed by IRC section 415(c) (and IRC section 415(e) for limitation years before 2000).
- (4) An employee who cannot make employee contributions or receive matching contributions because he or she was given a one-time election when the employee commenced employment with the employer or upon first becoming eligible under any section 401(m) plan of the employer and elected not to be eligible to make employee contributions or receive an allocation of matching contributions for the duration of employment with the employer is not an eligible employee.
- (5) The ACP test is performed on the plan level, so identification of the "plan" is the first step to be performed. See the discussion under "Coverage and Participation" above.
- (6) If a plan is disaggregated into separate plans for purposes of IRC section 410(b), the portion consisting of employee and matching contributions must also be disaggregated. For example, if a plan covers all employees, but, for testing purposes the plan is disaggregated into two plans, one covering employees who have less than 1 year of service or are less than age 21, and one covering all other employees, the employer would run two ACP tests, one for the employees with less than 1 year of service or less than age 21, and the other for all other employees.
- (7) Section 1459 of SBJPA added section 401(k)(3)(F) and section 401(m)(5)(C) to the Code to provide a special rule for early participation. Congress believed that some employers were reluctant to include younger or new employees in a section 401(k) plan because these employees tended to have lower deferral percentages and therefore could cause the plan to fail the ADP (and ACP) test. To encourage coverage of these employees, effective for plan years beginning after December 31, 1998, an employer may elect to disregard employees (other than HCEs) eligible to participate in the plan before they have completed 1 year of service and reached age 21, provided the plan separately satisfies the minimum coverage rules of IRC section 410(b) taking into account only those employees who have not completed 1 year of service or are under age 21. A single ACP test is applied that

compares the ACP for all eligible HCEs with the ACP for eligible NHCEs who have completed one year of service and reached age 21. A similar rule applies for purposes of the ADP test.

- (8) If an HCE is eligible to participate in more than one plan of an employer to which employee or matching contributions may be made, the HCE's contributions under all such plans of the employer must be combined to determine the HCE's ACR. This combination ACR is then used in the ACP test under each plan.
- (9) The compensation used to calculate ACRs is limited to the IRC section 401(a)(17) amount and must also satisfy IRC section 414(s). The definition of compensation used by the plan must be nondiscriminatory, and elective deferrals may be included or excluded from the definition.
- (10) Contributions on behalf of HCEs that exceed the limits imposed by the ADP test are called excess contributions, that is, they are the amount of contributions used to calculate the HCE ADP that exceeds the amount of such contributions permitted if the ADP test were passed. A plan must dispose of excess contributions by distributing them to certain HCEs or recharacterizing them as employee after-tax contributions. Recharacterized amounts are then counted in the ACP test.
- (11) Contributions on behalf of HCEs that exceed the limits imposed by the ACP test are called excess aggregate contributions, that is, they are the amount of contributions used to calculate the HCE ACP that exceeds the amount of such contributions permitted if the ACP test were passed. A plan must dispose of excess aggregate contributions by distributing them to certain HCEs or forfeiting certain matching contributions. QNECs and certain elective contributions contributed on behalf of NHCEs can be used to raise the NHCE ACP, thereby reducing or eliminating HCE contributions that might otherwise become excess aggregate contributions.
- (12) Prior to 1997, the HCE ACP was compared to the NHCE ACP for the same plan year (the "testing year"). For plan years beginning after December 31, 1996, a plan can choose, by specifying in the plan document, whether it will perform the ACP test by comparing the HCE ACP with the same year's NHCE ACP ("current year testing") or by comparing the HCE ACP for a testing year with the prior plan year's NHCE ACP ("prior year testing").

4.72.3.6.1.1 (03-01-2002)

**Current Year  
Testing**

- (1) Employee contributions of an employee are taken into account for a plan year in current year ACP testing for the plan year in which they are made to the trust. A payment to an agent of the plan, such as the employer, is at that time treated as made to the trust if the agent remits such funds to the trust within a reasonable time after receipt. (Note that under Department of Labor regulations, employee contributions must be paid into the trust by the earliest date such contributions can reasonably be segregated from the employer's general assets. See DOL Regs. 2510.3-102.) Excess contributions that are recharacterized as employee

contributions are taken into account for the plan year in which the excess contribution is included in the HCE's gross income.

- (2) Matching contributions are taken into account for a plan year only if:
  - a. under the terms of the plan they are allocated to the employee's account as of a date within the plan year,
  - b. they are paid to the trust no later than 12 months after the close of the plan year, and
  - c. they are made on account of the employee's elective contributions or employee contributions for the plan year.
- (3) Matching contributions that do not meet the requirements in (2) above are treated as employer nonelective contributions and must satisfy the general nondiscrimination rules under IRC section 401(a)(4) without the benefit of the ACP test.
- (4) A matching contribution that is forfeited because the contribution to which it relates is treated as an excess deferral, an excess contribution or an excess aggregate contribution is not counted in the ACP test. Also, QMACs used in the ADP test are not counted in the ACP test.
- (5) Under IRC section 401(m)(3), an employer may take into account QNECs in calculating the ACP, but, in order to do so, the regulations provide that such contributions must satisfy the nonforfeitability requirement, the distribution limitations and the 12-month contribution-to-the-trust rule that apply to elective contributions. In addition, QNECs, both before and after some or all are used in the ACP test, must satisfy IRC section 401(a)(4). A QNEC used in the ADP test cannot again be used for the ACP test.
- (6) Also, under IRC section 401(m)(3), an employer may take into account elective contributions in calculating the ACP, but the ADP test must be passed both with and without the elective contributions used in the ACP test.
- (7) Note that QNECs and QMACs made after the tax return filing date are not deductible for the prior taxable year. These contributions are counted, with other employer contributions, against the IRC section 404 deduction limits for the year made.

4.72.3.6.1.2 (03-01-2002)

**Prior Year Testing**

- (1) Generally, the rules that apply to calculating ACRs and ACPs in current year testing also apply to prior year testing. Prior year testing simplifies plan administration because an employer can determine the percentage of employee and matching contributions that can be made on behalf of HCEs early in the plan year and have more time to plan for correction. Consider the following examples:
  - a. Employer X maintains a section 401(m) plan that provides that distribution of excess aggregate contributions is the only method under the plan to correct ACP test failures. The plan has a calendar-year plan year and both HCEs and NHCEs make employee contributions to the plan. In January 1997, Employer X determines

that the plan fails the ACP test for 1996, and that a corrective distribution of excess aggregate contributions must be made to appropriate HCEs by March 15, 1997, to avoid all penalties.

- b. Same facts as above, except that the testing year is 1997 and the plan is using the prior year testing method. The ACP for the NHCEs for 1996 under the plan can be determined early in 1997 by Employer X because it has obtained the necessary data on prior year NHCE status, contributions and compensation by January 1997. This simplifies plan administration for Employer X.

- (2) The eligible employees taken into account in determining the prior year's ACP for NHCEs are those eligible employees who were NHCEs during the preceding year, without regard to the employee's status in the testing year. A special rule applies for the first plan year. In the case of the first plan year of any plan (other than a successor plan), the amount taken into account as the ACP for NHCEs for the preceding plan year is deemed to be 3 percent, unless an election is made to use the actual ACP data for the first plan year.

(3)

**Example:** Employee A was employed by Employer X and was an NHCE in Year One. Employee A no longer works for Employer X in Year Two. For purposes of determining the prior year's ACP for Employer X's section 401(m) plan for the Year Two testing year, Employee A is taken into account. The result would be the same if Employee A were still employed by Employer X but had become a HCE in Year Two.

- (4) Notice 97-2 and Notice 98-1 provide guidance on the use of the prior year method and the current year testing method and on changing from one method to the other. In general, Notice 98-1 requires that a plan must specify which of the two testing methods it is using. If the testing method is changed, the plan must be amended to reflect the change. See § IX of Notice 98-1.

4.72.3.6.1.2.1 (03-01-2002)

#### **Use of QNECs and QMACs in Prior Year Testing**

- (1) To be taken into account for the NHCE ACP for the prior year, a QNEC or QMAC must be allocated as of a date within that prior year, and must actually be paid to the trust by the end of the 12-month period following the end of that prior year. In other words, it must actually be paid to the trust by the end of the testing year; thus, when using prior year testing, an employer cannot use QNECs or QMACs to correct a failed ACP or ADP test because the employer won't know until after the testing year whether or not the ACP or ADP test is failed and by then the deadline for making corrective QNECs and QMACs has passed. Of course QNECs and QMACs made prior to the deadline can be counted.

(2)

**Example:** A plan uses the prior year testing method for the 1999 testing year. QMACs that are allocated to NHCEs' accounts as of the last day of

the 1998 plan year may be taken into account in calculating the ACP only if those QMACs are actually contributed to the plan by the last day of the 1999 plan year.

- (3) Note that this 12-month rule does not change the rule under IRC section 415, that employer contributions shall not be deemed credited to a participant's account for a particular limitation year unless the contributions are actually made no later than 30 days after the end of the IRC section 404(a)(6) period applicable to the taxable year with or within which the particular limitation year ends. See Regs. 1.415-6(b)(7)(ii).

4.72.3.6.1.2.2 (03-01-2002)  
**First-Year Rule  
for Prior Year  
Testing**

- (1) For the first plan year of a plan (other than a "successor plan," see below) that uses prior year testing, the ACP for NHCEs for the prior year is deemed to be 3%. See IRC section 401(m)(3). Alternatively, if the employer so elects in the plan document, the NHCE ACP is equal to the NHCE ACP for that first plan year (i.e., the current year).
- (2) For ACP testing purposes, the "first plan year" is the first year in which the plan provides for employee or matching contributions. A plan does not have a first plan year if for that year it is aggregated under the regulations with any other plan that provided for employee or matching contributions in the prior year.
- (3) A plan is a "successor plan" if 50% or more of the eligible employees for the first plan year were eligible employees under another section 401(m) plan maintained by the employer in the prior year.

4.72.3.6.1.2.3 (03-01-2002)  
**Changes in the  
Group of NHCEs  
in Prior Year  
Testing**

- (1) In general, under the prior year testing method, subsequent changes in the group of NHCEs are disregarded. That is, the ACP for NHCEs for the prior year is determined with respect to eligible employees who were NHCEs in that prior year, and without regard to changes in the group of eligible NHCEs in the testing year. This is true even though some NHCEs in the prior year have become HCEs in the testing year, or are no longer eligible employees under the plan. It is also true even though some NHCEs in the testing year were not eligible employees in the prior year.
- (2) However, if a plan results from or is affected by a "plan coverage change" that becomes effective during the testing year then the NHCE ACP for the prior year is the weighted average of the ACPs for the prior year subgroups. A "plan coverage change" is a change in the group(s) of eligible employees on account of:
- the establishment or amendment of a plan;
  - a plan merger, consolidation, or spinoff under IRC section 414(l);
  - a change in the way plans are (or are not) permissively aggregated under Regs. 1.410(b)-7(d); or
  - any combination of the above.
- (3) A "prior year subgroup" is all NHCEs for the prior year who were eligible employees under a specific section 401(m) plan maintained by the

employer, and who would have been eligible employees under the plan being tested if the plan coverage change had been effective as of the first day of the prior year.

- (4) The “weighted average of the ACPs for the prior year subgroups” is the sum, for all prior year subgroups of the “adjusted ACPs.”
- (5) The “adjusted ACP” for each prior year subgroup is the ACP for the prior year for all NHCEs of the specific plan under which the members of the prior year subgroup were eligible employees, multiplied by a fraction, the numerator of which is the number of NHCEs in the prior year subgroup, and the denominator of which is the total number of NHCEs in all prior year subgroups.
- (6) An exception to the exception: If there is a plan coverage change, and 90% or more of all NHCEs from all prior year subgroups are from a single prior year subgroup, then the employer may elect to use the prior year ACP for NHCEs of the plan that included that single prior year subgroup. Notice 98-1 contains examples involving plan coverage changes.

4.72.3.6.1.3 (03-01-2002)

#### **Changing Testing Method**

- (1) A plan that uses the prior year testing method may adopt the current year testing method for any subsequent testing year. Notification to or prior approval of the Service is not required for the election to be valid. However, the employer may wish to apply for a determination letter on the plan amendment needed to implement the change.
- (2) A plan that uses current year testing after the 1997 plan year (see Notice 97-2) is permitted to change to prior year testing in four situations only:
  - a. The plan is not the result of the aggregation of two or more plans, and current year testing was used for each of the 5 plan years preceding the year of the change (or, if lesser, the number of years the plan has been in existence).
  - b. The plan is the result of the aggregation of two or more plans, and for each of the aggregated plans current year testing was used for each of the 5 plan years preceding the year of the change (or, if lesser, the number of years the plan has been in existence).
  - c. A transaction occurs that is described in IRC section 410(b)(6)(C)(i) (i.e., the employer becomes or ceases to be a member of an IRC section 414(b), (c), (m) or (o) group), and, as a result, the employer maintains both a plan using prior year testing and a plan using current year testing, and the change occurs within the transition period described in IRC section 410(b)(6)(C)(ii) (i.e., by the last day of the 1st plan year beginning after the transaction).
  - d. The change occurs within the plan’s SBJPA remedial amendment period (generally, the last day of the first plan year beginning on or after January 1, 2001; see Rev. Proc. 2000-27, 2000-26 I.R.B. 1272).



4.72.3.6.1.4 (03-01-2002)

**Limits on  
Double  
Counting of  
Certain  
Contributions**

- (1) When a plan changes from current year testing to prior year testing, contributions on behalf of many, if not all, NHCEs are likely to be double counted. For example, if a plan used current year testing in 1998, and then changed to prior year testing in 1999, employee contributions on behalf of NHCEs for 1998 will be counted twice; once in 1998 in calculating the NHCE ACP under the current year testing method, and again in 1999 in calculating the NHCE ACP under the prior year testing method. To limit double counting, Notice 98-1 provides that the ACP for NHCEs for the prior year is determined taking into account only:
  - a. employee contributions made by NHCEs in the prior year,
  - b. matching contributions that were taken into account for the ACP test (but not QMACs used in the ACP test) under the current year testing method in the prior year, and
  - c. QNECs that were allocated to NHCEs' accounts for the prior year, but that were not used to satisfy either the ACP test or the ADP test under the current year testing method for the prior year.
- (2) Thus, the following contributions made for the prior year are disregarded for the ACP test: QNECs used to satisfy either the ACP or ADP test under the current year testing method for the prior year, QMACs taken into account for purposes of the ADP test, and all elective contributions.
- (3) These limitations on double counting do not apply for testing years beginning before January 1, 1999. Thus, for a plan that changes to prior year testing for the first time for the 1998 plan year, the ACP and ADP for NHCEs will be the same as for the 1997 plan year. See Notice 98-1 for examples involving double counting.

4.72.3.6.1.5 (03-01-2002)

**Plan Provisions  
Regarding  
Testing Method**

- (1) A plan must specify which of the two testing methods (current year or prior year) it is using. If the employer changes the testing method under a plan, the plan must be amended to reflect the change.
- (2) The regulations under IRC section 401(k) and (m) permit a plan to incorporate by reference IRC section 401(k)(3) and (m)(2) (and, if applicable, (m)(9)) and the underlying regulations. A plan that incorporates these provisions by reference may continue to do so, but must specify which of the two testing methods (current year or prior year) it is using. Further, for purposes of the first plan year rule, a plan that incorporates these provisions by reference must specify whether the ADP/ACP for NHCEs is 3% or the current year's ADP/ACP.
- (3) Rev. Proc. 2000-27 extends the remedial amendment period for SBJPA generally to the last day of the first plan year beginning on or after January 1, 2001. Any plan amendments to reflect a choice in testing method are not required to be adopted before the end of this remedial amendment period. However, plans must be operated in accordance with the SBJPA changes as of the statutory effective date (section 1433(c) and (d), which added the prior year testing method, were effective for plan years beginning after December 31, 1996). In addition, any retroactive amendments must reflect the choices made in the operation of

the plan for each testing year, including the choice of testing method (and any changes to that method), and must reflect the date(s) on which the plan began to operate in accordance with those choices (and any changes).

4.72.3.6.1.6 (03-01-2002)

#### **Correction of ACP Test**

- (1) If corrective QNECs or QMACs (for section 401(m) plans using current year testing) do not bring the plan within the ACP limits, the plan must distribute the excess aggregate contributions along with attributable earnings and/or forfeit excess aggregate contributions that are matching contributions, according to the terms of the plan. If a plan corrects by distributing employee contributions, any associated match must also be distributed (or forfeited) to prevent the plan from failing the current and effective availability requirement of Regs. 1.401(a)(4)(e)(3) with respect to the remaining matching contributions. A plan may provide for more than one correction method or may provide for a combination of methods.
- (2) If the ACP test is not corrected within the 12-month period following the end of the failed plan year, the plan is not qualified.

4.72.3.6.1.6.1 (03-01-2002)

#### **Determination of Excess Aggregate Contributions**

- (1) Excess aggregate contributions are determined after first determining the amount of excess deferrals and then determining the amount of excess contributions.
- (2) The amount of excess aggregate contributions is determined using a leveling method based on HCEs' ACRs, beginning with the HCE with the highest percentage and continuing in descending order of ACR percentages until the target HCE ACP is reached.
- (3)

**Example:** There are three fully vested HCEs in a section 401(m) plan: HCE1 has compensation of \$80,000 and employee and matching contributions of \$8,800 for an ACR of 11%; HCE2 has compensation of \$100,000 and employee and matching contributions of \$9,000 for an ACR of 9%; and HCE3 has compensation of \$150,000 and employee and matching contributions of \$10,500 for an ACR of 7%. The HCE ACP is 9%. If the HCE ACP needs to be 8% to pass the ACP test, the amount of excess aggregate contributions is determined by multiplying one or more HCE's compensation by the percentage that such HCE's ACR would have to be reduced, using the percentage leveling method, in order to produce a HCE ACP of 8%. The highest ACR percentage, HCE1's 11%, is reduced to the next highest, HCE2's 9%, and then both HCE1 and HCE2's reduced ACRs are further reduced to 8.5%, so that the HCE ACP using these reduced ACRs is 8%. HCE1's ACR reduction by 2.5% produces excess aggregate contributions of \$2,000 (2.5% x \$80,000) and HCE2's ACR reduction by 0.5% produces excess aggregate contributions of \$500 (0.5% x \$100,000) for a total amount of excess aggregate contributions of \$2,500.

4.72.3.6.1.6.2 (03-01-2002)

**Distribution of  
Excess  
Aggregate  
Contributions**

- (1) For plan years beginning before January 1, 1997, corrective distributions of excess aggregate contributions, adjusted for earnings, had to be made to the HCEs whose ACRs were used to determine the amount of excess aggregate contributions and in the same amount. So in the previous example, \$2,000 (adjusted for earnings) would be distributed to HCE1 and \$500 (adjusted for earnings) to HCE2.
- (2) Section 1433(e) of SBJPA amended IRC sections 401(k)(8)(C) and 401(m)(6)(C), effective for plan years beginning after December 31, 1996, to provide that corrective distributions are made based on HCEs' dollar amount of contributions rather than on their percentages. In other words, excess aggregate contributions are distributed to HCEs who have the largest amount of contributions in the numerator of their ACR (a dollar leveling method). The method of determining the amount of excess aggregate contributions (and excess contributions) remains the same. Thus the HOEs whose ACRs are used to calculate the excess amount may be different from the HCEs who receive a corrective distribution. So in the previous example, the \$2,500 of excess aggregate contributions would be allocated \$1,900 to HCE3 (the HCE with the largest amount of employee and matching contributions), \$400 to HCE2 (the HCE with the next largest amount of employee and matching contributions) and \$200 to HCE1. See Notice 97-2 for a more detailed example involving corrective distributions.
- (3) A plan must distribute both the excess aggregate contribution and the earnings attributable to the excess aggregate contribution. Any reasonable method of determining income or loss otherwise used by the plan may be used to determine income or loss attributable to excess aggregate contributions. The regulations do not require the plan to determine or pay out the "gap period" earnings (i.e., the earnings for the period from the end of the plan year to the distribution date). However, if a plan does provide for distribution of gap period earnings, the method used must be consistent for all participants and must otherwise be used in the plan. Earnings on distributions of recharacterized excess contributions are determined as if the distribution was of excess contributions.
- (4) A failed ACP test can be corrected by distributing excess aggregate contributions, adjusted for earnings, to certain HCEs by no later than 12 months after the close of the testing year, regardless of whether the plan is using the prior year or current year testing method.
- (5) Note that if these distributions are made, the section 401(m) plan is treated as meeting the ACP test even though the HCE ACP, if recalculated after distributions, would not satisfy the ACP test.
- (6) Notice 97-2 provides that after excess contributions and excess aggregate contributions, if any, have been distributed using the method described above, the multiple use test of section 401(m)(9) is applied. For purposes of section 401(m)(9), if a corrective distribution of excess contributions has been made, or a recharacterization has occurred, the ADP for HCEs is deemed to be the largest amount permitted under

section 401(k)(3). Similarly, if a corrective distribution of excess aggregate contributions has been made, the ACP for HCEs is deemed to be the largest amount permitted under section 401(m)(2).

- (7) Distributions of excess aggregate contributions and attributable earnings must be reported on Form 1099–R using the appropriate code. Such distributions are taxable distributions under IRC section 72, although the return of employee contributions are not included in gross income. The distributions are not subject to the consent rules under IRC sections 411(a)(11) and 417 or the early withdrawal tax under IRC section 72(t).
- (8) If the distribution is made within the first 2½ months following the end of the plan year, the distributed amount is included in the employee's gross income for his or her taxable year that ends with or within the plan year. In most cases, this means the distributions will be taxable in the preceding calendar year. If the distributions are made after the first 2½ months, the distributions are taxable in the year distributed (and the employer is subject to the 10% tax under IRC section 4979). However, under IRC section 4979(f)(2)(B), if the total excess aggregate contributions and any excess contributions are less than \$100 (without regard to attributable earnings), the amount is included in gross income in the year distributed even if the distribution is made in the 2½ month period.

4.72.3.6.1.6.3 (03-01-2002)

**Forfeiture of  
Excess  
Aggregate  
Contributions**

- (1) A plan can correct a failed ACP test by forfeiting matching contributions (but not employee contributions), plus attributable earnings. Vested matching contributions can only be forfeited to correct for ACP if they relate to employee contributions that have been distributed as excess aggregate contributions, an unlikely scenario: most likely the plan would correct by distributing the minimum amount of employee contributions, together with the related vested match, until the ACP test is satisfied.

4.72.3.6.1.7 (03-01-2002)

**IRC section  
4979 Tax**

- (1) IRC section 4979 imposes a tax on the employer equal to 10% of any excess aggregate contributions not corrected within 2½ months after the end of the plan year to which they relate. However, the tax does not apply if corrective QNECs or QMACs (current year testing plans only) are made within 12 months after the end of the plan year. If the QNECs or QMACs were insufficient to fully satisfy the ACP test, the tax will apply to the remaining excess aggregate contributions.
- (2) The plan has 12 months after the end of the plan year being tested to correct excess aggregate contributions. The plan can distribute excess aggregate contributions any time during the 12-month period, but the employer will still be subject to the 10% tax if the distribution is made after the 2½-month period.
- (3) The tax is reported on Form 5330 and is due 15 months after the end of the plan year. See Reg. 54.4979–1. Any extension of time to pay the tax is not an extension of time to correct the ACP test.

- (4) The tax is a one-time tax, meaning, if excess aggregate contributions are not timely corrected for a plan year, the tax applies only for that year.

4.72.3.6.1.8 (03-01-2002)

**Examination  
Steps**

- (1) Review the plan to determine whether it permits employee and/or matching contributions. If so, look for the ACP test (IRC section 401(m)(2)) stated in the plan or language stating that the test will be met.
- (2) If a DB plan has separate DC accounts for employee contributions, IRC section 401(m) is applicable to the employee contributions to these accounts.
- (3) For years after 12/31/98, review the plan to determine whether the safe harbor method of IRC section 401(m)(11) is being used. If in operation the requirements of IRC section 401(m)(11) are met, the ACP test is not required. If the plan states that it is a safe harbor plan, but in operation, the requirements of IRC section 401(m)(11) are not met, the plan cannot use the ACP test and the plan is not qualified.
- (4) If it is necessary to run the ACP test, have the plan administrator explain the policy/procedures for ACP testing, including correction.
- (5) Review financial audit reports and corporate minutes for comments on ACP testing and correction.
- (6) Identify the employees who are eligible to make employee contributions and/or receive matching contributions.
- (7) If an employee contribution is required as a condition of plan participation (i.e., a mandatory contribution) an employee who would be a participant in the plan if he or she made a contribution is treated as an eligible employee on behalf of whom no contributions are made. See IRC section 401(m)(5)(B). This means a nonparticipant is taken into account in computing the contribution percentage. Since the nonparticipant contributes nothing, the amount of contributions that can be made on behalf of HCEs may be affected.
- (8) Check the plan's definition of compensation to determine whether it meets the requirements of Regs. 1.414(s)-1.
- (9) Verify employee contributions and/or matching contributions with source documents. Determine whether there has been any recharacterization of excess contributions.
- (10) Analyze the testing methodology and results of the ACP test performed by the plan administrator, confirming the accuracy of the test. Ensure the correct year's (or years') data is used in the test.
- (11) If the plan is disaggregated under IRC section 410(b), make sure the ACP test is also run separately on each disaggregated plan. Apply the aggregation and disaggregation rules of Regs. section 1.410(b)-7 as modified by the IRC section 401(m) regulations to find the plan (or plans)

so that the ACP test can be applied to the proper employees. Make sure plans being aggregated are not prohibited from doing so under Regs. section 1.410(b)-7.

- (12) Determine the HCE and NHCE groups.
- (13) Determine the ACR for each individual HCE and NHCE being tested.
- (14) Verify that the ACP for each group has been properly determined in accordance with the plan provisions describing the testing method (current year or prior year).
- (15) If the ACP test is not met, verify the amount of excess aggregate contributions and determine proper and timely correction has taken place.
- (16) To be included under the ACP test, make sure the employer takes into account for a plan year only those employee and matching contributions paid to the trust within the proper time frames.
- (17) Determine whether any recharacterized excess contributions should have been included in the ACP test.
- (18) Verify that the proper leveling method was used to determine the amount of excess aggregate contributions allocated to each HCE. Verify proper and timely correction.
- (19) Verify that the method used to correct excess aggregate contributions was specified in the plan document, and that the document was followed.
- (20) Establish whether the corrections were made in a timely manner, and included applicable gains or losses.
  - a. If excesses were distributed, determine whether the distributions were made within 2½ months after the end of the plan year in which the excess arose. If not, verify that the 4979 tax was paid and Form 5330 filed. Regardless, the distribution must be made within 12 months after the close of the plan year.
  - b. Determine whether the employer properly reported the distribution of excess aggregate contributions as taxable income (other than employee contributions) to the participant on Form 1099-R, and whether the employee properly included the distribution on his or her return.
  - c. Determine whether forfeited matching contributions were reallocated to other participants' accounts during the plan year. If so, for IRC section 415 purposes, contributions are treated as annual additions for both the participants who receive them and the participants from whom the contributions are forfeited.
  - d. Determine whether QNECs satisfy IRC section 401(a)(4) both before and after any are used in the ACP test. If elective contributions are used in the ACP test, make sure the ADP test is passed both before and after some are moved to the ACP.
  - e. Check whether a suspense account has been established to hold excess aggregate contributions or if such contributions remain unallocated. The regulations under IRC section 401(m) provide that

excess aggregate contributions may not remain unallocated or be allocated to a suspense account for allocation to one or more employees in any future year.

4.72.3.6.2 (03-01-2002)

**Multiple Use  
Test**

- (1) The ADP and ACP tests for nondiscrimination each have two prongs; the second — the lesser of 2 times or 2 plus the HCE ADP/ACP — is referred to as the “alternative limitation.” IRC section 401(m)(9) directs the Secretary of the Treasury to prescribe “such regulations as may be necessary to prevent the multiple use of the alternative limitation.” Multiple use occurs only when all three of the following conditions are satisfied:
  - a. one or more of an employer’s HCEs are eligible under both a section 401(k) plan and a section 401(m) plan maintained by the employer,
  - b. the sum of the HCE ADP and ACP exceeds the aggregate limit (defined below), and
  - c. the alternative limitation was used to pass both the ADP and the ACP tests.
- (2) The “aggregate limit” is the greater of:
  - a. the sum of (i) 1.25 times the larger of the NHCE ADP or ACP plus (ii) the lesser of 2 times or 2 plus the smaller of the NHCE ADP or ACP; or
  - b. the sum of (i) 1.25 times the smaller of the NHCE ADP or ACP plus (ii) the lesser of 2 times or 2 plus the larger of the NHCE ADP or ACP.
- (3) The HCEs’ and NHCEs’ ADPs and ACPs in (1) and (2) above are determined after first correcting for any ADP and ACP failures for the plan year.
- (4) If multiple use occurs, it can be corrected by reducing the HCE ADP and/or ACP until the sum does not exceed the aggregate limit. Alternatively, QNECs and/or QMACs can be made to raise the NHCE ADP and/or ACP, again until the sum of the HCE ADP and ACP does not exceed the aggregate limit. If the reduction method is used, the required reduction is treated as an excess contribution for the ADP side and an excess aggregate contribution for the ACP side. The same rules apply as if the correction was for an ADP or ACP test failure, except that if the reduction method is used, the plan can choose to reduce the ADP and/or ACP of just those HCEs who are in both the section 401(m) plan and the section 401(k). Whichever method is used, such method must be specified in the plan.

4.72.3.6.2.1 (03-01-2002)

**Comprehensive Example**

A plan has 3 HCEs and a fully vested matching contribution equal to the participant's deferrals that do not exceed 5% of compensation.

	<b>Comp.</b>	<b>Deferrals</b>	<b>ADR</b>	<b>Match</b>	<b>ACR</b>
HCE1	150,000	6,000	4	6,000	4
HCE2	120,000	6,000	5	6,000	5
HCE3	80,000	4,800	6	4,000	5

HCE ADP = 5%; HCE ACP = 4.67%.

NHCE ADP = 2.5%; NHCE ACP = 2%.

To correct ADP (HCE ADP cannot exceed 4.5%) by distributing excess contributions:

**STEP 1** — determine amount of excess and assign deemed ADRs to HCEs

To get HCE ADP to 4.5%, reduce the ADR of HCE2 and HCE3 to 4.75%, which produces an excess of \$300 for HCE2 and \$1,000 for HCE3, for a total of \$1,300.

**STEP 2** — assign the excess to HCEs with largest deferrals

The \$1,300 is split evenly between HCE1 and HCE2 (because they have the same amount of deferrals), leaving them with \$5,350 each in deferrals:

	<b>Remaining Deferrals</b>	<b>Deemed ADR</b>
HCE1	5,350	4
HCE2	5,350	4.75
HCE3	4,800	4.75

HCE deemed ADP = 4.5%

To correct ACP (HCE ACP cannot exceed 4%) by distributing excess aggregate contributions:

**STEP 3** — determine amount of excess and assign deemed ACRs to HCEs

To get HCE ACP to 4%, reduce the ACR of HCE2 and HCE3 to 4%, which produces an excess of \$1,200 for HCE2 and \$800 for HCE3, for a total of \$2,000.



**STEP 4** — assign the excess to HCEs with largest matches

The \$2,000 is split evenly between HCE1 and HCE2, leaving them with \$5,000 each in matching contributions:

	<u>Remaining Matches</u>	<u>Deemed ACR</u>
HCE1	5,000	4
HCE2	5,000	4
HCE3	4,000	4

HCE deemed ACP =4%

If the multiple use test fails (it does, since the sum of the HCE ADP and ACP exceeds the maximum permitted amount), go on to STEP 5. Oorrection under the plan is by distribution of excess aggregate contributions.

**STEP 5** — use deemed HCE ADP and ACP, determine maximum sum permitted and repeat STEPs 3 and 4

Sum of HCE ADP and ACP is 8.5%; maximum permitted is 7.13% ((2 + 2%) + (1.25 x 2.5%)).

Need to reduce HCE ACP to 2.63% (by reducing all HCE ACRs to 2.63%) so that the sum of the HCE ADP (4.5%) and ACP equals 7.13%. This would produce an excess of \$2,055 for HCE1 (\$150,000 x 1.37%), \$1,644 for HCE2 (\$120,000 x 1.37%) and \$1,096 for HCE3 (\$80,000 x 1.37%), for a total of \$4,795. This would be assigned \$1,932 to be distributed from both HCE1 and HCE2 and \$932 from HCE3, leaving all three HCEs with matching contributions of \$3,068 each.<sup>1</sup>

4.72.3.6.2.2 (03-01-2002)  
**Examination  
Step**

- (1) Determine if the employer maintains a plan subject to the ADP test and a plan subject to the ACP test (there could be just one plan). If so, check to see if the multiple use test was passed.

4.72.3.7 (03-01-2002)  
**SIMPLE 401(k)  
Plans**

- (1) IRC sections 401(k)(11) and 401(m)(10) were added by section 1422 of SBJPA (as amended by section 1601(d) of TRA) to permit SIMPLE section 401(k) plans. SIMPLE 401(k) plans must be maintained on a calendar-year basis. A SIMPLE 401(k) plan is deemed to satisfy the ADP and ACP tests. See IRM 4.72.2.11 for details on SIMPLE 401(k) plans.

4.72.3.8 (03-01-2002)  
**Safe Harbor  
401(k) Plans**

- (1) Beginning in 1999, safe harbor 401(k) plans became available to employers. The Service has published two notices on safe harbor plans, Notice 98-52 and Notice 2000-3. These two notices provide guidance on the design-based alternative or “safe harbor” methods under IRC sections 401(k)(12) and 401(m)(11)for satisfying the ADP test and the ACP test under IRC sections 401(k) and 401(m). A safe harbor 401(k) plan is

deemed to satisfy the ADP test (and usually the ACP test as well). If a CODA satisfies the rules in IRC section 401(k)(12) and also the rules in IRC section 401(m)(11), the plan is deemed to satisfy both the ADP test and the ACP test. A plan can satisfy the ADP safe harbor without satisfying the ACP safe harbor, but a plan cannot satisfy the ACP safe harbor without satisfying the ADP safe harbor. See IRM 4.72.2.12 for details on safe harbor 401(k) plans.