(c) Under paragraph (c)(2) of this section, Employees M, N, O, P, Q, and R may be grouped into two component plans, one consisting of Employees M, N, and O, and all their accruals and other benefits, rights, and features under the plan (including the early retirement window benefit), and another consisting of Employees P, Q, and R, and all their accruals and other benefits, rights, and features under the plan. Each of the component plans identified in this manner satisfies the uniform subsidies requirement of §1.401(a)(4)–3(b)(2)(iii), and thus satisfies §1.401(a)(4)–3(b). The entire plan satisfies section 401(a)(4) under the rules of this paragraph (c), if each of these component plans also satisfies section 410(b) as if it were a separate plan (including, if applicable, the reasonable classification requirement of §1.410(b)–4(b), and taking into account the special rule of paragraph (c)(4)(i) of this section that forgives the average benefit percentage test in certain situations in which the average benefit percentage test would be required solely as a result of the early retirement window benefit).

Example 3. (a) Employer Z maintains Plan B, a defined benefit plan with a benefit formula that provides two percent of average annual compensation for each year of service up to 20 to each employee. Assume that Plan B would satisfy the fractional accrual rule safe harbor in §1.401(a)(4)–3(b)(4), except that some employees accrue a portion of their normal retirement benefit in the current plan year that is more than one-third larger than the portion of the same benefit accrued by other employees for the current plan year, and the plan therefore fails to satisfy the one-third-larger requirement of §1.401(a)(4)–3(b)(4)(i)(C)(*1*).

(b) Employer Z restructures Plan B into two plans, one covering employees with 30 years or less of service at normal retirement age, and the other covering all other employees. Each component plan would separately satisfy the one-third-larger requirement of §1.401(a)(4)–3(b)(4)(i)(C)(*1*) if the only employees taken into account were those employees included in the component plan in the current plan year. Under paragraph (c)(3)(i) of this section and §1.401(a)(4)–3(b)(4)(i)(C)(*1*), however, the component plans do not satisfy the one-third-larger requirement because the safe harbor determination is made taking into account the effect of the plan benefit formula on any potential employee in the component plan (other than employees with more than 33 years of service at normal retirement age), and not just those employees included in the component plan in the current plan year.

[T.D. 8485, 58 FR 46810, Sept. 3, 1993, as amended by T.D. 8954, 66 FR 34544, June 29, 2001]

§ 1.401(a)(4)–10 Testing of former employees.

(a) *Introduction.* This section provides rules for determining whether a plan satisfies the nondiscriminatory amount and nondiscriminatory availability requirements of §1.401(a)(4)–1(b)(2) and (3), respectively, with respect to former employees. Generally, this section is relevant only in the case of benefits provided through an amendment to the plan effective in the current plan year. See the definitions of employee and former employee in §1.401(a)(4)–12.

(b) *Nondiscrimination in amount of contributions or benefits*—(1) *General rule.* A plan satisfies §1.401(a)(4)–1(b)(2) with respect to the amount of contributions or benefits provided to former employees if, under all of the relevant facts and circumstances, the amount of contributions or benefits provided to former employees does not discriminate significantly in favor of former HCEs. For this purpose, contributions or benefits provided to former employees includes all contributions or benefits provided to former employees or, at the employer's option, only those contributions or benefits arising out of the amendment providing the contributions or benefits. A plan under which no former employee currently benefits (within the meaning of §1.410(b)–3(b)) is deemed to satisfy this paragraph (b).

(2) *Permitted disparity.* Section 401(l) and §1.401(a)(4)–7 generally apply to benefits provided to former employees in the same manner as those provisions apply to employees. Thus, for example, for purposes of determining a former employee's cumulative permitted disparity limit, the sum of the former employee's total annual disparity fractions (within the meaning of §1.401(l)–5) as an employee continues to be taken into account. However, the permitted disparity rate applicable to a former employee is determined under §1.401(l)–3(e) as of the age the former employee commenced receipt of benefits, not as of the date the employee receives the accrual for the current plan year.

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

Example 1. Employer X maintains a section 401(l) plan, Plan A, that uses maximum permitted disparity. Plan A is amended to increase the benefits of all former employees in pay status. The percentage increase for each former employee is reasonably comparable to the adjustment in social security benefits under section 215(i)(2)(A) of the Social Security Act since the former employee commenced receipt of benefits. Plan A does not fail to satisfy this paragraph (b) merely because of the amendment.

Example 2. The facts are the same as in *Example 1,* except that the amendment provides an across-the-board 20 percent increase in benefits for all former employees in pay status. The cost of living has increased at an average rate of three percent in the two years preceding the amendment, and some HCEs have retired and become former HCEs during that period. Because this amendment increases the disparity in the plan formula beyond the maximum permitted disparity adjusted for any reasonable approximation of the increase in the cost of living since the HCEs retired, Plan A discriminates significantly in favor of former HCEs, and thus does not satisfy this paragraph (b).

Example 3. The facts are the same as in *Example 1,* except that Plan A is only amended to increase the benefits of former employees in pay status who terminated employment with Employer X after attaining early retirement age. The determination of whether the amendment causes Plan A to fail to satisfy this paragraph (b) must take into account the relative numbers of former HCEs and former NHCEs who have terminated employment with Employer X after attaining early retirement age.

(c) *Nondiscrimination in availability of benefits, rights, or features.* A plan satisfies section 401(a)(4) with respect to the availability of benefits, rights, and features provided to former employees if any change in the availability of any benefit, right, or feature to any former employee is applied in a manner that, under all of the relevant facts and circumstances, does not discriminate significantly in favor of former HCEs. For purposes of demonstrating that a plan satisfies section 401(a)(4) with respect to the availability of loans provided to former employees, an employer may treat former employees who are parties in interest within the meaning of section 3(14) of the Employee Retirement Income Security Act of 1974 as employees.

[T.D. 8485, 58 FR 46812, Sept. 3, 1993]

§ 1.401(a)(4)–11 Additional rules.

(a) *Introduction.* This section provides additional rules for determining whether a plan satisfies section 401(a)(4). Paragraph (b) of this section provides rules for the treatment of the portion of an employee's accrued benefit or account balance that is attributable to rollovers, transfers between plans, and employee buybacks. Paragraph (c) of this section provides rules regarding vesting. Paragraph (d) of this section provides rules regarding service crediting. Paragraph (e) of this section, regarding family aggregation, and paragraph (f) of this section, regarding governmental plans, are reserved. Paragraph (g) of this section provides rules regarding the extent to which corrective amendments may be made for purposes of section 401(a).

(b) *Rollovers, transfers, and buybacks*—(1) *Rollovers and elective transfers.* The portion of an employee's accrued benefit or account balance under a plan that is attributable to rollover (including direct rollover) contributions to the plan that are described in section 402(c), 402(e)(6), 403(a)(4), 403(a)(5), or 408(d)(3), or elective transfers to the plan that are described in §1.411(d)–4, Q&A–3(b), is not taken into account in determining whether the plan satisfies the nondiscriminatory amount requirement of §1.401(a)(4)–1(b)(2).

(2) *Other transfers.* [Reserved]

(3) *Employee buybacks*—(i) *Rehired employee buyback of previous service.* An employee's repayment to a plan of a prior distribution from the plan (including reasonable interest from the time of the distribution) that results in the restoration of the employee's accrued benefit under the plan (or the service associated with that accrued benefit) that would otherwise be disregarded in determining the employee's accrued benefit in accordance with section 411 on account of the distribution is not treated as an employee contribution for purposes of §§1.401(a)(4)–1 through 1.401(a)(4)–13.

(ii) *Make-up of missed employee contributions.* If a contributory DB plan gives all employees who did not make employee contributions for a prior period the right to make the missed contributions at a later date (including reasonable interest from the time of