[T.D. 8357, 56 FR 40516, Aug. 15, 1991, as amended by T.D. 8376, 56 FR 63431, Dec. 4, 1991; T.D. 8581, 59 FR 66169, Dec. 23, 1994]

§ 1.401(k)–1 Certain cash or deferred arrangements.

(a) *General rules*—(1) *Certain plans permitted to include cash or deferred arrangements.* A plan, other than a profit-sharing, stock bonus, pre-ERISA money purchase pension or rural cooperative plan, does not satisfy the requirements of section 401(a) if the plan includes a cash or deferred arrangement. A profit-sharing, stock bonus, pre-ERISA money purchase pension, or rural cooperative plan does not fail to satisfy the requirements of section 401(a) merely because the plan includes a cash or deferred arrangement. A cash or deferred arrangement is part of a plan for purposes of this section if any contributions to the plan, or accruals or other benefits under the plan, are made or provided pursuant to the cash or deferred arrangement.

(2) *Rules applicable to cash or deferred arrangements generally*—(i) *Definition of cash or deferred arrangement.* Except as provided in paragraph (a)(2)(ii) of this section, a cash or deferred arrangement is an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of section 401(a) (including a contract that is intended to satisfy the requirements of section 403(a)).

(ii) *Treatment of after-tax employee contributions.* A cash or deferred arrangement does not include an arrangement under which amounts contributed under a plan at an employee's election are designated or treated at the time of contribution as after-tax employee contributions (e.g., by reporting the contributions as taxable income subject to applicable withholding requirements). See also section 414(h)(1). This is the case even if the employee's election to make after-tax employee contributions is made before the amounts subject to the election are currently available to the employee.

(iii) *Treatment of elective contributions as plan assets.* The extent to which elective contributions under a cash or deferred arrangement constitute plan assets for purposes of the prohibited transaction provisions of section 4975 of the Internal Revenue Code and title I of the Employee Retirement Income Security Act of 1974 is determined in accordance with regulations and rulings issued by the Department of Labor.

(3) *Rules applicable to cash or deferred elections generally*—(i) *Definition of cash or deferred election.* A cash or deferred election is any election (or modification of an earlier election) by an employee to have the employer either—

(A) Provide an amount to the employee in the form of cash or some other taxable benefit that is not currently available, or

(B) Contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation.

A cash or deferred election includes a salary reduction agreement between an employee and employer under which a contribution is made under a plan only if the employee elects to reduce cash compensation or to forgo an increase in cash compensation.

(ii) *Requirement that amounts not be currently available.* A cash or deferred election can only be made with respect to an amount that is not currently available to the employee on the date of the election. Further, a cash or deferred election can only be made with respect to amounts that would (but for the cash or deferred election) become currently available after the later of the date on which the employer adopts the cash or deferred arrangement or the date on which the arrangement first becomes effective.

(iii) *Amounts currently available.* Cash or another taxable amount is currently available to the employee if it has been paid to the employee or if the employee is able currently to receive the cash or other taxable amount at the employee's discretion. An amount is not currently available to an employee if there is a significant limitation or restriction on the employee's right to receive the amount currently. Similarly, an amount is not currently available as of a date if the employee may under no circumstances receive the amount before a particular time in the future. The determination of whether an amount is currently available to an employee does not depend on whether it has been constructively received by the employee for purposes of section 451.

(iv) *Certain one-time elections not treated as cash or deferred elections.* A cash or deferred election does not include a one-time irrevocable election upon an employee's commencement of employment with the employer or upon the employee's first becoming eligible under any plan of the employer, to have contributions equal to a specified amount or percentage of the employee's compensation (including no amount of compensation) made by the employer on the employee's behalf to the plan and to any other plan of the employer (including plans not yet established) for the duration of the employee's employment with the employer, or in the case of a defined benefit plan to receive accruals or other benefits (including no benefits) under such plans. Thus, for example, employer contributions pursuant to a one-time irrevocable election described in this paragraph are not treated as having been made pursuant to a cash or deferred election and are not includible in an employee's gross income by reason of §1.402(a)–1(d). In no event is an election made after December 23, 1994 treated as one-time irrevocable election under this paragraph if the election is made by an employee who previously became eligible under another plan (whether or not terminated) of the employer. See paragraph (a)(6)(ii)(C) of this section for an additional one-time election permitted under a cash or deferred arrangement in which partners may participate.

(v) *Tax treatment of employees.* An amount generally is includible in an employee's gross income for the taxable year in which the employee actually or constructively receives the amount. But for section 402(e)(3) and section 401(k), an employee is treated as having received an amount that is contributed to a plan pursuant to the employee's cash or deferred election. This is the case even if the election to defer is made before the year in which the amount is earned, or before the amount is currently available. See §1.402(a)–1(d).

(vi) *Examples.* The provisions of this paragraph (a)(3) are illustrated by the following examples:

Example 1. An employer maintains a profit-sharing plan under which each eligible employee has an election to defer an annual bonus payable on January 30 each year. The bonus equals 10 percent of compensation during the previous calendar year. Deferred amounts are not treated as after-tax employee contributions. The bonus is currently available on January 30. An election made prior to January 30 to defer all or part of the bonus is a cash or deferred election, and the bonus deferral arrangement is a cash or deferred arrangement.

Example 2. An employer maintains a profit-sharing plan under which each eligible employee may elect to defer up to 10 percent of compensation for each payroll period during the plan year. An election to defer compensation for a payroll period is a cash or deferred election if the election is made prior to the date on which the compensation is to be paid to the employee and if the deferred amount is not treated as an after-tax employee contribution at the time of deferral.

Example 3. (i) Employer A establishes a qualified money purchase pension plan in 1986. This is the first qualified plan established by Employer A. All salaried employees are eligible to participate under the plan. Hourly-paid employees are not eligible to participate under the plan. In 1996, Employer A establishes a profit-sharing plan under which all employees (both salaried and hourly) are eligible. Employer A permits all employees on the effective date of the profit-sharing plan to make a one-time irrevocable election to have Employer A contribute five percent of compensation on their behalf to the plan and to any other plan of Employer A (including plans not yet established) for the duration of the employee's employment with Employer A, and have their salaries reduced by five percent.

(ii) The election provided under the profit-sharing plan is not a one-time irrevocable election within the meaning of §1.401(k)–1(a)(3)(iv) with respect to the salaried employees of Employer A who, at any time before becoming eligible to participate under the profit-sharing plan, became eligible to participate under the money purchase pension plan. The election under the profit-sharing plan is a one-time irrevocable election within the meaning of §1.401(k)– 1(a)(3)(iv) with respect to the hourly employees, because they were not previously eligible to participate under another plan of the employer.

(4) *Rules applicable to qualified cash or deferred arrangements*—(i) *Definition of qualified cash or deferred arrangement.* A qualified cash or deferred arrangement is a cash or deferred arrangement that satisfies the requirements of paragraphs (b), (c), (d), and (e) of this section and that is part of a plan that otherwise satisfies the requirements of section 401(a).

(ii) *Treatment of elective contributions as employer contributions.* Except as provided in paragraph (f) of this section, elective contributions under a qualified cash or deferred arrangement are treated as employer contributions. Thus, for example, elective contributions are treated as employer contributions for purposes of sections 401(a) and 401(k), 402, 404, 409, 411, 412, 415, 416, and 417.

(iii) *Tax treatment of employees.* Except as provided in section 402(g) and paragraph (f) of this section, elective contributions under a qualified cash or deferred arrangement are neither includible in an employee's gross income at the time the cash or other taxable amounts would have been includible in the employee's gross income (but for the cash or deferred election), nor at the time the elective contributions are contributed to the plan. See §1.402(a)–1(d)(2)(i).

(iv) *Application of nondiscrimination requirements to plan that includes a qualified cash or deferred arrangement.* A plan that includes a qualified cash or deferred arrangement must satisfy the requirements of sections 401(a)(4) and 410(b). Thus, for example, the plan must satisfy section 401(a)(4) with respect to the amount of contributions or benefits and the availability of benefits, rights and features under the plan. See §1.401(a)(4)–1(b)(3). The right to make each level of elective contributions under a cash or deferred arrangement is a benefit, right or feature subject to this requirement, and each of these rights must therefore generally be available to a group of employees that satisfies section 410(b). See §1.401(a)(4)–4(e)(3)(i) and (iii)(D). Thus, for example, if all employees are eligible to make a stated level of elective contributions under a cash or deferred arrangement, but that level of contributions can only be made from compensation in excess of a stated amount, such as the Social Security taxable wage base, the arrangement will generally favor highly compensated employees with respect to the availability of elective contributions and thus will generally not satisfy the requirements of section 401(a)(4). For plan years beginning after December 31, 1984, the amount of elective contributions under a qualified cash or deferred arrangement satisfies the requirements of section 401(a)(4) only if the amount of elective contributions satisfies the special nondiscrimination test of section 401(k)(3) and paragraph (b)(2) of this section. See §1.401(a)(4)–1(b)(2)(ii)(B). See also §1.401(a)(4)– 11(g)(3)(vii)(A), relating to corrective amendments that may be made to satisfy the minimum coverage requirements of section 410(b).

(5) *Rules applicable to nonqualified cash or deferred arrangements*—(i) *Definition of nonqualified cash or deferred arrangement.* A nonqualified cash or deferred arrangement is a cash or deferred arrangement that is not a qualified cash or deferred arrangement. Thus, if a cash or deferred arrangement fails to satisfy one or more of the requirements in paragraph (b), (c), (d) or (e) of this section, the arrangement is a nonqualified cash or deferred arrangement.

(ii) *Treatment of elective contributions as employer contributions.* Except as specifically provided otherwise, elective contributions under a nonqualified cash or deferred arrangement are treated as nonelective employer contributions. Thus, for example, the elective contributions are treated as nonelective employer contributions for purposes of sections 401(a) (including section 401(a)(4)) and 401(k), 404, 409, 411, 412, 415, 416, and 417 and are not subject to the requirements of section 401(m).

(iii) *Tax treatment of employees.* Elective contributions under a nonqualified cash or deferred arrangement are includible in an employee's gross income at the time the cash or other taxable amount that the employee would have received (but for the cash or deferred election) would have been includible in the employee's gross income. See §1.402(a)–1(d)(1).

(iv) *Qualification of plan that includes a nonqualified cash or deferred arrangement.* A profit-sharing, stock bonus, pre-ERISA money purchase pension, or rural cooperative plan does not fail to satisfy the requirements of section 401(a) merely because the plan includes a nonqualified cash or deferred arrangement. In determining whether the plan satisfies the requirements of section 401(a)(4), the special nondiscrimination tests of sections 401(k)(3) and 401(m)(2) may not be used. See §§1.401(a)(4)–1(b)(2)(ii)(B) and 1.410(b)–9 (definition of section 401(k) plan).

(6) *Rules applicable to partnership cash or deferred arrangements*—(i) *Application of general rules.* A partnership may maintain a cash or deferred arrangement, and individual partners may make cash or deferred elections with respect to compensation attributable to services rendered to the partnership. Generally, the same rules apply to partnership cash or deferred arrangements as apply to other cash or deferred arrangements. Thus, a partnership cash or deferred arrangement is not a qualified cash or deferred arrangement unless the requirements of section 401(k) and this section are satisfied. For example, any contributions made on behalf of an individual partner pursuant to a partnership cash or deferred arrangement are elective contributions unless they are designated or treated as after-tax employee contributions. Consistent with §1.402(a)–1(d), the elective contributions are includible in income and are not deductible under section 404(a) unless the arrangement is a qualified cash or deferred arrangement. Also, even if the arrangement is a qualified cash or deferred arrangement, the elective contributions are includible in gross income and are not deductible under section 404(a) to the extent they exceed the applicable limit under section 402(g). See also §1.401(a)–30.

(ii) *Definition of partnership cash or deferred arrangement*—(A) *General rule.* Effective for contributions made for plan years beginning after December 31, 1988, a cash or deferred arrangement includes any arrangement that directly or indirectly permits individual partners to vary the amount of contributions made on their behalf.

(B) *Timing of partner's cash or deferred election.* For purposes of paragraph (a)(3)(ii) of this section, a partner's compensation is deemed currently available on the last day of the partnership taxable year. Accordingly, an individual partner may not make a cash or deferred election with respect to compensation for a partnership taxable year after the last day of that year. A partner's compensation for a partnership taxable year ending with or within a plan year beginning before January 1, 1992, is, however, deemed not to be currently available until the due date, including extensions, for filing the partnership's federal income tax return for its taxable year ending with or within the plan year. See §1.401(k)–1(b)(4)(iii) for the rules regarding when contributions are treated as allocated.

(C) *Transition rule for partnership cash or deferred elections.* A one-time irrevocable election to participate or not to participate in a plan in which partners may participate is not a cash or deferred election if the election was made on or before the later of the first day of the first plan year beginning after December 31, 1988, or March 31, 1989. This election may be made after the commencement of employment or after the employee's first becoming eligible under any plan of the employer. In no event, however, may the election be made after December 23, 1994. The election may be made even if the one-time irrevocable election in §1.401(k)–1(a)(3)(iv) was previously made.

(iii) *Treatment of certain matching contributions as elective contributions.* If a partnership makes matching contributions with respect to an individual partner's elective contributions or employee contributions, then the matching contributions are treated as elective contributions made on behalf of the partner. In the case of a plan that, on August 8, 1988, did not treat matching contributions as elective contributions, the preceding sentence applies only to plan years beginning after August 8, 1988. See also §§1.401(m)–1(f)(12) and 1.404(e)–1A(f).

(7) *Rules applicable to collectively bargained plans*—(i) *In general.* The amount of employer contributions under a nonqualified cash or deferred arrangement is treated as satisfying section 401(a)(4) if the arrangement is part of a collectively bargained plan (including a plan adopted by a state or local government before May 6, 1986) that automatically satisfies the requirements of section 410(b). See §§1.401(a)(4)–1(c)(5) and 1.410(b)–2(b)(7). Except as specifically provided otherwise, elective contributions under the arrangement are treated as employer contributions. See §1.401(k)–1(a)(5)(ii). However, elective contributions under the nonqualified cash or deferred arrangement are treated as employee contributions for purposes of section 402(a) for plan years beginning after December 31, 1992, and are therefore not excludable from gross income under section 402(e)(3). See §1.402(a)–1(d)(3)(iv).

(ii) *Example.* The provisions of this paragraph (a)(7) are illustrated by the following example:

Example. For the 1994 plan year, Employer A maintains a collectively bargained plan that includes a cash or deferred arrangement. Employer contributions under the cash or deferred arrangement not satisfy the actual deferral percentage test of section 401(k)(3) and paragraph (b) of this section. Therefore, the arrangement is a nonqualified cash or deferred arrangement. The employer contributions under the cash or deferred arrangement are considered to be nondiscriminatory under section 401(a)(4), and the elective contributions are generally treated as employer contributions. Under §1.402(a)–1(d)(1), however, elective contributions are includible in an employee's gross income.

(b) *Coverage and nondiscrimination requirements*—(1) *In general.* A cash or deferred arrangement satisfies this paragraph (b) for a plan year only if:

(i) The group of eligible employees under the section 401(k) plan and the group of employees benefiting under the plan to which the nonelective employer contributions are made separately satisfy the requirements of section 410(b) (including the average benefit percentage test, if applicable). For special rules governing the application of section 410(b) to a cash or deferred arrangement, see §§1.410(b)–7(c)(1) and 1.410(b)–8(a)(1). See also §1.401(a)(4)–11(g)(3)(vii)(A), relating to corrective amendments that may be made to satisfy the minimum coverage requirements of section 410(b).

(ii) The cash or deferred arrangement satisfies the actual deferral percentage test described in paragraph (b)(2) of this section. This is the exclusive nondiscrimination test applicable to the amount of elective contributions under a qualified cash or deferred arrangement. See §1.401(a)(4)–1(b)(2)(ii)(B).

(2) *Actual deferral percentage test*—(i) *General rule.* For plan years beginning after December 31, 1986, or such later date provided in paragraph (h) of this section, a cash or deferred arrangement satisfies this paragraph (b) for a plan year only if:

(A) The actual deferral percentage for the group of eligible highly compensated employees is not more than the actual deferral percentage for the group of all other eligible employees multiplied by 1.25; or

(B) The excess of the actual deferral percentage for the group of eligible highly compensated employees over the actual deferral percentage for the group of all other eligible employees is not more than two percentage points, and the actual deferral percentage for the group of eligible highly compensated employees is not more than the actual deferral percentage for the group of all other eligible employees multiplied by two.

An arrangement does not fail to satisfy the requirements of this paragraph (b)(2) merely because all of the eligible employees under an arrangement for a year are highly compensated employees.

(ii) *Rule for plan years beginning after 1979 and before 1987.* For plan years beginning after December 31, 1979, and before January 1, 1987, or such later date provided in paragraph (h) of this section, a cash or deferred arrangement satisfies this paragraph (b) for a plan year only if:

(A) The actual deferral percentage for the group of eligible highly compensated employees (top one-third) is not more than the actual deferral percentage for the group of all other eligible employees (lower two-thirds) multiplied by 1.5; or

(B) The excess of the actual deferral percentage for the top one-third over the actual deferral percentage for the lower two-thirds is not more than three percentage points, and the actual deferral percentage for the top one-third is not more than the actual deferral percentage for the lower two-thirds multiplied by 2.5.

(iii) *Plan provision requirement.* For plan years beginning after December 31, 1986, or such later date provided in paragraph (h) of this section, a plan that includes a cash or deferred arrangement does not satisfy the requirements of section 401(a) unless it provides that the actual deferral percentage test of section 401(k)(3) will be met. For purposes of this paragraph (b)(2)(iii), the plan may incorporate by reference the provisions of section 401(k)(3), this paragraph (b), and if applicable, section 401(m)(9) and §1.401(m)–2.

(3) *Aggregation*—(i) *Aggregation of arrangements and plans.* Except as otherwise specifically provided in this paragraph (b)(3), all cash or deferred arrangements included in a plan are treated as a single cash or deferred arrangement. Thus, for example, if two groups of employees are eligible for separate cash or deferred arrangements under the same plan, the two cash or deferred arrangements are treated as a single cash or deferred arrangement, even if they have significantly different features, such as significantly different limits on elective contributions. See §1.401(k)–1(g)(11) for the definition of plan used for purposes of this section. That definition contains the exclusive rules for aggregation and disaggregation of plans for purposes of this section. See also paragraph (g)(1)(ii) of this section for rules requiring the aggregation of elective contributions under two or more plans in computing the actual deferral ratios of certain employees.

(ii) *Restructuring and Permissive Aggregation.* Effective for plan years beginning after December 31, 1991, restructuring under §1.401(a)(4)–9(c) may not be used to demonstrate compliance with the requirements of section 401(k). See §1.401(a)(4)–9(c)(3)(ii). For plan years beginning before January 1, 1992, see §1.401(k)– 1(h)(3)(iii). An employer may, however, treat a plan benefiting otherwise excludable employees as two separate plans for purposes of sections 401(k) and 410(b) in accordance with §§1.410(b)–6(b)(3) and 1.410(b)–7(c)(3).

(4) *Elective contributions taken into account under the actual deferral percentage test*—(i) *General rule.* An elective contribution is taken into account under paragraph (b)(2) of this section for a plan year only if each of the following requirements is satisfied:

(A) The elective contribution is allocated to the employee's account under the plan as of a date within that plan year. For purposes of this rule, an elective contribution is considered allocated as of a date within a plan year only if—

(*1*) The allocation is not contingent upon the employee's participation in the plan or performance of services on any date subsequent to that date, and

(*2*) The elective contribution is actually paid to the trust no later than the end of the 12-month period immediately following the plan year to which the contribution relates.

(B) The elective contribution relates to compensation that either—

(*1*) Would have been received by the employee in the plan year but for the employee's election to defer under the arrangement, or

(*2*) Is attributable to services performed by the employee in the plan year and, but for the employee's election to defer, would have been received by the employee within two and one-half months after the close of the plan year.

(ii) *Elective contributions and qualified nonelective contributions used to satisfy* *actual contribution percentage test.* Except as provided in §1.401(m)–1(b)(5)(iii), elective contributions treated as matching contributions must satisfy the actual contribution percentage test of section 401(m)(2) and are not taken into account under paragraph (b)(2) of this section. A qualified nonelective contribution that is treated as a matching contribution is subject to the actual contribution percentage test of section 401(m)(2) and is not taken into account as an elective contribution under paragraph (b)(2) or (5) of this section.

(iii) *Elective contributions for partners.* For purposes of paragraph (b)(2) of this section, a partner's distributive share of partnership income is treated as received on the last day of the partnership taxable year. Thus, an elective contribution made on behalf of a partner is treated as allocated to the partner's account for the plan year that includes the last day of the partnership taxable year, provided the requirements of paragraph (b)(4)(i)(A) of this section are met.

(iv) *Elective contributions not taken into account.* Elective contributions that do not satisfy the requirements of paragraph (b)(4)(i) of this section may not use the special nondiscrimination rule of section 401(k)(3) and paragraph (b)(2) of this section for the plan year with respect to which the contributions were made, or for any other plan year. Instead, the amount of the elective contributions must satisfy the requirements of section 401(a)(4) (without regard to the special nondiscrimination test in section 401(k)(3) and paragraph (b)(2) of this section) for the plan year in which they are allocated under the plan as if they were nonelective employer contributions and were the only nonelective employer contributions for the year. See §§1.401(a)(4)–1(b)(2)(ii)(B); 1.410(b)–7(c)(1).

(5) *Qualified nonelective contributions and qualified matching contributions that may be taken into account under the actual deferral percentage test.* Except as specifically provided otherwise, for purposes of paragraph (b)(2) of this section, all or part of the qualified nonelective contributions and qualified matching contributions made with respect to any or all employees who are eligible employees under the cash or deferred arrangement being tested may be treated as elective contributions under the arrangement, provided that each of the following requirements (to the extent applicable) is satisfied:

(i) The amount of nonelective contributions, including those qualified nonelective contributions treated as elective contributions for purposes of the actual deferral percentage test, satisfies the requirements of section 401(a)(4). See §1.401(a)(4)–1(b)(2).

(ii) The amount of nonelective contributions, excluding those qualified nonelective contributions treated as elective contributions for purposes of the actual deferral percentage test and those qualified nonelective contributions treated as matching contributions under §1.401(m)–1(b)(5) for purposes of the actual contribution percentage test, satisfies the requirements of section 401(a)(4). See §1.401(a)(4)–1(b)(2).

(iii) For plan years beginning before January 1, 1987, or such later date provided in paragraph (h) of this section, the matching contributions, including those qualified matching contributions treated as elective contributions for purposes of the actual deferral percentage test, satisfy the requirements of section 401(a)(4).

(iv) For plan years beginning before January 1, 1987, or such later date provided in paragraph (h) of this section, the matching contributions, excluding those qualified matching contributions treated as elective contributions for purposes of the actual deferral percentage test, satisfy the requirements of section 401(a)(4).

(v) The qualified nonelective contributions and qualified matching contributions satisfy the requirements of paragraph (b)(4)(i)(A) of this section for the plan year as if the contributions were elective contributions.

(vi) For plan years beginning after December 31, 1988, or such later date provided in paragraph (h) of this section, the section 401(k) plan and the plan or plans to which the qualified nonelective contributions and qualified matching contributions are made, could be aggregated under §1.410(b)–7(d) after application of the mandatory disaggregation rules of §1.410(b)–7(c), as modified in §1.401(k)–1(g)(11). If the plan year of the section 401(k) plan is changed to satisfy the requirement under §1.410(b)–7(d)(5) that aggregated plans have the same plan year, the qualified nonelective contributions and qualified matching contributions may be taken into account in the resulting short plan year only if the contributions satisfy the requirements of paragraph (b)(4)(i) of this section with respect to the short year as if the contributions were elective contributions and the aggregated plans could otherwise be aggregated for purposes of section 410(b).

(6) *Examples.* The provisions of this paragraph (b) are illustrated by the following examples.

Example 1. (i) Employees A, B, and C are eligible employees who earn $30,000, $15,000, and $10,000, respectively, in 1989. In addition, their employer, X, contributes a bonus of up to 10 percent of their regular compensation to a trust under a profit-sharing plan that includes a cash or deferred arrangement. Under the arrangement, each eligible employee may elect to receive none, all, or any part of the 10 percent in cash. The employer contributes the remainder to the trust. The cash portion of the bonus, if any, is paid after the end of the plan year. The 10 percent is therefore not included in compensation until the year paid. Employee A is highly compensated. For the 1989 plan year, A, B, and C make the following elections:

Employee	Compensation	Elective contribution
A	$30,000	$1,780
B	15,000	750
C	10,000	450

(ii) The ratios of employer contributions to the trust on behalf of each eligible employee to the employee's compensation for the plan year (calculated separately for each employee) are:

Employee	Ratio of elective contribution to compensation	Actual deferral ratio (percent)
A	$1,780/30,000	5.93
B	750/15,000	5.00
C	450/10,000	4.50

(iii) The actual deferral percentage for the highly compensated group (Employee A) is 5.93 percent. The actual deferral percentage for the nonhighly compensated group is 4.75 percent ((5%+4.5%)/2)). Because 5.93 percent is less than 5.94 percent (4.75% multiplied by 1.25), the first percentage test is satisfied.

Example 2. (i) The facts are the same as in *Example 1*, except that elective contributions are made pursuant to a salary reduction agreement and no bonuses are paid. Employer X includes elective contributions in compensation as permitted under §1.414(s)–1(c)(4)(i). See §1.401(k)–1(g)(2)(i). In addition, A defers $2,025. Thus, the compensation and elective contributions for A, B, and C are:

Employee	Compensation	Elective contributions	Actual deferral ratio (percent)
A	$30,000	$2,025	6.75
B	15,000	750	5.00
C	10,000	450	4.50

(ii) The actual deferral percentage for the highly compensated group (Employee A) is 6.75 percent. The actual deferral percentage for the nonhighly compensated group is 4.75 percent ((5.00%+4.50%)/2). Because 6.75 percent exceeds 5.94 percent (4.75×1.25), the first percentage test is not satisfied. However, since the actual deferral percentage equals the maximum percentage allowed under the second percentage test, (4.75+2=6.75), the second percentage test is satisfied.

Example 3. (i) Employees D through L are eligible employees in Employer A's profit-sharing plan that contains a cash or deferred arrangement. Employer A includes elective contributions in compensation as permitted under §1.414(s)–1(c)(4)(i). Each eligible employee may elect to defer up to six percent of compensation under the cash or deferred arrangement. Employees D and E are highly compensated. The compensation, elective contributions, and actual deferral ratios of these employees for the 1989 plan year are shown below:

Employee	Compensation	Elective contributions	Actual deferral ratio (percent)
D	$100,000	$6,000	6
E	80,000	4,000	5
F	60,000	3,600	6
G	40,000	1,600	4
H	30,000	1,200	4
I	20,000	600	3
J	20,000	600	3
K	10,000	300	3
L	5,000	150	3

(ii) The actual deferral percentage for the highly compensated group is 5.5 percent. The actual deferral percentage for the nonhighly compensated group is 3.71 percent. Because 5.5 percent is greater than 4.64 percent (3.71%×1.25), the first percentage test is not satisfied. However, because 5.5 percent is less than 5.71 percent (the lesser of 3.71%+2 or 3.71%×2), the second percentage test is satisfied.

Example 4. (i) Employer D maintains a profit-sharing plan that contains a cash or deferred arrangement. Employer D includes elective contributions in compensation as permitted under §1.414(s)–1(c)(4)(i). The following amounts are contributed under the plan:

(A) Six percent of each employee's compensation. These contributions are not qualified nonelective contributions (QNCs).

(B) Two percent of each employee's compensation. These contributions are QNCs.

(C) Three percent of each employee's compensation that the employee may elect to receive as cash or to defer under the plan.

(ii) For the 1990 plan year, the compensation, elective contributions, and actual deferral ratios of employees M through S were:

Employee	Compensation	Elective contributions	Actual deferral ratio (percent)
M	$100,000	$3,000	3
N	80,000	1,600	2
O	60,000	1,800	3
P	40,000	0	0
Q	30,000	0	0
R	20,000	0	0
S	20,000	0	0

(iii) Both types of nonelective contributions are made for all employees. Thus, both the six percent and the two percent employer contributions satisfy the requirements of section 401(a)(4) and paragraph (b)(5)(i) of this section.

(iv) The elective contributions alone do not satisfy the special rules in paragraph (b)(4) of this section because the actual deferral percentage for the highly compensated group, consisting of employees M and N, is 2.5 percent and the actual deferral percentage for the nonhighly compensated group is 0.6 percent. However, the two percent QNCs may be taken into account in applying the special rules. The six percent nonelective contributions may not be taken into account because they are not QNCs.

(v) If the two percent QNCs are taken into account, the actual deferral percentage for the highly compensated group is 4.5 percent, and the actual deferral percentage for the nonhighly compensated group is 2.6 percent. Because 4.5 percent is not more than two percentage points greater than 2.6 percent, and not more than two times 2.6, the actual deferral percentage test of section 401(k)(3) and paragraph (b)(2) of this section is satisfied. Thus, the plan satisfies this paragraph (b).

Example 5. (i) Employer N maintains a plan that contains a cash or deferred arrangement. The plan year and the employer's taxable year are the calendar year. The plan provides for employee contributions, elective contributions, matching contributions, and qualified nonelective contributions (QNCs), all of which meet the applicable requirements of section 401(a)(4). Matching contributions on behalf of nonhighly compensated employees are qualified matching contributions (QMACs). Matching contributions on behalf of highly compensated employees are not QMACs. For the 1988 plan year, elective contributions and matching contributions with respect to highly compensated and nonhighly compensated employees are shown in the following chart.

	Elective contributions (including QNCs) (percent)	Total matching contributions (percent)	QMACs (percent)
Highly compensated	15	5	0
Nonhighly compensated	11	5	5

(ii) The plan fails to meet the requirements of section 401(k)(3)(A) because 15 percent is more than 125 percent of, and more than two percentage points greater than, 11 percent. However, the plan provides that QMACs may be used to meet the requirements of section 401(k)(3)(A)(ii) to the extent needed under that section. Under this provision, the plan takes QMACs of one percent of compensation into account for each nonhighly compensated employee in applying the actual deferral percentage test. After this adjustment, the actual deferral and actual contribution percentages are as follows:

	Actual deferral percentage	Actual contribution percentage
Highly compensated	15	5
Nonhighly compensated	12	4

(iii) The elective contributions and QMACs taken into account under section 401(k) meet the requirements of section 401(k)(3)(A)(ii) because 15 percent is 125 percent of 12 percent. The remaining matching contributions meet the requirements of section 401(m) because five percent is 125 percent of four percent.

(c) *Nonforfeitability requirement*—(1) *General rule.* A cash or deferred arrangement satisfies this paragraph (c) only if the elective contributions meet each of the following requirements:

(i) Each employee's right to the amount attributable to elective contributions is immediately nonforfeitable within the meaning of section 411, and would be nonforfeitable under the plan regardless of the age and service of the employee or whether the employee is employed on a specific date. A contribution that is subject to forfeitures or suspensions permitted by section 411(a)(3) does not satisfy the requirements of this paragraph (c).

(ii) The contributions are disregarded for purposes of applying section 411(a) to other contributions or benefits.

(iii) The contributions remain nonforfeitable even if the employee makes no additional elective contributions under a cash or deferred arrangement.

(2) *Example.* The provisions of this paragraph (c) are illustrated by the following example:

Example. (i) Employees B and C are covered by Employer Y's stock bonus plan, which includes a cash or deferred arrangement. Under the plan, Employer Y makes a nonelective contribution on behalf of each employee equal to four percent of compensation. All employees participating in the plan have a nonforfeitable right to a percentage of their accrued benefit derived from this contribution as shown in the following table:

Years of service	Nonforfeitable percentage
Less than 1	0
1	20
2	40
3	60
4	80
5 or more	100

(ii) B and C have three and six years of service, respectively. Employer Y also permits employees to elect to defer up to 6 percent of compensation through salary reduction agreements. Amounts deferred under these agreements are nonforfeitable at all times. In accordance with paragraph (c)(1)(i) of this section, the nonforfeitable percentage of Employer Y's nonelective contribution on behalf of B and C may not be treated as a qualified nonelective contribution under paragraph (b)(3) of this section, because these amounts are nonforfeitable by reason of the completion by B and C of a stated number of years of service, and not regardless of the age and service of B and C.

(d) *Distribution limitation*—(1) *General rule.* A cash or deferred arrangement satisfies this paragraph (d) only if amounts attributable to elective contributions may not be distributed before one of the following events, and any distributions so permitted also satisfy the requirements of paragraphs (d) (2) through (6) of this section (to the extent applicable):

(i) The employee's retirement, death, disability, or separation from service.

(ii) In the case of a profit-sharing or stock bonus plan, the employee's attainment of age 59½, or the employee's hardship.

(iii) For plan years beginning after December 31, 1984, the termination of the plan.

(iv) For plan years beginning after December 31, 1984, the date of the sale or other disposition by a corporation of substantially all the assets (within the meaning of section 409(d)(2)) used by the corporation in a trade or business of the corporation to an unrelated corporation.

(v) For plan years beginning after December 31, 1984, the date of the sale or other disposition by a corporation of its interest in a subsidiary (within the meaning of section 409(d)(3)) to an unrelated entity or individual.

(2) *Rules applicable to hardship distributions*—(i) *Distribution must be on account of hardship.* A distribution is treated as made after an employee's hardship for purposes of paragraph (d)(1)(ii) of this section only if it is made on account of the hardship. For purposes of this rule, a distribution is made on account of hardship only if the distribution both is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the financial need. The determination of the existence of an immediate and heavy financial need and of the amount necessary to meet the need must be made in accordance with nondiscriminatory and objective standards set forth in the plan. See section 411(d)(6) and the regulations thereunder.

(ii) *Limit on distributable amount.* For plan years beginning after December 31, 1988, a distribution on account of hardship must be limited to the distributable amount. The distributable amount is equal to the employee's total elective contributions as of the date of distribution, reduced by the amount of previous distributions on account of hardship. If the plan so provides, the employee's total elective contributions used in determining the distributable amount may be increased by income allocable to elective contributions, by amounts treated as elective contributions under paragraph (b)(5) of this section, and by income allocable to amounts treated as elective contributions. The distributable amount may only include amounts that were credited to the employee's account as of a date specified in the plan that is no later than December 31, 1988, or if later, the end of the last plan year ending before July 1, 1989 (or such later date provided in paragraph (h) of this section).

(iii) *General hardship distribution standards*—(A) *Immediate and heavy financial need.* Whether an employee has an immediate and heavy financial need is to be determined based on all relevant facts and circumstances. Generally, for example, the need to pay the funeral expenses of a family member would constitute an immediate and heavy financial need. A distribution made to an employee for the purchase of a boat or television would generally not constitute a distribution made on account of an immediate and heavy financial need. A financial need may be immediate and heavy even if it was reasonably foreseeable or voluntarily incurred by the employee.

(B) *Distribution necessary to satisfy financial need.* A distribution is not treated as necessary to satisfy an immediate and heavy financial need of an employee to the extent the amount of the distribution is in excess of the amount required to relieve the financial need or to the extent the need may be satisfied from other resources that are reasonably available to the employee. This determination generally is to be made on the basis of all relevant facts and circumstances. For purposes of this paragraph, the employee's resources are deemed to include those assets of the employee's spouse and minor children that are reasonably available to the employee. Thus, for example, a vacation home owned by the employee and the employee's spouse, whether as community property, joint tenants, tenants by the entirety, or tenants in common, generally will be deemed a resource of the employee. However, property held for the employee's child under an irrevocable trust or under the Uniform Gifts to Minors Act is not treated as a resource of the employee. The amount of an immediate and heavy financial need may include any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution. A distribution generally may be treated as necessary to satisfy a financial need if the employer relies upon the employee's written representation, unless the employer has actual knowledge to the contrary, that the need cannot reasonably be relieved:

(*1*) Through reimbursement or compensation by insurance or otherwise;

(*2*) By liquidation of the employee's assets;

(*3*) By cessation of elective contributions or employee contributions under the plan; or

(*4*) By other distributions or nontaxable (at the time of the loan) loans from plans maintained by the employer or by any other employer, or by borrowing from commercial sources on reasonable commercial terms, in an amount sufficient to satisfy the need.

For purposes of this paragraph (d)(2)(iii)(B), a need cannot reasonably be relieved by one of the actions listed above if the effect would be to increase the amount of the need. For example, the need for funds to purchase a principal residence cannot reasonably be relieved by a plan loan if the loan would disqualify the employee from obtaining other necessary financing.

(iv) *Deemed hardship distribution standards*—(A) *Deemed immediate and heavy financial need.* A distribution is deemed to be on account of an immediate and heavy financial need of the employee if the distribution is for:

(*1*) Expenses for medical care described in section 213(d) previously incurred by the employee, the employee's spouse, or any dependents of the employee (as defined in section 152) or necessary for these persons to obtain medical care described in section 213(d);

(*2*) Costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments);

(*3*) Payment of tuition, related educational fees, and room and board expenses, for the next 12 months of post-secondary education for the employee, or the employee's spouse, children, or dependents (as defined in section 152); or

(*4*) Payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence.

(B) *Distribution deemed necessary to satisfy financial need.* A distribution is deemed necessary to satisfy an immediate and heavy financial need of an employee if all of the following requirements are satisfied:

(*1*) The distribution is not in excess of the amount of the immediate and heavy financial need of the employee. The amount of an immediate and heavy financial need may include any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution.

(*2*) The employee has obtained all distributions, other than hardship distributions, and all nontaxable (at the time of the loan) loans currently available under all plans maintained by the employer.

(*3*) The plan and all other plans maintained by the employer limit the employee's elective contributions for the next taxable year to the applicable limit under section 402(g) for that year minus the employee's elective contributions for the year of the hardship distribution.

(*4*) The employee is prohibited, under the terms of the plan or an otherwise legally enforceable agreement, from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least 12 months after receipt of the hardship distribution. For this purpose the phrase ''all other plans maintained by the employer'' means all qualified and nonqualified plans of deferred compensation maintained by the employer. The phrase includes a stock option, stock purchase, or similar plan, or a cash or deferred arrangement that is part of a cafeteria plan within the meaning of section 125. However, it does not include the mandatory employee contribution portion of a defined benefit plan. It also does not include a health or welfare benefit plan, including one that is part of a cafeteria plan within the meaning of section 125. See §1.401(k)–1(g)(4)(i) for the continued treatment of suspended employees as eligible employees.

(C) *Commissioner may expand standards.* The Commissioner may expand the list of deemed immediate and heavy financial needs and may prescribe additional methods for distributions to be deemed necessary to satisfy an immediate and heavy financial need only in revenue rulings, notices, and other documents of general applicability, and not on an individual basis.

(3) *Rules applicable to distributions upon plan termination.* A distribution may not be made under paragraph (d)(1)(iii) of this section if the employer establishes or maintains a successor plan. For purposes of this rule, the definition of the term ''employer'' contained in paragraph (g)(6) of this section is applied as of the date of plan termination, and a successor plan is any other defined contribution plan maintained by the same employer. However, if at all times during the 24-month period beginning 12 months before the termination, fewer than two percent of the employees who were eligible under the defined contribution plan that includes the cash or deferred arrangement as of the date of plan termination are eligible under the other defined contribution plan, the other plan is not a successor plan. The term ''defined contribution plan'' means a plan that is a defined contribution plan as defined in section 414(i), but does not include an employee stock ownership plan as defined in section 4975(e) or 409(a) or a simplified employee pension as defined in section 408(k). A plan is a successor plan only if it exists at any time during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan.

(4) *Rules applicable to distributions upon sale of assets or subsidiary*—(i) *Seller must maintain the plan.* A distribution may be made under section 401(k)(10) and paragraph (d)(1) (iv) or (v) of this section only from a plan that the seller continues to maintain after the disposition. This requirement is satisfied if and only if the purchaser does not maintain the plan after the disposition. A purchaser maintains the plan of the seller if it adopts the plan or otherwise becomes an employer whose employees accrue benefits under the plan. A purchaser also maintains

the plan if the plan is merged or consolidated with, or any assets or liabilities are transferred from the plan to a plan maintained by the purchaser in a transaction subject to section 414(*l*)(1). A purchaser is not treated as maintaining the plan merely because a plan that it maintains accepts elective transfers described in § 1.411(d)–4, Q&A–3(b)(1), or rollover contributions of amounts distributed by the plan (including distributions that the recipient elects, under section 401(a)(31), to have paid in a direct rollover to the plan of the purchaser).

(ii) *Employee must continue employment.* A distribution may be made under paragraph (d)(1) (iv) or (v) of this section only to an employee who continues employment with the purchaser of assets or with the subsidiary, whichever is applicable.

(iii) *Distribution must be in connection with disposition of assets or subsidiary.* Elective contributions may not be distributed under paragraph (d)(1) (iv) or (v) of this section except in connection with the disposition that results in the employee's transfer to the purchaser. Whether a distribution is made in connection with the disposition of assets or a subsidiary depends on all of the facts and circumstances. Except in unusual circumstances, however, a distribution will not be treated as having been made in connection with a disposition unless it was made by the end of the second calendar year after the calendar year in which the disposition occurred.

(iv) *Definitions*—(A) *Substantially all.* For purposes of paragraph (d)(1)(iv) of this section, the sale of ''substantially all'' the assets used in a trade or business means the sale of at least 85 percent of the assets.

(B) *Unrelated employer.* For purposes of paragraph (d)(1) (iv) and (v) of this section, an ''unrelated'' entity or individual is one that is not required to be aggregated with the seller under section 414 (b), (c), (m), or (o) after the sale or other disposition.

(5) *Lump sum requirement for certain distributions.* After March 31, 1988, a distribution may be made under paragraph (d)(1) (iii), (iv), or (v) of this section only if it is a lump sum distribution. The term *lump sum distribution* has the meaning provided in section 402(d)(4), without regard to subparagraphs (A) (i) through (iv), (B), and (F) of that section.

(6) *Rules applicable to all distributions*—(i) *Impermissible distributions.* Amounts attributable to elective contributions may not be distributed on account of any event not described in this paragraph (d), such as completion of a stated period of plan participation or the lapse of a fixed number of years. For example, if excess deferrals (and income) for an employee's taxable year are not distributed within the time prescribed in § 1.402(g)–1(e) (2) or (3), the amounts may be distributed only on account of an event described in this paragraph (d).

(ii) *Deemed distributions.* The cost of life insurance (P.S. 58 costs) is not treated as a distribution for purposes of section 401(k)(2) and this paragraph. The making of a loan is not treated as a distribution, even if the loan is secured by the employee's accrued benefit attributable to elective contributions or is includible in the employee's income under section 72(p). However, the reduction, by reason of default on a loan, of an employee's accrued benefit derived from elective contributions is treated as a distribution.

(iii) *ESOP dividend distributions.* A plan does not fail to satisfy the requirements of this paragraph (d) merely by reason of a dividend distribution described in section 404(k)(2).

(iv) *Limitations apply after transfer.* The limitations of this paraqraph (d) generally continue to apply to amounts attributable to elective contributions (including amounts treated as elective contributions) that are transferred to another qualified plan of the same or another employer. Thus, the transferee plan will generally fail to satisfy the requirements of section 401(a) and this section if transferred amounts may be distributed before the times specified in this paragraph (d). The limitations of paragraph (d) of this section cease to apply after the transfer, however, if the amounts could have been distributed at the time of the transfer (other than on account of hardship), and the transfer is an elective transfer described in § 1.411(d)–4, Q&A–3(b)(1). The limitations of paragraph (d) of this section also do not apply to amounts distributed from another plan that the recipient elects under section 401(a)(31) to have paid in a direct rollover to the plan.

(v) *Required consent.* A distribution may be made under this paragraph (d) only if any consent or election required under section 411(a)(11) or 417 is obtained.

(7) *Examples.* The provisions of this paragraph (d) are illustrated by the following examples:

Example 1. Employer C maintains a profit-sharing plan that includes a cash or deferred arrangement. Elective contributions under the arrangement may be withdrawn for any reason after two years following the end of the plan year in which the contributions were made. Because the plan permits distributions of elective contributions before the occurrence of one of the events specified in section 401(k)(2)(B) and this paragraph (d), the plan includes a nonqualified cash or deferred arrangement and the elective contributions are currently includible in income under section 402.

Example 2. Employer D maintains a pre-ERISA money purchase plan that includes a cash or deferred arrangement. Elective contributions under the arrangement may be distributed to an employee on account of hardship. Under paragraph (d)(1) of this section, hardship is a distribution event only in a profit-sharing or stock bonus plan. Since elective contributions under the arrangement may be distributed before a distribution event occurs, the cash or deferred arrangement does not satisfy this paragraph (d), and is not a qualified cash or deferred arrangement. Moreover, the plan is not a qualified plan because a pension plan may not provide for payment of benefits upon hardship. See §1.401–1(b)(1)(i).

(e) *Additional requirements for qualified cash or deferred arrangements*—(1) *Qualified profit-sharing, stock bonus, pre-ERISA money purchase or rural cooperative plan requirement.* A cash or deferred arrangement satisfies this paragraph (e) only if the plan of which it is a part is a profit-sharing, stock bonus, pre-ERISA money purchase or rural cooperative plan that otherwise satisfies the requirements of section 401(a) (taking into account the cash or deferred arrangement). A plan that includes a cash or deferred arrangement may provide for other contributions, including employer contributions (other than elective contributions), employee contributions, or both. See paragraph (e)(7) of this section, however, for limitations on the extent to which elective contributions under a cash or deferred arrangement may be taken into account in determining whether the other contributions satisfy the requirements of section 401(a).

(2) *Cash availability requirement.* A cash or deferred arrangement satisfies this paragraph (e) only if the arrangement provides that the amount that each eligible employee may defer as an elective contribution is available to the employee in cash. Thus, for example, if an eligible employee is provided the option to receive a taxable benefit (other than cash) or to have the employer contribute on the employee's behalf to a profit-sharing plan an amount equal to the value of the taxable benefit, the arrangement is not a qualified cash or deferred arrangement. Similarly, if an employee has the option to receive a specified amount in cash or to have the employer contribute an amount in excess of the specified cash amount to a profit-sharing plan on the employee's behalf, any contribution made by the employer on the employee's behalf in excess of the specified cash amount is not treated as made pursuant to a qualified cash or deferred arrangement. This cash availability requirement applies even if the cash or deferred arrangement is part of a cafeteria plan within the meaning of section 125.

(3) *Separate accounting requirement*—(i) *General rule.* A cash or deferred arrangement satisfies this paragraph (e) only if the portion of an employee's benefit subject to the requirements of paragraphs (c) and (d) of this section is determined by an acceptable separate accounting between that portion and any other benefits. Separate accounting is not acceptable unless gains, losses, withdrawals, and other credits or charges are separately allocated on a reasonable and consistent basis to the accounts subject to the requirements of paragraphs (c) and (d) of this section and to other accounts. Subject to section 401(a)(4), forfeitures are not required to be allocated to the accounts in which benefits are subject to paragraphs (c) and (d) of this section.

(ii) *Failure to satisfy separate accounting requirement.* The requirements of paragraph (e)(3)(i) of this section are treated as satisfied if all amounts held under a plan that includes a cash or deferred arrangement or under another plan, contributions under which are taken into account under the arrangement for purposes of paragraph (b) of this section are treated as attributable to elective contributions subject to the requirements of paragraphs (c) and (d) of this section.

(4) *Limitations on cash or deferred arrangements of state and local governments and tax-exempt organizations*—(i) A cash or deferred arrangement does not satisfy the requirements of this paragraph (e) if the arrangement is adopted:

(A) After May 6, 1986, by a state or local government or political subdivision thereof, or any agency or instrumentality thereof (''a governmental unit''), or

(B) After July 1, 1986, by any organization exempt from tax under subtitle A of the Internal Revenue Code.

For purposes of paragraph (e)(4) of this section, whether an organization is exempt from tax under subtitle A of the Internal Revenue Code is determined without regard to section 414 (b), (c), (m) or (o).

(ii) A cash or deferred arrangement is treated as adopted after the dates described in paragraph (e)(4)(i) of this section with respect to all employees of any employer that adopts the arrangement after such dates. If an employer adopted an arrangement prior to such dates, all employees of the employer may participate in the arrangement.

(iii) For purposes of this paragraph (e)(4), an employer that has made a legally binding commitment to adopt a cash or deferred arrangement is treated as having adopted the arrangement on that date.

(iv) If a governmental unit adopted a cash or deferred arrangement before May 7, 1986, then any cash or deferred arrangement adopted by the unit at any time is treated as adopted before that date.

(v) This paragraph (e)(4) does not apply to a rural cooperative plan.

(vi) For purposes of this paragraph (e)(4), an employee representative is treated as an employee of a tax exempt employer even if the employee could be treated as an employee by another employer under § 1.413–1(i)(1).

(5) *One-year eligibility requirement.* For plan years beginning after December 31, 1988, or such later date provided in paragraph (h) of this section, a cash or deferred arrangement satisfies this paragraph (e) only if no employee is required to complete a period of service greater than one year (determined without regard to section 410(a)(1)(B)(i)) with the employer maintaining the plan to be eligible to make an election under the arrangement.

(6) *Other benefits not contingent upon elective contributions*—(i) *General rule.* For plan years beginning after December 31, 1988, or such later date provided in paragraph (h) of this section, a cash or deferred arrangement satisfies this paragraph (e) only if no other benefit is conditioned (directly or indirectly) upon the employee's electing to make or not to make elective contributions under the arrangement. The preceding sentence does not apply to any matching contribution (as defined in section 401(m)) made by reason of such an election or to any benefit that is provided at the employee's election under a plan described in section 125(d) in lieu of an elective contribution under a qualified cash or deferred arrangement.

(ii) *Definition of other benefits.* Other benefits include, but are not limited to, benefits under a defined benefit plan; nonelective employer contributions under a defined contribution plan; the availability, cost, or amount of health benefits; vacations or vacation pay; life insurance; dental plans; legal services plans; loans (including plan loans); financial planning services; subsidized retirement benefits; stock options; property subject to section 83; and dependent care assistance. Also, increases in salary and bonuses (other than those actually subject to the cash or deferred election) are benefits for purposes of this paragraph (e)(6). The ability to make after-tax employee contributions is a benefit, but that benefit is not contingent upon an employee's electing to make or not make elective contributions under the arrangement merely because the amount of elective contributions reduces dollar-for-dollar the amount of after-tax employee contributions that may be made. Benefits under any other plan or arrangement (whether or not qualified) are not contingent upon an employee's electing to make or not to make elective contributions under a cash or deferred arrangement merely because the elective contributions are or are not taken into account as compensation under the other plan or arrangement for purposes of determining benefits.

(iii) *Effect of certain statutory limits.* A benefit under a defined benefit plan that is contingent upon elective contributions solely by reason of the combined plan fraction of section 415(e) is not treated as contingent for purposes of this paragraph (e)(6). Similarly, any benefit under an excess benefit plan described in section 3(36) of the Employee Retirement Income Security Act of 1974 that is dependent on the employee's electing to make or not to make elective contributions is not treated as contingent.

(iv) *Nonqualified deferred compensation.* Participation in a nonqualified deferred compensation plan is treated as contingent for purposes of this paragraph (e)(6) only to the extent that an employee may receive additional deferred compensation under the nonqualified plan to the extent the employee makes or does not make elective contributions. Deferred compensation under a nonqualified plan of deferred compensation that is dependent on an employee's having made the maximum elective deferrals under section 402(g) or the maximum elective contributions permitted under the terms of the plan also is not treated as contingent.

(v) *Plan loans and distributions.* A loan or distribution of elective contributions is not a benefit conditioned on an employee's electing to make or not make elective contributions under the arrangement merely because the amount of the loan or distribution is based on the amount of the employee's account balance.

(vi) *Examples.* The provisions of this paragraph (e)(6) are illustrated by the following examples.

Example 1. Employer T maintains a cash or deferred arrangement for all of its employees. Employer T also maintains a nonqualified deferred compensation plan for two highly paid executives, Employees R and C. Under the terms of the nonqualified deferred compensation plan, R and C are eligible to participate only if they do not make elective contributions under the cash or deferred arrangement. Participation in the nonqualified plan is a contingent benefit for purposes of this paragraph (e)(6), because R's and C's participation is conditioned on their electing not to make elective contributions under the cash or deferred arrangement.

Example 2. Employer T maintains a cash or deferred arrangement for all its employees. Employer T also maintains a nonqualified deferred compensation plan for two highly paid executives, Employees R and C. Under the terms of the arrangements, Employees R and C may defer a maximum of 10 percent of their compensation, and may allocate their deferral between the cash or deferred arrangement and the nonqualified deferred compensation plan in any way they choose (subject to the overall 10 percent maximum). Because the maximum deferral available under the nonqualified deferred compensation plan depends on the elective deferrals made under the cash or deferred arrangement, the right to participate in the nonqualified plan is a contingent benefit for purposes of paragraph (e)(6).

(7) *Coordination with other plans.* For plan years beginning after December 31, 1988, or such later date provided in paragraph (h) of this section, a cash or deferred arrangement satisfies this paragraph (e) only if no elective contributions (or qualified matching contributions treated as elective contributions under paragraph (b)(5) of this section) under the arrangement are taken into account for purposes of determining whether any other contributions under any plan (including the plan to which the elective contributions are made) satisfy the requirements of section 401(a). Indeed, the portion of a plan that consists of elective contributions is treated as a separate plan for purposes of sections 401(a)(4) and 410(b). See §1.410(b)–7(c)(1). Similarly, elective contributions under a cash or deferred arrangement generally may not be taken into account in determining whether a plan satisfies the minimum contribution or benefit requirements of section 416. See §1.416–1, M–20. However, qualified nonelective contributions that are treated as elective contributions for purposes of section 401(k)(3) under paragraph (b)(5) of this section may be used to enable a

plan to satisfy the minimum contribution or benefit requirements under section 416. See §1.416–1, M–18. This paragraph (e) does not apply for purposes of determining whether a plan satisfies the average benefit percentage requirement of section 410(b)(2)(A)(ii). See also §1.401(m)–1(b)(5) for circumstances under which elective contributions may be used to determine whether a plan satisfies the requirements of section 401(m).

(8) *Recordkeeping requirements.* For plan years beginning after December 31, 1986, or such later date provided in paragraph (h) of this section, a cash or deferred arrangement satisfies this paragraph (e) only if the employer maintains the records necessary to demonstrate compliance with the applicable nondiscrimination requirements of paragraph (b) of this section, including the extent to which qualified nonelective contributions and qualified matching contributions are taken into account.

(9) *Consistent application of separate line of business rules.* If an employer is treated as operating qualified separate lines of business under section 414(r) in accordance with §1.414(r)–1(b) for purposes of applying section 410(b), and applies the special rule for employer-wide plans in §1.414(r)–1(c)(2)(ii) to the portion of the plan that consists of contributions under the cash or deferred arrangement, then the requirements of section 401(k) and this section must be applied on an employer-wide rather than a qualified-separate-line-of-business basis to all of the plans or portions of plans taken into account in determining whether the cash or deferred arrangement is a qualified cash or deferred arrangement, regardless of whether those plans or portions of plans also satisfy the requirements necessary to apply the special rule in §1.414(r)–1(c)(2)(ii). Conversely, if an employer is treated as operating qualified separate lines of business under section 414(r) in accordance with §1.414(r)–1(b) for purposes of applying section 410(b), and does not apply the special rule for employer-wide plans in §1.414(r)–1(c)(2)(ii) to the portion of the plan that consists of contributions under the cash or deferred arrangement, then the requirements of section 401(k) and this section must be applied on a qualified-separate-line-of-business rather than an employer-wide basis to all of the plans or portions of plans taken into account in determining whether the cash or deferred arrangement is a qualified cash or deferred arrangement, regardless of whether one or more of those plans or portions of plans is tested under the special rule §1.414(r)–1(c)(2)(ii). This requirement applies solely for purposes of determining whether the cash or deferred arrangement is a qualified cash or deferred arrangement under section 401(k) and this section. The rules of this paragraph are illustrated by the following example.

Example. (i) Employer A maintains a profit-sharing plan that includes a cash or deferred arrangement in which all of the employees of Employer A are eligible to participate. Employer A is treated as operating qualified separate lines of business under section 414(r) in accordance with §1.414(r)–1(b) for purposes of applying section 410(b). However, Employer A applies the special rule for employer-wide plans in §1.414(r)–1(c)(2)(ii) to the portion of its profit-sharing plan that consists of elective contributions under the cash or deferred arrangement (and to no other plans or portions of plans). Employer A makes qualified nonelective contributions to the profit-sharing plan for the 1995 plan year, and the profit-sharing plan provides that these qualified nonelective contributions may be used to satisfy the actual deferral percentage test.

(ii) Under these facts, the requirements of sections 401(a)(4) and 410(b) must be applied on an employer-wide rather than a qualified-separate-line-of-business basis in determining whether the qualified nonelective contributions made to the profit-sharing plan satisfy the requirements of §1.401(k)–1(b)(5), and thus whether they may be taken into account under the actual deferral percentage test. Therefore, in order for the nonelective contributions to be used to satisfy the actual deferral percentage test, both (1) the total amount of nonelective contributions under the profit-sharing plan, including the qualified nonelective contributions to be used to satisfy the actual deferral percentage test, and (2) the total amount of nonelective contributions under the profit-sharing plan, excluding the qualified nonelective contributions to be used to satisfy the actual deferral percentage test, must satisfy the requirements of section 401(a)(4) on an employer-wide basis. Of course, in order for the profit-sharing plan to satisfy section 401(a), it must still satisfy sections

410(b) and 401(a)(4) on a qualified-separate-line-of-business basis.

(f) *Correction of excess contributions*—(1) *General rule*—(i) *Permissible correction methods.* A cash or deferred arrangement does not fail to satisfy the requirements of section 401(k)(3) or paragraph (b)(2) of this section with respect to the amount of elective contributions under the arrangement if the employer, in accordance with the terms of the plan that includes the cash or deferred arrangement and paragraph (b)(5) of this section, makes qualified nonelective contributions or qualified matching contributions that are treated as elective contributions under the arrangement and that, in combination with the elective contributions, satisfy the requirements of paragraph (b)(2) of this section. In addition, a cash or deferred arrangement does not fail to satisfy the requirements of section 401(k)(3) or paragraph (b)(2) of this section for a plan year with respect to the amount of the elective contributions under the arrangement if, in accordance with the terms of the plan that includes the cash or deferred arrangement, excess contributions are recharacterized in accordance with paragraph (f)(3) of this section, or excess contributions (and income allocable thereto) are distributed in accordance with paragraph (f)(4) of this section.

(ii) *Combination of correction methods.* A plan may use any of the correction methods described in paragraph (f)(1)(i) of this section, may limit elective contributions in a manner designed to prevent excess contributions from being made, or may use a combination of these methods, to avoid or correct excess contributions. Thus, for example, a portion of the excess contributions for a highly compensated employee may be recharacterized under paragraph (f)(3) of this section, and the remaining portion of the excess contributions may be distributed under paragraph (f)(4) of this section. A plan may require or permit a highly compensated employee to elect whether any excess contributions are to be recharacterized or distributed.

(iii) *Impermissible correction methods.* Excess contributions for a plan year may not remain unallocated or be allocated to a suspense account for allocation to one or more employees in any future year. In addition, excess contributions may not be corrected using the retroactive correction rules of §1.401(a)(4)–11(g). See §1.401(a)(4)–11(g)(3)(vii) and (5). See paragraph (f)(6) of this section for the effects of a failure to correct excess contributions.

(iv) *Partial distributions.* Any distribution of less than the entire amount of excess contributions with respect to any highly compensated employee is treated as a pro rata distribution of excess contributions and allocable income or loss.

(2) *Amount of excess contributions.* The amount of excess contributions for a highly compensated employee for a plan year is the amount (if any) by which the employee's elective contributions must be reduced for the employee's actual deferral ratio to equal the highest permitted actual deferral ratio under the plan. To calculate the highest permitted actual deferral ratio under a plan, the actual deferral ratio of the highly compensated employee with the highest actual deferral ratio is reduced by the amount required to cause the employee's actual deferral ratio to equal the ratio of the highly compensated employee with the next highest actual deferral ratio. If a lesser reduction would enable the arrangement to satisfy the actual deferral percentage test, only this lesser reduction may be made. This process must be repeated until the cash or deferred arrangement satisfies the actual deferral percentage test. The highest actual deferral ratio remaining under the plan after leveling is the highest permitted actual deferral ratio. Thus, for each highly compensated employee, the amount of excess contributions for a plan year is equal to the employee's elective contributions, plus qualified nonelective contributions and qualified matching contributions taken into account in determining the employee's actual deferral ratio under paragraph (g)(1) of this section, minus the amount determined by multiplying the employee's actual deferral ratio (determined after application of this paragraph (f)(2)) by the compensation used in determining the ratio. In no case may the amount of excess contributions to be recharacterized or distributed for a

plan year with respect to any highly compensated employee exceed the amount of elective contributions made on behalf of the highly compensated employee for the plan year.

(3) *Recharacterization of excess contributions*—(i) *General rule.* Excess contributions are recharacterized in accordance with this paragraph (f)(3) only if the excess contributions are treated as described in paragraph (f)(3)(ii) of this section, and all of the conditions set forth in paragraph (f)(3)(iii) of this section are satisfied.

(ii) *Treatment of recharacterized excess contributions.*

(A) Excess contributions recharacterized under this paragraph (f)(3) are includable in the employee's gross income on the earliest dates any elective contribution made on behalf of the employee during the plan year would have been received by the employee had the employee originally elected to receive the amounts in cash, or on such later date permitted in paragraph (f)(3)(iv) of this section. The recharacterized excess contributions must be treated as employee contributions for purposes of section 72, section 401(a)(4) and 401(m), and paragraphs (b) and (d) of this section. This requirement is not treated as satisfied unless:

(*1*) The payor or plan administrator reports the recharacterized excess contributions as employee contributions to the Internal Revenue Service and the employee by—

(*i*) Timely providing such forms as the Commissioner may designate to the employer and to employees whose excess contributions are recharacterized under this paragraph (f)(3); and

(*ii*) Timely taking such other action as the Commissioner may require; and

(*2*) The plan administrator accounts for the amounts as contributions by the employee for purposes of sections 72 and 6047.

(B) Recharacterized excess contributions continue to be treated as employer contributions that are elective contributions for all other purposes under the Internal Revenue Code, including sections 401(a) (other than 401(a)(4) and 401(m)), 404, 409, 411, 412, 415, 416, and 417. Thus, for example, recharacterized excess contributions remain subject to the requirements of paragraph (c) of this section; must be deducted under section 404; and are treated as employer contributions described in section 415(c)(2)(A) and §1.415–6(b). In addition, these amounts are not treated as compensation for purposes of sections 404 and 415, and may be treated as compensation for purposes of sections 401(a)(4), 401(a)(5), 401(k), 401(l) and 414(s) only to the extent that elective contributions may be treated, and are treated under the plan, as compensation. See §1.414(s)–1(c)(4)(i). Recharacterized excess contributions that relate to plan years ending on or before October 24, 1988, may be treated as either employer contributions or employee contributions for purposes of paragraph (d) of this section. The amount of excess contributions included in an employee's gross income is reduced as provided under paragraph (f)(5)(i)(B) of this section.

(iii) *Additional rules*—(A) *Time of recharacterization.* Excess contributions may not be recharacterized under this paragraph (f)(3) after the later of October 24, 1988, or 2½ months after the close of the plan year to which the recharacterization relates. Recharacterization is deemed to have occurred on the date on which the last of those highly compensated employees with excess contributions to be recharacterized is notified in accordance with paragraph (f)(3)(ii)(A) of this section. The Commissioner may designate the means by which this notification is to be provided.

(B) *Employee contributions must be permitted under plan.* The amount of recharacterized excess contributions, in combination with the employee contributions actually made by the highly compensated employee, may not exceed the maximum amount of employee contributions (determined without regard to the actual contribution percentage test of section 401(m)(2)) that the highly compensated employee could have made under the provisions of the plan in effect on the first day of the plan year in the absence of recharacterization. See §1.401(m)–1(a)(2) for requirements relating to the availability of employee contributions.

(C) *Plans under which excess contributions may be recharacterized.* For plan years beginning after December 31, 1991, elective contributions may be recharacterized under this paragraph (f)(3) only under the plan under which they are made or under a plan with which that plan could be aggregated under §1.410(b)–7(d) after application of the mandatory disaggregation rules of §1.410(b)–7(c), as modified in §1.401(k)–1(g)(11). For plan years beginning before that date and after December 31, 1988, or such later date provided under paragraph (h) of this section, elective contributions may be recharacterized under this paragraph (f)(3) only under the plan under which they are made or under a plan with the same plan year as that plan.

(iv) *Transition rules.* If amounts recharacterized for any plan year were not previously included in income, they must be treated as received by employees for income tax purposes on the first day of the first plan year ending after 1987. If notice of recharacterization was provided to the affected highly compensated employees by October 24, 1988, recharacterization is deemed to have occurred 2½ months after the close of the plan year and the penalty tax of section 4979 will not be imposed. The rules in this paragraph (f)(3)(iv) are effective only for plan years ending before August 9, 1988.

(v) *Example.* The provisions of this paragraph (f)(3) are illustrated by the following example:

Example. (i) Employer X maintains Plan Y, a calendar year profit-sharing plan that includes a qualified cash or deferred arrangement. Under Plan Y, each eligible employee may elect to defer up to 10 percent of compensation under a salary reduction agreement. An eligible employee may also make employee contributions of up to 10 percent of compensation. X pays the amounts deferred to the trust on the last day of each month. Employer X includes elective contributions in compensation as permitted under §1.414(s)–1(c)(4)(i). See §1.401(k)–1(g)(2)(i). Salaries are paid on the same date.

(ii) (A) In January 1989, X determines that during 1988 the compensation and actual deferral ratios (ADRs) of X's six employees were as follows:

Employee	Compensation (A)	Elective contribution (B)	ADR (%)(B/A)
A	$70,000	$7,000	10.00
B	60,000	4,500	7.50
C	20,000	1,000	5.00
D	15,000	0	0
E	10,000	350	3.50
F	10,000	350	3.50

(B) The average deferral percentage (ADP) for X's highly compensated group, A and B, is 8.75 percent ((10.00%+7.50%)/2). The ADP for X's other employees is 3 percent ((5.00%+0% + 3.50% + 3.50%)/4). Because 8.75 percent is more than 2 times 3 percent and more than 3 percent plus 2 percentage points, the plan fails to satisfy paragraph (b)(2) of this section. Neither A nor B made any employee contributions for the year.

(iii) Plan Y provides that each highly compensated participant will have excess contributions, as defined in paragraph (g)(7) of this section, recharacterized. The amount to be recharacterized will be determined according to the method described in paragraph (f)(2) of this section.

(iv) In order to satisfy paragraph (b)(2) of this section, Plan Y must reduce the ADP for X's highly compensated employees to not more than 5 percent. This will satisfy the test described in paragraph (b)(2) of this section, because 5 percent is not more than 2 times 3 percent and is not more than 2 percentage points greater than 3 percent. Plan Y first reduces A's ADR to 7.5 percent (the ADR of the highly compensated employee having the next highest ADR). Since this is not sufficient to satisfy the ADP test in paragraph (b)(2) of this section, the ADR of both A and B must be reduced to 5 percent.

(v) The maximum dollar amount that may be deferred by each employee is determined by using the formula D=(ADR×S) where D is the maximum allowable deferral, ADR is the reduced ADR, and S is the compensation. Thus, A's maximum allowable deferral is $3,500 (.05×$70,000), and B's maximum allowable deferral is $3,000 (.05×$60,000). The balance of the original deferrals by A and B ($3,500 and $1,500 respectively) must be included in their taxable wages for 2988, the year in which X would have paid cash to A and B.

(vi) A deferred $583.33 per month, except for January, February, March, and April, when A deferred $583.34. Pursuant to the first-in, first-out rule in paragraph (f)(3)(ii) of this section, the deferrals made in January, February, March, April, and May, as well as $583.31 of the deferral made in June, are treated as employee contributions. A similar procedure is undertaken with respect to B. X and the plan administrator provide A and B with the forms and notices that the Commissioner requires. If A and B had already filed income tax returns for 1988, they must file amended returns. If Plan Y had a plan year ending November 30, 1987, and A and B had made elective deferrals in December 1987, they would also have to file amended returns for 1987. In addition, the plan administrator must satisfy paragraph (f)(3)(ii)(B) of this section. Of course, the actual contribution percentage test of section 401(m)(2) must be satisfied for 1988, taking the recharacterized amounts into account.

(4) *Corrective distribution of excess contributions (and income)*—(i) *General rule.* Excess contributions (and income allocable thereto) are distributed in accordance with this paragraph (f)(4) only if the excess contributions and allocable income are designated by the employer as a distribution of excess contributions (and income), and are distributed to the appropriate highly compensated employees after the close of the plan year in which the excess contributions arose and within 12 months after the close of that plan year. In the event of a complete termination of the plan during the plan year in which an excess contribution arose, the corrective distribution must be made as soon as administratively feasible after the date of termination of the plan, but in no event later than 12 months after the date of termination. If the entire account balance of a highly compensated employee is distributed during the plan year in which an excess contribution arose, the distribution is deemed to have been a corrective distribution of excess contributions (and income) to the extent that a corrective distribution would otherwise have been required.

(ii) *Income allocable to excess contributions*—(A) *General rule.* The income allocable to excess contributions is equal to the sum of the allocable gain or loss for the plan year and, if the plan so provides, the allocable gain or loss for the period between the end of the plan year and the date of distribution (the "gap period").

(B) *Method of allocating income.* A plan may use any reasonable method for computing the income allocable to excess contributions, provided that the method does not violate section 401(a)(4), is used consistently for all participants and for all corrective distributions under the plan for the plan year, and is used by the plan for allocating income to participants' accounts. See § 1.401(a)(4)–1(c)(8).

(C) *Alternative method of allocating income.* A plan may allocate income to excess contributions by multiplying the income for the plan year (and the gap period, if the plan so provides) allocable to elective contributions and amounts treated as elective contributions by a fraction. The numerator of the fraction is the excess contributions for the employee for the plan year. The denominator of the fraction is equal to the sum of:

(*1*) The total account balance of the employee attributable to elective contributions and amounts treated as elective contributions as of the beginning of the plan year; plus

(*2*) The employee's elective contributions and amounts treated as elective contributions for the plan year and for the gap period if gap period income is allocated.

(D) *Safe harbor method of allocating gap period income.* Under the safe harbor method, income on excess contributions for the gap period is equal to 10 percent of the income allocable to excess contributions for the plan year (calculated under the method described in paragraph (f)(4)(ii)(C)) of this section, multiplied by the number of calendar months that have elapsed since the end of the plan year. For purposes of calculating the number of calendar months that have elapsed under the safe harbor method, a corrective distribution that is made on or before the fifteenth day of the month is treated as made on the last day of the preceding month. A distribution made after the fifteenth day of the month is treated as made on the first day of the next month.

(iii) *No employee or spousal consent required.* A corrective distribution of excess contributions (and income) may be made under the terms of the plan without regard to any notice or consent otherwise required under sections 411(a)(11) and 417.

(iv) *Treatment of corrective distributions as employer contributions.* Excess contributions are treated as employer contributions for purposes of sections 404 and 415 even if distributed from the plan.

(v) *Tax treatment of corrective distributions*—(A) *General rule.* Except as provided in paragraph (f)(4)(v) (B) or (C) of this section, a corrective distribution of excess contributions (and income) that is made within 2½ months after the end of the plan year for which the excess contributions were made is includible in the employee's gross income on the earliest dates any elective contributions by the employee during the plan year would have been received by the employee had the employee originally elected to receive the amounts in cash. A corrective distribution of excess contributions (and income) that is made more than 2½ months after the end of the plan year for which the contributions were made is includible in the employee's gross income in the employee's taxable year in which distributed. Regardless of when the corrective distribution is made, it is not subject to the early distribution tax of section 72(t) and is not treated as a distribution for purposes of applying the excise tax under section 4980A. See paragraph (f)(5)(i)(B) of this section for rules relating to the taxation of excess contributions that reduce excess deferrals. See paragraph (f)(6)(i) of this section for additional rules relating to the employer excise tax on amounts distributed more than 2½ months after the end of the plan year.

(B) *Rule for de minimis distributions.* If the total amount of excess contributions and excess aggregate contributions distributed to a recipient under a plan for any plan year is less than $100 (excluding income), a corrective distribution of excess contributions (and income) is includible in the gross income of the recipient in the taxable year of the recipient in which the corrective distribution is made.

(C) *Rule for certain 1987 and 1988 excess contributions.* Distributions for plan years beginning in 1987 and 1988 to which the de minimis rule of this section would otherwise apply may be reported by the recipient, at the recipient's option, either in the year described in paragraph (f)(4)(v)(A) of this section, or in the year described in paragraph (f)(4)(v)(B) of this section. This special rule may be used only for distributions made within 2½ months after the close of the plan year, but in no event later than April 17, 1989.

(vi) *No reduction of required minimum distribution.* A distribution of excess contributions (and income) is not treated as a distribution for purposes of determining whether the plan satisfies the minimum distribution requirements of section 401(a)(9).

(5) *Rules applicable to all corrections*—(i) *Coordination with distribution of excess deferrals*—(A) *In general.* The amount of excess contributions to be recharacterized under paragraph (f)(3) of this section or distributed under paragraph (f)(4) of this section with respect to an employee for a plan year, is reduced by any excess deferrals previously distributed to the employee for the employee's taxable year ending with or within the plan year in accordance with section 402(g)(2).

(B) *Treatment of excess contributions that reduce excess deferrals.* Under §1.402(g)–1(e), the amount of excess deferrals that may be distributed with respect to an employee for a taxable year is reduced by any excess contributions previously distributed or recharacterized with respect to the employee for the plan year beginning with or within the taxable year. The amount of excess contributions includible in the gross income of the employee, and the amount of excess contributions reported by the payor or plan administrator as includible in the gross income of the employee, does not include the amount of any reduction under §1.402(g)–1(e)(6).

(ii) *Correction of family members.* The determination and correction of excess contributions of a highly compensated employee whose actual deferral ratio is determined under the family aggregation rules of paragraph (g)(1)(ii)(C) of this section is accomplished by reducing the actual deferral ratio as required under paragraph (f)(2) of this section and allocating the excess contributions for the family group among the family members in proportion to the elective contribution of each family member that is combined to determine the actual deferral ratio.

(iii) *Matching contributions forfeited because of excess deferral or contribution.* For purposes of section 401(k)(2)(C) and paragraph (c)(1) of this section, a qualified matching contribution is not treated as forfeitable merely because under the plan it is forfeited if the contribution to which it relates is treated as an excess contribution, excess deferral, or excess aggregate contribution.

(6) *Failure to correct*—(i) *Failure to correct within 2½ months after end of plan year.* If a plan does not correct excess contributions within 2½ months after the close of the plan year for which the excess contributions are made, the employer will be liable for a 10-percent excise tax on the amount of the excess contributions. See section 4979 and §54.4979–1. Qualified nonelective contributions and qualified matching contributions properly taken into account under paragraph (b)(5) of this section for a plan year may enable a plan to avoid having excess contributions, even if the contributions are made after the close of the 2½ month period.

(ii) *Failure to correct within 12 months after end of plan year.* If excess contributions are not corrected within 12 months after close of the plan year for which they were made, the cash or deferred arrangement will fail to satisfy the requirements of section 401(k)(3) for the plan year for which the excess contributions are made and all subsequent plan years during which the excess contributions remain in the trust.

(7) *Examples.* The provisions of this paragraph (f) are illustrated by the following examples:

Example 1. (i) The Y corporation maintains a cash or deferred arrangement. The plan year is the calendar year. For plan year 1989, all 10 of Y's employees are eligible to participate in the cash or deferred arrangement. The Y corporation includes elective contributions in compensation as permitted under §1.414(s)–1(c)(4)(i). See §1.401(k)–1(g)(2)(i). The employees' compensation, elective contributions, and actual deferral ratios are shown in the following table:

Employee	Compensation	Elective contributions	Actual deferral ratio (ADR) (percent)
A	$160,000	$6,400	4.0
B	140,000	7,000	5.0
C	70,000	7,000	10.0
D	65,000	6,500	10.0
E	42,000	2,100	5.0
F	35,000	3,500	10.0
G	28,000	2,800	10.0
H	21,000	700	3.33
I	21,000	0	0
J	21,000	0	0

(ii) Employees A, B, C, and D are highly compensated employees. Employees E, F, G, H, I, and J are nonhighly compensated employees. The actual deferral percentage (ADP) for the highly compensated group is 7.25 percent. The ADP for the nonhighly compensated group is 4.72 percent. These percentages do not meet the requirements of section 401(k)(3)(A)(ii).

(iii) Employees A and C have each received a distribution of excess deferrals of $1,000. However, the ADR for employee A remains 4.0 percent and the actual deferral ratio for Employee C remains 10.0 percent. The ADP for the group of highly compensated employees remains 7.25 percent.

(iv) The ADP for the highly compensated group must be reduced to 6.72 percent. This is done by reducing the ADR of the highly compensated employees with the highest ADR (Employees C and D) to 8.94 percent. This makes Employee C's maximum elective contribution $6,258. This requires a distribution or recharacterization of $742. But since $1,000 has already been distributed as an excess deferral, no additional distribution or recharacterization is required or permitted. Employee D's elective contribution must be reduced by $689 ($6,500—.0894 ($65,000)) to $5,811 through distribution or recharacterization.

Example 2. A, B, and C are highly compensated employees of Employer R. Employer R maintains a cash or deferred arrangement. Employer R includes elective contributions in compensation as permitted under §1.414(s)–1(c)(4)(i). For the plan year 1990, A, B, and C each earns compensation of $100,000 and contributes $7,000 to the plan during the period January through June. B retires in November of 1990 and makes a withdrawal of B's entire account balance of $200,000. In January of 1991, R computes the ADP test for its employees and learns that the highly compensated employees should have contributed only five percent of compensation. Since B made a contribution of $7,000 for 1990, B's contribution and compensation are used in determining the ADP despite the subsequent $200,000 withdrawal. A, B, and C must each receive a corrective distribution of $2,000 in order to meet the ADP test. Since B has already withdrawn B's total account balance under the plan, only A and C must receive a distribution of $2,000 each in order for the plan to meet the ADP test of section 401(k)(3)(A)(ii). Pursuant to the 1990 Form 1099–R Instructions, the plan must issue two Forms 1099–R to B, one reporting the portion of the distribution that was necessary to correct the excess contribution (including income), and one reporting the balance of the distribution. If B had withdrawn less than the total account balance, B would have to withdraw the lesser of $2,000 or the remaining account balance.

Example 3. Individual A has a child, B. Both participate in a cash or deferred arrangement maintained by Employer X. A is one of the 10 most highly compensated employees and B is a nonhighly compensated employee. Employer X includes elective contributions in compensation as permitted under

§ 1.414(s)–1(c)(4)(i). A has compensation of $100,000 and defers $7,000 under the cash or deferred arrangement; B has compensation of $40,000 and defers $4,000 under the arrangement. The actual deferral ratio of the family unit is 7.86 percent, calculated by aggregating the contributions and compensation of A and B ($7,000 + $4,000)/($100,000 + $40,000). For the plan, it is determined that under § 1.401(k)–1(f)(2), the actual deferral ratio of the aggregate family unit must be reduced to 7.20 percent. This reduction is applied in proportion to A's and B's contributions. The excess contributions are $920 ($11,000 total contributions minus $10,080 (7.20% x $140,000)). A's share of the excess contributions is $585.45 ($7,000/$11,000 x $920); B's share is $334.55 ($4,000/$11,000 x $920).

Example 4. (i) Employer T maintains a profit-sharing plan containing a cash or deferred arrangement for all employees. Six employees are covered by a collective bargaining agreement, the other seven employees are not. The employee data for 1994 is shown in the following table:

Employee	Collective bargaining unit status	Actual deferral ratio (ADR), (percent)
A	Member	8.0
B	Member	6.0
C	Nonmember	9.0
D	Nonmember	7.0
E–H	Members	4.5
I–M	Nonmembers	6.0

Employees A, B, C, and D are highly compensated.

(ii) For purposes of sections 410(b), 401(a)(4) and 401(k), the portion of T's plan covering collectively bargained unit members must be disaggregated from the portion covering other employees.

Employee	ADR (percent)
Collective Bargaining Unit Members:	
A	8.0
B	6.0
E–H	[1] 4.5
Other Employees:	
C	9.0
D	7.0
I–M	[1] 6.0

[1] Average.

(iii) The ADPs for the collectively bargained highly compensated group and nonhighly compensated group, respectively, are seven percent and 4.5 percent. The ADPs for the other highly compensated and nonhighly compensated employees, respectively, are eight percent and six percent.

(iv) The non-collectively bargained portion of the disaggregated plan satisfies the ADP test for the 1994 plan year, but the collectively bargained portion does not. Employer T is not required to make corrections to the collectively bargained portion of the cash or deferred arrangement, because a collectively bargained plan automatically satisfies the nondiscrimination requirements of 401(a)(4). However, unless Employer T corrects the ADP test failure in the collectively bargained portion of the plan, either by reducing A's ADR to seven percent or adding QNCs for the nonhighly compensated employees, all elective contributions made by collectively bargained employees for the year will be includible in income in 1994.

(g) *Definitions.* The following definitions apply for purposes of this section, unless the context clearly indicates otherwise:

(1) *Actual deferral percentage*—(i) *General rule.* The actual deferral percentage for a group of employees for a plan year is the average of the actual deferral ratios of employees in the group for that plan year. For plan years that begin after December 31, 1988, or such later date provided in paragraph (h) of this section, actual deferral ratios and the actual deferral percentage for a group are calculated to the nearest hundredth of a percentage point.

(ii) *Actual deferral ratio*—(A) *General rule.* An employee's actual deferral ratio for the plan year is the sum of the employee's elective contributions and amounts treated as elective contributions for the plan year, divided by the employee's compensation taken into account for the plan year. If an eligible employee makes no elective contributions, and no qualified matching contributions or qualified nonelective contributions are taken into account with respect to the employee, the actual deferral ratio of the employee is zero. See paragraphs (b)(4), (b)(5), and (g)(2) of this section for rules regarding the elective contributions, qualified nonelective contributions, and compensation taken into account in calculating this fraction.

(B) *Employee eligible under more than one arrangement*—(*1*) *Highly compensated employees.* For plan years beginning after December 31, 1984, the actual deferral ratio of a highly compensated employee who is eligible to participate in more than one cash or deferred arrangement of the same employer is generally calculated by treating all the cash or deferred arrangements in which the employee is eligible to participate as one arrangement. However, plans that are not permitted to be aggregated under §1.410(b)–7(c), as modified in paragraph (g)(11) of this section, are not aggregated for this purpose. For example, if a highly compensated employee with compensation of $80,000 could make elective contributions under two separate cash or deferred arrangements, the actual deferral ratio for the employee under each arrangement would generally be calculated by dividing the total elective contributions by the employee under both arrangements by $80,000. If one of the cash or deferred arrangements were part of an ESOP, however, while the other was not, the actual deferral percentage of the employee under each arrangement would be calculated by dividing the employee's elective contributions under each arrangement by $80,000 because the ESOP portion is mandatorily disaggregated from the non-ESOP portion.

(*2*) *Nonhighly compensated employees.* For plan years beginning after December 31, 1984, and before January 1, 1987 (or such later date provided under paragraph (h) of this section), this paragraph (g)(1)(ii)(B) applies to all employees, and not only to highly compensated employees.

(*3*) *Treatment of plans with different plan years.* If the cash or deferred arrangements that are treated as a single arrangement under this paragraph (g)(1)(ii)(B) are parts of plans that have different plan years, the cash or deferred arrangements are treated as a single arrangement with respect to the plan years ending with or within the same calendar year.

(C) *Employees subject to family aggregation rules*—(*1*) *Aggregation of elective contributions and other amounts.* For plan years beginning after December 31, 1986, or any later date provided in paragraph (h) of this section, if a highly compensated employee is subject to the family aggregation rules of section 414(q)(6) because that employee is either a five-percent owner or one of the 10 most highly compensated employees, the combined actual deferral ratio for the family group (which is treated as one highly compensated employee) must be determined by combining the elective contributions, compensation, and amounts treated as elective contributions of all family members.

(*2*) *Effect on actual deferral percentage of nonhighly compensated employees.* The elective contributions, compensation, and amounts treated as elective contributions of all family members are disregarded for purposes of determining the actual deferral percentage for the group of nonhighly compensated employees.

(*3*) *Multiple family groups.* If an employee is required to be aggregated as a member of more than one family group in a plan, all eligible employees who are members of those family groups that include that employee are aggregated as one family group.

(2) *Compensation*—(i) *Years beginning after December 31, 1986.* For plan years beginning after December 31, 1986, or such later date provided in paragraph (h) of this section, the term *compensation* means compensation as defined in section 414(s) and §1.414(s)–1. The period used to determine an employee's compensation for a plan year must be either the plan year or the calendar year ending within the plan year. Whichever period is selected must be applied uniformly to determine the compensation of every eligible employee under the plan for that plan year for purposes of this section. An employer may, however, limit the period taken into account under either method to that portion of the plan year or calendar year in which the employee was an eligible employee, provided that this limit is applied uniformly to all eligible employees under the plan for the plan year for purposes of this section. See also section 401(a)(17) and §1.401(a)(17)–1(c)(1).

(ii) *Years beginning before January 1, 1987*—(A) *General rule.* An employee's compensation for a plan year beginning before January 1, 1987, or such later date provided under paragraph (h) of this section, is the amount taken into account under the plan (or plans) in calculating the elective contribution that may be made on behalf of the employee. In a plan that is top-heavy (as defined in section 416), compensation may not exceed $200,000. Compensation may not exclude amounts less than a stated amount, such as the integration level under the plan. Compensation may include all compensation for the plan year, including compensation for the period when an employee was ineligible to make a cash or deferred election.

(B) *Nondiscrimination requirement*—(*1*) If the plan's definition of compensation has the effect of discriminating in favor of employees who are highly compensated, a nondiscriminatory definition shall be determined by the Commissioner.

(*2*) A plan's definition of compensation is treated as nondiscriminatory if the plan defines compensation for a plan year either as—

(*i*) an employee's total nondeferred compensation includible in gross income plus elective contributions under the plan and elective contributions under a plan described in section 125, and/or

(*ii*) an employee's W–2 or total nondeferred compensation includible in gross income.

(3) *Elective contributions.* The term ''elective contribution'' means employer contributions made to a plan that were subject to a cash or deferred election under a cash or deferred arrangement (whether or not the arrangement is a qualified cash or deferred arrangement under paragraph (a)(4) of this section). No amount that has become currently available to an employee or that is designated or treated, at the time of deferral or contribution, as an after-tax employee contribution may be treated as an elective contribution. See paragraphs (a)(2) and (a)(3) of this section. See also paragraph (a)(6)(iii) of this section for rules relating to the treatment as elective contributions of certain matching contributions made by partnerships.

(4) *Eligible employee*—(i) *General rule.* The term ''eligible employee'' means an employee who is directly or indirectly eligible to make a cash or deferred election under the plan for all or a portion of the plan year. For example, if an employee must perform purely ministerial or mechanical acts (e.g., formal application for participation or consent to payroll withholding) in order to be eligible to make a cash or deferred election for a plan year, the employee is an eligible employee for the plan year without regard to whether the employee performs the acts. An employee who is unable to make a cash or deferred election because the employee has not contributed to another plan is also an eligible employee. By contrast, if an employee must perform additional service (e.g., satisfy a minimum period of service requirement) in order to be eligible to make a cash or deferred election for a plan year, the employee is not an eligible employee for the plan year unless the service is actually performed. See paragraph (e)(5) of this section, however, for certain limits on the use of minimum service requirements. An employee who would be eligible to make elective contributions but for a suspension due to a distribution, a loan, or an election not to participate in the plan, is treated as an eligible employee for purposes of section 401(k)(3) for a plan year even though the employee may not make a cash or deferred election by reason of the suspension. Finally, an employee does not fail to be treated as an eligible employee merely because the employee may receive no additional annual additions because of section 415(c)(1) or 415(e).

(ii) *Certain one-time elections.* An employee is not an eligible employee merely because the employee, upon commencing employment with the employer or upon the employee's first becoming eligible to make a cash or deferred election under any arrangement of the employer, is given the one-time opportunity to elect, and the employee does in fact elect, not to be eligible to make a cash or deferred election under the plan or any other plan maintained by the employer (including plans not yet established) for the duration of the employee's employment with the employer. This rule applies in addition to the rules in paragraphs (a)(3)(iv) and (a)(6)(ii)(C) of this section relating to the definition of a cash or deferred election. In no event is an election made after December 23, 1994 treated as a one-time irrevocable election under this paragraph if the election is made by an employee who previously became eligible under another plan (whether or not terminated) of the employer.

(5) *Employee.* The term *employee* means an employee within the meaning of §1.410(b)–9.

(6) *Employer*. The term *employer* means the employer within the meaning of § 1.410(b)–9.

(7) *Excess contributions and excess deferrals*—(i) *Excess contributions*. The term ''excess contribution'' means, with respect to a plan year, the excess of the elective contributions, including qualified nonelective contributions and qualified matching contributions that are treated as elective contributions under paragraph (b)(2) of this section, on behalf of eligible highly compensated employees for the plan year over the maximum amount of the contributions permitted under paragraph (b)(2) of this section. The amount of excess contributions for each highly compensated employee is determined by using the method described in paragraph (f)(2) of this section.

(ii) *Excess deferrals*. The term ''excess deferrals'' means excess deferrals as defined in § 1.402(g)–1(e)(3).

(8) *Highly compensated employees*—(i) *Plan years beginning after December 31, 1986*. For plan years beginning after December 31, 1986, or such later date provided under paragraph (h) of this section, the term ''highly compensated employee'' has the meaning provided in section 414(q).

(ii) *Plan years beginning after December 31, 1979, and before January 1, 1987*. For plan years beginning after December 31, 1979, and before January 1, 1987, or such later date provided under paragraph (h) of this section, for purposes of the actual deferral percentage test, highly compensated employees are the one-third of all eligible employees (rounded to the nearest integer) who receive the most compensation. When one or more employees of a group would be highly compensated employees except that each member of the group receives the same amount of compensation, the employer must designate which employees of the group are highly compensated, so that one-third of all eligible employees are considered highly compensated.

(9) *Matching contributions*. The term ''matching contribution'' means matching contributions as defined in § 1.401(m)–1(f)(12).

(10) *Nonelective contributions*. The term ''nonelective contribution'' means employer contributions (other than matching contributions) with respect to which the employee may not elect to have the contributions paid to the employee in cash or other benefits instead of being contributed to the plan.

(11) *Plan*—(i) *Application of section 410(b) rules*. The term *plan* means a plan within the meaning of § 1.410(b)–7 (a) and (b), after application of the mandatory disaggregation rules of § 1.410(b)–7(c) and the permissive aggregation rules of § 1.410(b)–7(d), with the modifications provided in paragraph (g)(11)(ii) of this section. Thus, for example, two plans (within the meaning of § 1.410(b)–7(b)) that are treated as a single plan pursuant to the permissive aggregation rules of § 1.410(b)–7(d) are treated as a single plan for purposes of section 401(k). See also § 1.401(k)–1(b)(3)(ii).

(ii) *Modifications to section 410(b) rules*—(A) *In general*. For purposes of this paragraph (g)(11), § 1.410(b)–7 (c) and (d) are applied without regard to § 1.410(b)–7(c)(1), relating to section 401(k) and 401(m) plans.

(B) *Plans benefiting collective bargaining unit employees*. A plan that benefits employees who are included in a unit of employees covered by a collective bargaining agreement and employees who are not included in such a collective bargaining unit is treated as comprising separate plans. This paragraph (g)(11)(ii)(B) is generally applied separately with respect to each collective bargaining unit. At the option of the employer, however, two or more separate collective bargaining units can be treated as a single collective bargaining unit, provided that the combinations of units are determined on a basis that is reasonable and reasonably consistent from year to year. Thus, for example, if a plan benefits employees in three categories—employees included in collective bargaining unit A, employees included in collective bargaining unit B, and employees who are not included in any collective bargaining unit—the plan can be treated as comprising three separate plans, each of which benefits only one category of employees. However, if collective bargaining units A and B are treated as a single collective bargaining unit, the plan will be treated as comprising only two separate plans, one benefiting all employees who are included in a collective bargaining unit and another benefiting all other employees. Similarly, if a plan benefits only employees who are included in collective bargaining unit A and employees who are included in collective bargaining unit B, the plan can be treated as comprising two separate plans. However, if collective bargaining units A and B are treated as a single collective bargaining unit, the plan will be treated as a single plan. An employee is treated as included in a unit of employees covered by a collective bargaining agreement if and only if the employee is a collectively bargained employee within the meaning of §1.410(b)–6(d)(2).

(C) *Multiemployer plans.* Consistent with section 413(b), the portion of the plan that is maintained pursuant to a collective bargaining agreement (within the meaning of §1.413–1(a)(2)) is treated as a single plan maintained by a single employer that employs all the employees benefiting under the same benefit computation formula and covered pursuant to that collective bargaining agreement. The rules of paragraph (g)(11)(ii)(B) of this section (including the optional aggregation of collective bargaining units) apply to the resulting deemed single plan in the same manner as they would to a single employer plan, except that the plan administrator is substituted for the employer where appropriate and appropriate fiduciary obligations are taken into account. The noncollectively bargained portion of the plan is treated as maintained by one or more employers, depending on whether the noncollective bargaining unit employees who benefit under the plan are employed by one or more employers.

(12) *Pre-ERISA money purchase pension plan*—(i) A pre-ERISA money purchase pension plan is a pension plan:

(A) That is a defined contribution plan (as defined in section 414(i));

(B) That was in existence on June 27, 1974, and as in effect on that date, included a salary reduction agreement described in paragraph (a)(3)(i) of this section; and

(C) Under which neither the employee contributions nor the employer contributions, including elective contributions, may exceed the levels (as a percentage of compensation) provided for by the contribution formula in effect on June 27, 1974.

(ii) A plan was in existence on June 27, 1974, if it was a written plan adopted on or before that date, even if no funds had yet been paid to the trust associated with the plan.

(13) *Qualified matching contributions and qualified nonelective contributions*—(i) *Qualified matching contributions.* The term ''qualified matching contribution'' means matching contributions that satisfy the additional requirements of paragraph (g)(13)(iii) of this section.

(ii) *Qualified nonelective contributions.* The term ''qualified nonelective contribution'' means employer contributions, other than elective contributions and matching contributions, that satisfy the additional requirements of paragraph (g)(13)(iii) of this section.

(iii) *Additional requirements.* Except to the extent that paragraphs (c) and (d) of this section specifically provide otherwise, the matching contributions and the nonelective contributions must satisfy the requirements of paragraphs (c) and (d) of this section as though the contributions were elective contributions, without regard to whether the contributions are actually taken into account as elective contributions under paragraph (b)(2) of this section. Thus, the matching and nonelective contributions must satisfy the vesting requirements of paragraph (c) of this section and be subject to the distribution requirements of paragraph (d) of this section when they are contributed to the plan. See §1.401(k)–1(f)(5)(iii) for rules regarding matching contributions not treated as forfeitable under section 411(a)(3)(G) because of excess deferrals or contributions.

(14) *Rural cooperative plan.* For purposes of this section, a rural cooperative plan is a plan described in section 401(k)(7).

(15) *Section 401(k) plan.* The term *section 401(k) plan* means a section 401(k) plan within the meaning of §1.410(b)–9.

(16) *Section 401(m) plan.* The term *section 401(m) plan* means a section 401(m) plan within the meaning of §1.401(b)–9.

(h) *Effective dates*—(1) *General rule.* Except as otherwise provided in this paragraph (h) or as specifically provided elsewhere in this section, this section applies to plan years beginning after December 31, 1979.

(2) *Collectively bargained plans.* In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before March 1, 1986:

(i) The provisions of this section first effective for plan years beginning after December 31, 1986, do not apply to years that begin before the earlier of January 1, 1989, or the date on which the last of the collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986).

(ii) The provisions of this section first effective for plan years beginning after December 31, 1988, do not apply to years beginning before the earlier of:

(A) The later of January 1, 1989, or the date on which the last of the collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986); or

(B) January 1, 1991.

(3) *Transition rules*—(i) *Cash or deferred arrangements in existence on June 27, 1974.* See §1.402(a)–1(d)(3)(ii) for a transition rule applicable to cash or deferred arrangements in existence on June 27, 1974.

(ii) *Plan years beginning after December 31, 1979, and before January 1, 1992.* For plan years beginning after December 31, 1979 (or, in the case of a pre-ERISA money purchase plan, plan years beginning after July 18, 1984) and before January 1, 1992, a reasonable interpretation of the rules set forth in section 401 (k) and (m) of the Internal Revenue Code (as in effect during those years) may be relied upon to determine whether a cash or deferred arrangement was qualified during those years.

(iii) *Restructuring*—(A) *General rule.* In determining whether the requirements of section 401(k) are satisfied for plan years beginning before January 1, 1992, a plan may be treated as consisting of two or more component plans, each consisting of all of the allocations and other benefits, rights, and features provided to a group of employees under the plan. See §1.401(a)(4)–9(c). An employee may not be included in more than one component plan of the same plan for a plan year under this method. If this method is used for a plan year, the requirements of section 401(k) are applied separately with respect to each component plan for the plan year. Thus, for example, the actual deferral ratio and the amount of excess contributions, if any, of each eligible employee under each component plan must be determined as if the component plan were a separate plan. This method applies solely for purposes of section 401(k). Thus, for example, the requirements of section 410(b) must still be satisfied by the entire plan.

(B) *Identification of component plans*—(*1*) *Minimum coverage requirement.* The group of eligible employees described in §1.401(k)–1(g)(4) under each component plan must separately satisfy the requirements of section 410(b) as if the component plan were a separate plan. Component plans may not be aggregated to satisfy this requirement.

(*2*) *Commonality requirement.* The group of employees used to identify a component plan must share some common attribute or attributes, other than similar actual deferral ratios. Permissible common attributes include, for example, employment at the same work site, in the same job category, for the same division or subsidiary, or for a unit acquired in a specific merger or acquisition, employment for the same number of years, compensation under the same method, e.g., salaried or hourly, coverage under the same contribution formula, and attributes that could be used as the basis of a classification that would be treated as reasonable under §1.410(b)–4(b). Employees whose only common attribute is the same or similar actual deferral ratios, or another attribute having substantially the same effect as the same or similar actual deferral ratios, are not considered as sharing a common attribute for this purpose. This rule applies regardless of whether the component plan or the plan of which it is a part satisfies the ratio or percentage test of section 410(b).

(4) *State and local government plans*—(i) *Plans adopted before May 6, 1986.* A

plan adopted by a state or local government prior to May 6, 1986, is subject to the transitional rules of paragraph (h)(4) (ii) or (iii) of this section.

(ii) *Plan years beginning before January 1, 1996.* (A) The plan does not fail to satisfy the requirements of section 401(a) merely because of the nonqualified cash or deferred arrangement.

(B) Employer contributions under the nonqualified cash or deferred arrangement are considered to satisfy the requirements of section 401(a)(4).

(C) Except as provided in paragraphs (a)(7) and (f) of this section, elective contributions under the arrangement are treated as employer contributions under the Internal Revenue Code of 1986, as if the arrangement were a qualified cash or deferred arrangement. See §1.401(k)–1(a)(4)(ii). See §1.402(a)–1(d) for rules governing when elective contributions under the arrangement are includible in an employee's gross income.

(iii) *Collectively bargained plans.* The transition rules in paragraph (h)(4)(ii) of this section apply to a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers and adopted by a state or local government before May 6, 1986, effective on the date the provisions of section 401(k) and this section would be effective under paragraph (h)(2) of this section.

[T.D. 8357, 56 FR 40517, Aug. 15, 1991, as amended by T.D. 8376, 56 FR 63432, Dec. 4, 1991; T.D. 8357, 57 FR 10289, 10290, Mar. 25, 1992; 58 FR 14151, Mar. 16, 1993; T.D. 8581, 59 FR 66169, Dec. 23, 1994; T.D. 8581, 60 FR 12416, Mar. 7, 1995; T.D. 8581, 60 FR 15874, Mar. 28, 1995; T.D. 8581, 60 FR 25140, May 11, 1995]

§ 1.401(l)–0 Table of contents.

This section contains a listing of the headings of §§1.401(l)–1 through 1.401(l)–6.