§ 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.

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