Example 4. Employer Z maintains a money purchase pension plan with a plan year beginning July 1 and ending June 30. The taxable wage base for the 1990 calendar year is $51,300 and the taxable wage base for the 1991 calendar year is $53,400. For the plan year beginning July 1, 1990, and ending June 30, 1991, the plan provides that the account of each employee will receive an allocation of 4 percent of the employee's plan year compensation up to $53,400 plus an allocation of 6 percent of the employee's plan year compensation in excess of $53,400. Although the excess contribution percentage (6 percent) for the plan year does not exceed the base contribution percentage (4 percent) for the plan year by more than the lesser of the base contribution percentage (4 percent) or the percentage determined under paragraph (b)(2)(ii) of this section (5.7 percent), the plan does not satisfy paragraph (a)(5) of this section because the integration level of $53,400 exceeds the maximum permitted integration level of $51,300 (the taxable wage base in effect as of the beginning of the plan year).

Example 5. Assume the same facts as in *Example 4*, except that for the plan year beginning July 1, 1990, and ending June 30, 1991, the plan provides that the account of each employee will receive an allocation of 5 percent of the employee's plan year compensation up to $30,000 plus an allocation of 9 percent of the employee's plan year compensation in excess of $30,000. The integration level of $30,000 is 58 percent of the taxable wage base of $51,300 for the 1990 calendar year. The maximum excess allowance is not exceeded for the plan year because the excess contribution percentage (9 percent) for the plan year does not exceed the base contribution percentage (5 percent) for the plan year by more than the lesser of the base contribution percentage (5 percent) or the percentage determined under paragraphs (b)(2)(ii) and (d) of this section (4.3 percent) for the plan year.

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§ 1.401(l)–3 Permitted disparity for defined benefit plans.

(a) *Requirements*—(1) *In general.* Disparity in the rates of employer-provided benefits under a defined benefit plan is permitted under section 401(l) and this section for a plan year only if the plan satisfies paragraphs (a)(2) through (a)(6) of this section. A plan that otherwise satisfies this paragraph (a) will not be considered to fail section 401(l) merely because it contains one or more provisions described in §1.401(a)(4)–3(b)(6) (such as multiple

formulas). Section 401(a)(5)(D) and §1.401(a)(5)–1(d) provide other rules under which benefits provided under a defined benefit plan (including defined benefit excess and offset plans) may be limited. See §1.401(a)(4)–3(b)(5)(viii) for special rules under which an insurance contract plan may satisfy §1.401(a)(4)–1(b)(2) and section 401(l). See §1.401(a)(4)–8(c)(3)(iii)(B) for special rules applicable to cash balance plans.

(2) *Excess or offset plan requirement.* The plan must be a defined benefit excess plan or an offset plan.

(3) *Maximum disparity.* The disparity for all employees under the plan must not exceed the maximum permitted disparity prescribed in paragraph (b) of this section.

(4) *Uniform disparity.* The disparity for all employees under the plan must be uniform within the meaning of paragraph (c) of this section.

(5) *Integration or offset level.* The integration or offset level specified in the plan must satisfy paragraph (d) of this section.

(6) *Benefits, rights, and features.* The benefits, rights, and features provided under the plan must satisfy paragraph (f)(1) of this section.

(b) *Maximum permitted disparity*—(1) *In general.* In the case of a defined benefit excess plan, the disparity provided for the plan year may not exceed the maximum excess allowance as defined in paragraph (b)(2) of this section. In the case of an offset plan, the disparity provided for the plan year may not exceed the maximum offset allowance as defined in paragraph (b)(3) of this section. In addition, either type of plan must satisfy the overall permitted disparity limits of §1.401(l)–5.

(2) *Maximum excess allowance.* The maximum excess allowance for a plan year is the lesser of—

(i) 0.75 percent, reduced as required under paragraphs (d) and (e) of this section, or

(ii) The base benefit percentage for the plan year.

(3) *Maximum offset allowance.* The maximum offset allowance for a plan year is the lesser of—

(i) 0.75 percent, reduced as required under paragraphs (d) and (e) of this section, or

(ii) One-half of the gross benefit percentage, multiplied by a fraction (not to exceed one), the numerator of which is the employee's average annual compensation, and the denominator of which is the employee's final average compensation up to the offset level.

(4) *Rules of application*—(i) *Disparity provided for the plan year*. Disparity provided for the plan year generally means the disparity provided under the plan's benefit formula for the employee's year of service with respect to the plan year. However, if a plan determines each employee's accrued benefit under the fractional accrual method of section 411(b)(1)(C), disparity provided under the plan also means the disparity in the benefit accrued for the employee for the plan year. Thus, a plan using the fractional accrual method must satisfy this paragraph (b) with respect to the plan's benefit formula and with respect to the benefits accrued for the plan year.

(ii) *Reduction in disparity rate*. Any reductions in the 0.75–percent factor required under paragraphs (d) and (e) of this section are cumulative.

(iii) *Normal and optional forms of benefit*—(A) *In general*. A plan satisfies the maximum permitted disparity requirement of this paragraph (b) only if the plan satisfies this paragraph (b) with respect to each optional form of benefit (including the normal form of benefit) provided under the plan.

(B) *Level annuity forms*. In the case of an optional form of benefit payable as a level annuity over a period of not less than the life of the employee, the optional form must satisfy the maximum permitted disparity requirement of this paragraph (b). Thus, for example, if the form of a defined benefit plan's normal retirement benefit is an annuity for life with a 10-year certain feature and the plan permits employees to elect an optional form of benefit in the form of a straight life annuity, the plan must satisfy the maximum disparity requirement of this paragraph (b) with respect to each of the optional forms of benefit. An annuity that decreases only after the death of the employee, or that decreases only after the death of either the employee or the joint annuitant, is considered a level annuity for purposes of this paragraph (b).

(C) *Other forms*. In the case of an optional form of benefit that is not described in paragraph (b)(4)(iii)(B) of this section, the optional form must satisfy the maximum permitted disparity requirement of this paragraph (b), when the respective portions of the optional form are normalized under the rules of § 1.401(a)(4)–12 to a straight life annuity commencing at the same time as the optional form of benefit, regardless of whether the straight life annuity form is actually provided under the plan. In the case of a defined benefit excess plan, the respective portions are the portion of the optional form attributable to average annual compensation up to the integration level (the "base portion") and the portion of the optional form attributable to average annual compensation in excess of the integration level (the "excess portion"). In the case of an offset plan, the respective portions are the optional form determined without regard to the offset (the "gross amount") and the offset applied to the gross amount to determine the optional form (the "offset amount").

(D) *Post-retirement cost-of-living adjustments*—(*1*) *In general*. A benefit does not fail to be a level annuity described in paragraph (b)(4)(iii)(B) of this section merely because it provides an automatic post-retirement cost-of-living adjustment that satisfies paragraph (b)(4)(iii)(D)(*2*) of this section. Thus, increases in the employee's annuity pursuant to such a cost-of-living adjustment do not cause the disparity provided under the optional form of benefit to exceed the maximum disparity permitted under this paragraph (b). For rules on ad hoc post-retirement cost-of-living adjustments, see § 1.401(a)(4)–10(b).

(*2*) *Requirements*. A cost-of-living adjustment satisfies this paragraph (b)(4)(iii)(D)(*2*) if—

(*i*) It is included in the accrued benefit of all employees, and.

(*ii*) It increases, on a uniform and consistent basis, the benefits of all former employees who are no younger than age 62, at a rate no greater than adjustments to social security benefits under section 215(i)(2)(A) of the Social Security Act that have occurred since

the later of the employee's attainment of age 62 or commencement of benefits.

(E) *Section 417(e) exception.* A plan will not fail to satisfy this paragraph (b) merely because the disparity in a benefit that is subject to the interest rate restrictions of sections 401(a)(11) and 417(e) exceeds the maximum disparity that would otherwise be allowed under this paragraph (b) if the increase in disparity is required to satisfy §1.417(e)–1(d). In applying the exception in this paragraph (b)(4)(iii)(E), for purposes of determining what is required under §1.417(e)–1(d), a plan may use the rate described in §1.417(e)–1(d)(2)(i) for all employees, without regard to whether the present value of an employee's vested benefit exceeds $25,000.

(5) *Examples.* The following examples illustrate this paragraph (b). Unless otherwise provided, the following facts apply. The plan is noncontributory and is the only plan ever maintained by the employer. The plan uses a normal retirement age of 65 and contains no provision that would require a reduction in the 0.75-percent factor under paragraph (b)(2) or (b)(3) of this section. In the case of a defined benefit excess plan, the plan uses each employee's covered compensation as the integration level; in the case of an offset plan, the plan uses each employee's covered compensation as the offset level and provides that an employee's final average compensation is limited to the employee's average annual compensation. Each example discusses the benefit formula applicable to an employee who has a social security retirement age of 65.

Example 1. Plan N is a defined benefit excess plan that provides a normal retirement benefit of 0.5 percent of average annual compensation in excess of the integration level, for each year of service. The plan provides no benefits with respect to average annual compensation up to the integration level. The disparity provided under the plan exceeds the maximum excess allowance because the excess benefit percentage (0.5 percent) exceeds the base benefit percentage (0 percent) by more than the base benefit percentage (0 percent).

Example 2. Plan O is an offset plan that provides a normal retirement benefit equal to 2 percent of average annual compensation, minus 0.75 percent of final average compensation up to the offset level, for each year of service up to 35. The disparity provided

under the plan satisfies this paragraph (b) because the offset percentage (0.75 percent) does not exceed the maximum offset allowance equal to the lesser of 0.75 percent or one-half of the gross benefit percentage (1 percent).

Example 3. Plan P is a defined benefit excess plan that provides a normal retirement benefit of 0.5 percent of average annual compensation up to the integration level, plus 1.25 percent of average annual compensation in excess of the integration level, for each year of service up to 35. The disparity provided under the plan exceeds the maximum excess allowance because the excess benefit percentage (1.25 percent) exceeds the base benefit percentage (0.5 percent) by more than the base benefit percentage (0.5 percent).

Example 4. Plan Q is an offset plan that provides a normal retirement benefit of 1 percent of average annual compensation, minus 0.75 percent of final average compensation up to the offset level, for each year of service up to 35. The disparity under the plan exceeds the maximum offset allowance because the offset percentage exceeds one-half of the gross benefit percentage (0.5 percent).

Example 5. (a) Plan R is an offset plan that provides a normal retirement benefit of 1 percent of average annual compensation, minus 0.5 percent of final average compensation up to the offset level, for each year of service up to 35. The plan determines an employee's average annual compensation using an averaging period comprising five consecutive 12-month periods and taking into account the employee's compensation for the ten consecutive 12-month periods ending with the plan year. The plan does not provide that an employee's final average compensation is limited to the employee's average annual compensation.

(b) Employee A has average annual compensation of $20,000, final average compensation of $25,000, and covered compensation of $32,000. The maximum offset allowance applicable to Employee A for the plan year under paragraph (b)(3) of this section is one-half of the gross benefit percentage multiplied by the ratio, not to exceed one, of Employee A's average annual compensation to Employee A's final average compensation up to the offset level. Thus, the maximum offset allowance is 0.4 percent ($\frac{1}{2} \times 1$ percent×$20,000/ $25,000). With respect to Employee A, the benefit formula provides an offset that exceeds the maximum offset allowance. The plan must therefore reduce Employee A's offset percentage to 0.4 percent. (Under paragraph (c)(2)(viii) of this section, Employee A's adjusted disparity rate is deemed uniform.)

(c) Alternatively, under §1.401(l)–1(c)(17)(ii) (the definition of final average compensation), the plan could specify that an employee's final average compensation is limited to

the amount of the employee's average annual compensation. Thus, the ratio of average annual compensation to final average compensation would always be equal to at least one, and the maximum offset allowance under the plan would be one-half of the gross benefit percentage.

Example 6. Plan S is a defined benefit excess plan that provides a base benefit percentage of 1 percent of average annual compensation up to the integration level for each year of service. The plan also provides, for each of the first 10 years of service, an excess benefit percentage of 1.85 percent of average annual compensation in excess of the integration level. For each year of service after 10, the plan provides an excess benefit percentage of 1.65 percent of the employee's average annual compensation in excess of the integration level. The disparity provided under the plan exceeds the maximum excess allowance because the excess benefit percentage for each of the first ten years of service (1.85 percent) exceeds the base benefit percentage (1 percent) by more than 0.75 percent.

Example 7. The facts are the same as in *Example 6*, except that the plan provides an excess benefit percentage of 1.65 percent of average annual compensation in excess of the integration level for each of the first 10 years of service and an excess benefit percentage of 1.85 percent of average annual compensation in excess of the integration level for each year of service after 10. The disparity provided under the plan exceeds the maximum excess allowance because the excess benefit percentage for each year of service after 10 (1.85 percent) exceeds the base benefit percentage (1 percent) by more than 0.75 percent.

Example 8. Plan T is a defined benefit excess plan that provides a normal retirement benefit of 1.0 percent of average annual compensation up to the integration level, plus 1.7 percent of average annual compensation in excess of the integration level, for each year of service up to 35, payable in the form of a joint and survivor annuity. The plan also allows an employee to receive the retirement benefit in the form of an actuarially equivalent straight life annuity. The actuarially equivalent straight life annuity equals 1.09 percent of average annual compensation up to the integration level, plus 1.85 percent of average annual compensation in excess of the integration level, for each year of service up to 35. The disparity provided under the plan with respect to the straight life annuity form of benefit (0.76 percent) exceeds the maximum excess allowance because the excess benefit percentage (1.85 percent) exceeds the base benefit percentage (1.09 percent) by more than 0.75 percent.

Example 9. Plan U is a defined benefit excess plan that provides a normal retirement benefit of 1.0 percent of average annual com-

pensation up to the integration level, plus 1.7 percent of average annual compensation in excess of the integration level, for each year of service up to 35, payable in the form of a straight life annuity. Plan U provides a single sum optional form of benefit at normal retirement age equal to 100 times the monthly annuity payable at that age. Thus, if an employee elects the single sum optional form of benefit, the base portion of the single sum benefit is 8.33 percent (100 times 1.0 percent/12) of average annual compensation up to the integration level per year of service, and the excess portion of the single sum benefit is 14.17 percent (100 times 1.7 percent/12) of average annual compensation in excess of the integration level per year of service. Each respective portion of the single sum option is normalized to a straight life annuity commencing at normal retirement age, using 8-percent interest and the UP–84 mortality table. After normalization, the base portion of the benefit is 1.02 percent of average annual compensation up to the integration level, and the excess portion of the benefit is 1.73 percent of average annual compensation in excess of the integration level. The single sum optional form of benefit satisfies this paragraph (b) because the disparity provided in the optional form of benefit does not exceed the maximum excess allowance.

(c) *Uniform disparity*—(1) *In general.* The disparity provided under a defined benefit excess plan is uniform only if the plan uses the same base benefit percentage and the same excess benefit percentage for all employees with the same number of years of service. The disparity provided under an offset plan is uniform only if the plan uses the same gross benefit percentage and the same offset percentage for all employees with the same number of years of service. The disparity provided under a plan that determines each employee's accrued benefit under the fractional accrual method of section 411(b)(1)(C) is uniform only if the plan satisfies one of the deemed uniformity rules of paragraph (c)(2) (ii) or (iii) of this section.

(2) *Deemed uniformity*—(i) *In general.* The disparity provided under a plan does not fail to be uniform for purposes of this paragraph (c) merely because the plan contains one or more of the provisions described in paragraphs (c)(2) (ii) through (ix) of this section.

(ii) *Use of fractional accrual and disparity for 35 years.* The plan contains a

benefit formula as described in paragraphs (c)(2)(ii) (A) and (B) of this section, and the plan determines each employee's accrued benefit under the method described in §1.401(a)(4)–3(b)(4)(i)(B), i.e., by multiplying the employee's fractional rule benefit (within the meaning of §1.411(b)–1(b)(3)(ii)(A)) by a fraction, the numerator of which is the employee's years of service determined as of the plan year, and the denominator of which is the employee's projected years of service as of normal retirement age.

(A) For each year of service at least up to 35, the benefit plan formula provides the same base benefit percentage and the same excess benefit percentage for all employees in the case of a defined benefit excess plan or the same gross benefit percentage and the same offset percentage for all employees in the case of an offset plan.

(B) For each additional year of service, the benefit formula provides a uniform percentage of all average annual compensation that is no greater than the excess benefit percentage or the gross benefit percentage under paragraph (c)(2)(ii)(A) of this section, whichever is applicable.

(iii) *Use of fractional accrual and disparity for fewer than 35 years.* The plan contains a benefit formula as described in paragraphs (c)(2)(iii) (A) through (C) of this section, and the plan determines each employee's accrued benefit under the method described in §1.401(a)(4)–3(b)(4)(i)(B).

(A) For each year in the employee's initial period of service comprising fewer than 35 years, the benefit formula provides the same base benefit percentage and the same excess benefit percentage for all employees in the case of a defined benefit excess plan or the same gross benefit percentage and the same offset percentage for all employees in the case of an offset plan.

(B) For each year of service after the initial period and at least up to 35, the benefit formula provides a uniform percentage of all average annual compensation, that is equal to the excess benefit percentage or the gross benefit percentage under paragraph (c)(2)(iii)(A) of this section.

(C) For each year of service after the period described in paragraph (c)(2)(iii)(B) of this section, the benefit formula provides a uniform percentage of all average annual compensation that is no greater than the excess benefit percentage or the gross benefit percentage under paragraph (c)(2)(iii)(A) of this section.

(iv) *Different social security retirement ages.* The benefit formula uses the same excess benefit percentage or the same gross benefit percentage for all employees with the same number of years of service and, for employees with social security retirement ages later than age 65, adjusts the 0.75-percent factor in the maximum excess or offset allowance as required under paragraph (e)(1) of this section, by increasing the base benefit percentage in the case of a defined benefit excess plan, or reducing the offset percentage in the case of an offset plan.

(v) *Reduction for integration level.* The plan uses an integration level or offset level greater than each employee's covered compensation and makes individual reductions in the 0.75-percent factor, as permitted under paragraph (d)(9)(iii)(B) of this section, by increasing the base benefit percentage in the case of a defined benefit excess plan or reducing the offset percentage in the case of an offset plan.

(vi) *Overall permitted disparity*—(A) *In general.* The benefit formula provides that, with respect to each employee's years of service after reaching the cumulative permitted disparity limit applicable to the employee under §1.401(l)–5(c), employer-provided benefits are determined with respect to the employee's total average annual compensation at a rate equal to the nondisparate percentage. For purposes of this paragraph (c)(2)(vi), the nondisparate percentage is generally the excess benefit percentage or gross benefit percentage otherwise applicable under the benefit formula to an employee with the same number of years of service.

(B) *Unit credit plans.* In the case of a unit credit plan described in §1.401(a)(4)–3(b)(3), if the 411(b)(1)(B) limit percentage is less than the nondisparate percentage, the 411(b)(1)(B) limit percentage must be substituted for the nondisparate percentage. For this purpose, the 411(b)(1)(B) limit percentage is 133⅓ percent of the smallest

base benefit percentage, or 133⅓ percent of the smallest difference between the gross benefit percentage and the offset percentage, whichever is applicable, where the smallest base benefit percentage or difference is determined by reference to the benefit formula as applied to employees with no more years of service than the employee.

(C) *Fractional accrual plans.* In the case of a fractional accrual plan described in §1.401(a)(4)–3(b)(4), the benefit formula must provide for the nondisparate percentage with respect to years of service after the employee would reach the cumulative permitted disparity limit applicable to the employee under §1.401(l)–5(c) as modified by this paragraph (c)(2)(vi)(C). Solely for purposes of this paragraph (c)(2)(vi)(C), the employee's annual disparity fractions (and thus the year in which the employee would reach the cumulative permitted disparity limit) are determined using the disparity provided under the benefit formula (rather than the special rule for fractional accrual plans in §1.401(l)–5(b)(8)(v)).

(vii) *Non-FICA employees.* The plan provides that, in the case of each employee under the plan with respect to whom none of the taxes under section 3111(a), section 3221, or section 1401 is required to be paid, employer-provided benefits are determined with respect to the employee's total average annual compensation at the excess benefit percentage or gross benefit percentage applicable to an employee with the same number of years of service.

(viii) *Average annual compensation adjustment for offset plan.* In the case of each employee whose final average compensation exceeds the employee's average annual compensation, the plan adjusts the offset percentage as required under paragraph (b)(3)(ii) of this section in order to satisfy the maximum offset allowance.

(ix) *PIA offsets.* In the case of an offset plan, the plan provides that the offset applied to each employee's benefit is the lesser of a specified percentage of the employee's PIA and an offset that otherwise satisfies the requirements of this section (the "section 401(l) overlay"). The specified percentage of PIA must be the same for all employees with the same number of years of service. In the case of a plan that determines each employee's accrued benefit under the fractional accrual method of section 411(b)(1)(C), the specified percentage of PIA is deemed to be the same for all employees with the same number of years of service if the plan satisfies either of the deemed uniformity rules in paragraph (c)(2)(ii) or (iii) of this section, substituting "offset, expressed as a percentage of PIA, per year of service" for the term "offset percentage" (in addition to satisfying either of those rules with respect to the section 401(l) overlay).

(3) *Examples.* The following examples illustrate this paragraph (c). Unless otherwise provided, the following facts apply. The plan is noncontributory and is the only plan ever maintained by the employer. The plan uses a normal retirement age of 65 and contains no provision that would require a reduction in the 0.75-percent factor under paragraph (b)(2) or (b)(3) of this section. In the case of a defined benefit excess plan, the plan uses each employee's covered compensation as the integration level; in the case of an offset plan, the plan uses each employee's covered compensation as the offset level and provides that an employee's final average compensation is limited to the employee's average annual compensation. Each example discusses the benefit formula applicable to an employee who has a social security retirement age of 65.

Example 1. Plan M is a defined benefit excess plan that satisfies the 133⅓ percent accrual rule of section 411(b)(1)(B). The plan provides a normal retirement benefit of 1.0 percent of average annual compensation up to the integration level, plus 1.65 percent of average annual compensation in excess of the integration level, for each year of service up to 25. The plan also provides a benefit of 1.0 percent of all average annual compensation for each year of service in excess of 25. The disparity provided under the plan is uniform because the plan uses the same base and excess benefit percentages for all employees with the same number of years of service. If the plan formula were the same except that it used a different excess benefit percentage for some of the years of service between one and 25, the disparity under the plan would continue to be uniform.

Example 2. Plan O is a defined benefit excess plan that provides a normal retirement

benefit of 50 percent of average annual compensation up to the integration level and 68.75 percent of average annual compensation in excess of the integration level, multiplied by a fraction, the numerator of which is the employee's service, up to 25 years, and the denominator of which is 25. The plan determines an employee's accrued benefit as described in §1.401(a)(4)–3(b)(4)(i)(B). The benefit formula thus provides a base benefit percentage of 2 percent (50 percent×$\frac{1}{25}$) and an excess benefit percentage of 2.75 percent (68.75 percent×$\frac{1}{25}$) for each of an employee's first 25 years of service and no benefit for years of service after 25. The disparity provided under the plan is not uniform within the meaning of this paragraph (c) because the benefit formula does not satisfy either of the uniform disparity rules for fractional accrual plans under paragraphs (c)(2) (ii) and (iii) of this section.

Example 3. Plan P is an offset plan that provides a normal retirement benefit of 2 percent of average annual compensation for each year of service up to 35, minus 0.75 percent of the final average compensation up to the offset level for each year of service up to 25. The plan determines an employee's accrued benefit under the method described in §1.401(a)(4)–3(b)(4)(i)(B). Because the formula under the plan provides the same gross benefit percentage and offset percentage for 25 years of service (fewer than 35) and, for years of service after 25 and up to 35, provides a benefit at a uniform rate (equal to the gross benefit percentage) of all average annual compensation, and the plan accrues the benefit ratably, the disparity under the plan is deemed to be uniform under paragraph (c)(2)(iii) of this section.

Example 4. Plan Q is an offset plan that benefits employees with social security retirement ages of 65, 66, and 67. For each year of service up to 35, the plan provides a normal retirement benefit equal to 2 percent of average annual compensation, minus an offset based on the employee's final average compensation up to the offset level. For employees with a social security retirement age of 65, the offset percentage is 0.75 percent; for employees with a social security retirement age of 66, the offset percentage is 0.70 percent; and for employees with a social security retirement age of 67, the offset percentage is 0.65 percent. The disparity under the plan is deemed to be uniform under paragraph (c)(2)(iv) of this section because the plan uses the same gross benefit percentage for all employees and reduces the offset percentage for employees with social security retirement ages of 66 and 67 to comply with the adjustments in the 0.75-percent factor in the maximum excess or offset allowance required under paragraph (e)(1) of this section. (Because Plan Q effectively provides unreduced benefits prior to the social security retirement age for employees with social security

retirement ages of 66 and 67, the 0.75-percent factor in the maximum offset allowance must be reduced to 0.70 percent and 0.65 percent, respectively.) Alternatively, Plan Q could satisfy this paragraph (c) if it provided a uniform offset percentage of 0.65 percent for all employees because 0.65 percent is the maximum offset allowance under the plan for an employee with a social security retirement age of 67.

Example 5. Plan R is an offset plan that provides a normal retirement benefit of 2 percent of average annual compensation, minus an offset determined as a percentage of total final average compensation, for each year of service up to 35. For an employee whose final average compensation does not exceed the employee's covered compensation, the offset percentage is 0.75 percent. For an employee whose final average compensation exceeds the employee's covered compensation, the plan reduces the offset percentage, as required by paragraph (d) of this section. The reduced offset percentage is determined by comparing the employee's final average compensation to the employee's covered compensation as permitted under paragraph (d)(9)(iii)(B) of this section. The disparity provided under the plan is deemed uniform under paragraph (c)(2)(v) of this section because the plan uses the same gross benefit percentage for all employees and makes individual reductions in the 0.75-percent factor, as permitted under paragraph (d)(9)(iii)(B) of this section, by reducing the offset percentage in the case of an employee whose final average compensation exceeds covered compensation.

(d) *Requirements for integration or offset level*—(1) *In general.* The integration level under a defined benefit excess plan or the offset level under an offset plan must satisfy paragraphs (d)(2), (d)(3), (d)(4), (d)(5) or (d)(6) of this section, as modified by paragraph (d)(7) of this section in the case of a short plan year. Paragraph (d)(8) of this section contains demographic tests that apply to certain defined benefit plans. Paragraph (d)(9) of this section explains certain reductions required in the 0.75-percent factor under paragraph (b)(2) or (b)(3) of this section. Paragraph (d)(10) of this section contains examples. If a reduction applies to the 0.75-percent factor under this paragraph (d), the reduced factor is used for all purposes in determining whether the permitted disparity rules for defined benefit plans are satisfied.

(2) *Covered compensation.* The requirement of this paragraph (d)(2) is satisfied only if the integration or offset

level under the plan for each employee is the employee's covered compensation.

(3) *Uniform percentage of covered compensation.* The requirement of this paragraph (d)(3) is satisfied only if—

(i) The integration or offset level under the plan for each employee is a uniform percentage (greater than 100 percent) of each employee's covered compensation,

(ii) In the case of a defined benefit excess plan, the integration level does not exceed the taxable wage base in effect for the plan year, and, in the case of an offset plan, the offset level does not exceed the employee's final average compensation, and

(iii) The plan adjusts the 0.75-percent factor in the maximum excess or offset allowance in accordance with paragraph (d)(9) of this section.

(4) *Single dollar amount.* The requirement of this paragraph (d)(4) is satisfied only if the integration or offset level under the plan for all employees is a single dollar amount (either specified in the plan or determined under a formula specified in the plan) that does not exceed the greater of $10,000 or one-half of the covered compensation of an individual who attains social security retirement age in the calendar year in which the plan year begins. In the case of a calendar year in which no individual could attain social security retirement age, for example, the year 2003, this rule is applied using covered compensation of an individual attaining social security retirement age in the preceding calendar year.

(5) *Intermediate amount.* The requirement of this paragraph (d)(5) is satisfied only if—

(i) The integration or offset level under the plan for all employees is a single dollar amount (either specified in the plan or determined under a formula specified in the plan) that is greater than the highest amount determined under paragraph (d)(4) of this section,

(ii) In the case of a defined benefit excess plan, the single dollar amount does not exceed the taxable wage base in effect for the plan year, and, in the case of an offset plan, the single dollar amount does not exceed the employee's final average compensation,

(iii) The plan satisfies the demographic requirements of paragraph (d)(8) of this section, and

(iv) The plan adjusts the 0.75-percent factor in the maximum excess or offset allowance in accordance with paragraph (d)(9) of this section.

For purposes of this paragraph (d)(5), an offset level of each employee's final average compensation is considered a single dollar amount determined under a formula specified in the plan.

(6) *Intermediate amount safe harbor.* The requirement of this paragraph (d)(6) is satisfied only if—

(i) The integration or offset level under the plan for all employees is a single dollar amount described in paragraph (d)(5) of this section, and

(ii) The 0.75-percent factor in the maximum excess or offset allowance under paragraph (b)(2) or (b)(3) of this section is reduced to the lesser of the adjusted factor determined under paragraph (d)(9) of this section or 80 percent of the otherwise applicable factor under paragraph (b)(2) or (b)(3) of this section, determined without regard to paragraph (d)(9) of this section.

(7) *Prorated integration level for short plan year.* If an accumulation plan uses paragraph (2) or (4) of the definition of plan year compensation under §1.401(a)(4)–12 (i.e., section 414(s) compensation for the plan year or the period of plan participation) and has a plan year that comprises fewer than 12 months, the integration or offset level under the plan for each employee must be an amount equal to the otherwise applicable integration or offset level described in paragraph (d)(2), (d)(3), (d)(4), (d)(5), or (d)(6) of this section, multiplied by a fraction, the numerator of which is the number of months in the plan year and the denominator of which is 12. No adjustment to the maximum excess or offset allowance is required as a result of the application of this paragraph (d)(7), other than any adjustment already required under paragraph (d)(6) or (d)(9) of this section.

(8) *Demographic requirements*—(i) *In general.* A plan that satisfies the demographic requirements of paragraphs (d)(8)(ii) and (iii) of this section may use an integration level described in paragraph (d)(5) of this section.

(ii) *Attained age requirement.* The requirement of this paragraph (d)(8)(ii) is satisfied only if the average attained age of the nonhighly compensated employees in the plan is not greater than the greater of—

(A) Age 50, or

(B) 5 plus the average attained age of the highly compensated employees in the plan. For purposes of this paragraph (d)(8)(ii), attained ages are determined as of the beginning of the plan year.

(iii) *Nondiscrimination requirement.* The requirement of this paragraph (d)(8)(iii) is satisfied only if at least one of the following tests in paragraphs (d)(8)(iii) (A) through (D) of this section is satisfied.

(A) *Minimum percentage test.* This test is satisfied only if more than 50 percent of the nonhighly compensated employees in the plan have average annual compensation at least equal to 120 percent of the integration or offset level.

(B) *Ratio test.* This test is satisfied only if the percentage of nonhighly compensated nonexcludable employees, who are in the plan and who have average annual compensation at least equal to 120 percent of the integration or offset level, is at least 70 percent of the percentage of highly compensated nonexcludable employees who are employees in the plan.

(C) *High dollar amount test.* This test is satisfied only if the integration or offset level exceeds 150 percent of the covered compensation of an individual who attains social security retirement age in the calendar year in which the plan year begins. In the case of a calendar year in which no individual could attain social security retirement age, for example, the year 2003, this rule is applied using covered compensation of an individual attaining social security retirement age in the preceding calendar year.

(D) *Individual disparity reductions.* This test is satisfied only if the plan is an offset plan that uses an offset level of each employee's final average compensation and makes individual disparity reductions as permitted under paragraph (d)(9)(iii)(B) of this section.

(9) *Reduction in the 0.75-percent factor if integration or offset level exceeds covered compensation*—(i) *In general.* If the integration or offset level specified under the plan is each employee's covered compensation as of the plan year, no reduction in the 0.75-percent factor in the maximum excess or offset allowance is required for the plan year under this paragraph (d)(9). If a plan specifies an integration or offset level that exceeds an employee's covered compensation, the 0.75-percent factor in the maximum excess or offset allowance must be reduced as required in paragraph (d)(9)(ii) or (iii) of this section. Paragraph (d)(9)(iv) of this section contains a table of the applicable reductions.

(ii) *Uniform percentage of covered compensation.* If a plan specifies an integration or offset level that is a uniform percentage (in excess of 100 percent) of each employee's covered compensation, the 0.75-percent factor in the maximum excess or offset allowance must be reduced in accordance with the table in paragraph (d)(9)(iv) of this section. Thus, for example, if a plan specifies an integration or offset level of 120 percent of each employee's covered compensation, the 0.75-percent factor in the maximum excess or offset allowance must be reduced to 0.69 percent in accordance with the table because the specified integration or offset level is more than covered compensation but not more than 125 percent of covered compensation.

(iii) *Single dollar amount.* If a plan specifies an integration or offset level of a single dollar amount as permitted under paragraph (d)(5) of this section (for example, $30,000), the applicable reduction in the maximum excess or offset allowance must be determined under paragraph (d)(9)(iii) (A) or (B) of this section, as specified under the plan.

(A) *Plan-wide reduction.* The applicable reduction in the maximum excess or offset allowance under the table in paragraph (d)(9)(iv) of this section may be determined by comparing the single dollar amount specified in the plan to the covered compensation of an individual attaining social security retirement age in the calendar year in which the plan year begins. Thus, for example, if a plan specifies a single integration or offset level of $30,000 that is uniformly applicable to all employees

for a plan year and the covered compensation of an individual attaining social security retirement age in the calendar year in which the plan year begins is $20,000, the 0.75-percent factor in the maximum excess or offset allowance must be reduced to 0.60 percent for all employees in accordance with the table in paragraph (d)(9)(iv) of this section because the specified integration or offset level of $30,000 is more than 125 percent of $20,000 but not more than 150 percent of $20,000. In the case of a calendar year in which no individual could attain social security retirement age (for example, 2003), the comparison is made with covered compensation of an individual who attained social security retirement age in the preceding calendar year. If an offset plan uses an offset level of each employee's final average compensation, the reduction under this paragraph (d)(9)(iii)(A) is determined by comparing the highest possible amount of final average compensation to the covered compensation of an individual attaining social security retirement age in the calendar year in which the plan year begins.

(B) *Individual reductions.* The applicable reduction in the maximum excess or offset allowance under the table in paragraph (d)(9)(iv) of this section may be determined by comparing the single dollar amount specified in the plan to the covered compensation of each employee under the plan. Thus, for example, if a plan specifies a single integration or offset level of $30,000 that is uniformly applicable to all employees for a plan year, the 0.75-percent factor in the maximum excess or offset allowance must be reduced to 0.60 percent for an employee with covered compensation of $20,000, but need not be reduced for an employee whose covered compensation is $30,000 or greater.

(iv) *Reductions*—(A) *Table.*

TABLE

If the integration or offset level is	The permitted disparity factor is
100 percent of covered compensation	0.75 percent
125 percent of covered compensation	0.69 percent
150 percent of covered compensation	0.60 percent
175 percent of covered compensation	0.53 percent
200 percent of covered compensation	0.47 percent
The taxable wage base or final average compensation.	0.42 percent

(B) *Interpolation.* If the integration or offset level used under a plan is between the percentages of covered compensation in the table, the permitted disparity factor applicable to the plan can be determined either by straight-line interpolation between the permitted disparity factors in the table or by rounding the integration or offset level up to the next highest percentage of covered compensation in the table.

(10) *Examples.* The following examples illustrate this paragraph (d). Unless otherwise provided, the following facts apply. The plan is noncontributory and is the only plan ever maintained by the employer. The plan uses a normal retirement age of 65 and contains no provision that would require a reduction in the 0.75-percent factor under paragraph (b)(2) or (b)(3) of this section. In the case of an offset plan, the plan provides that an employee's final average compensation is limited to the employee's average annual compensation. Each example discusses the benefit formula applicable to an employee who has a social security retirement age of 65.

Example 1. (a) Plan M is a defined benefit excess plan that uses the calendar year as its plan year. For the 1989 plan year, the plan uses an integration level of $20,000, which is 118 percent of the 1989 covered compensation of $16,968 for an individual reaching social security retirement age in 1989. The plan may use that integration level without satisfying paragraph (d)(8) of this section, provided the adjustment to the 0.75-percent factor required under paragraph (d)(6) of this section is made. That adjustment is the lesser of the factor determined under paragraph (d)(9) of this section or 80 percent of the factor otherwise applicable under paragraph (b)(2) or (b)(3) of this section.

(b) The plan determines the factor under paragraph (d)(9) of this section by comparing the integration level to the covered compensation of an individual attaining social security retirement age in the calendar year in which the plan year begins and by rounding the integration level up to 125 percent of that covered compensation amount. The 0.75-percent factor is therefore replaced by 0.69 percent pursuant to the table in paragraph (d)(9) of this section. The 0.69–percent factor is 92 percent of the 0.75-percent factor. Because the lesser of 80 percent and 92 percent is 80 percent, the 0.75-percent factor is reduced to 0.6 percent (80 percent of 0.75 percent) under paragraph (d)(6) of this section. The 0.6–percent factor applies to benefits

commencing at age 65 for an employee with a social security retirement age of 65. In determining normal retirement benefits for employees with social security retirement ages of 66 or 67, the applicable factors for benefits commencing at age 65 are, respectively, 0.56 percent (80 percent of 0.7 percent) and 0.52 percent (80 percent of 0.65 percent).

(c) The plan could also determine the factor under paragraph (d)(9) of this section by comparing the integration level to the covered compensation of each employee under the plan, or by straight line interpolation between the disparity factors contained in the table in paragraph (d)(9) of this section, or both. (Of course, if the plan satisfied paragraph (d)(8) of this section, the plan could use the factor determined under paragraph (d)(9) of this section.)

Example 2. (a) Plan N, an accumulation plan, is a defined benefit excess plan that, for each year of service up to 35, accrues a normal retirement benefit of 1 percent of plan year compensation up to the taxable wage base, plus 1.75 percent of plan year compensation above the taxable wage base, for each year of service up to 35. An employee's total retirement benefit is the sum of the accruals for all years. The plan satisfies paragraph (d)(8) of this section.

(b) Because the plan uses the taxable wage base (an amount above covered compensation) as the integration level, it must reduce the 0.75-percent factor in the maximum excess allowance as required under paragraphs (d)(5) and (d)(9) of this section. The reduced factor, if determined on a plan-wide basis under paragraph (d)(9)(iii)(A) of this section, is 0.42 percent. The plan must therefore reduce the disparity in the plan so that it does not exceed 0.42 percent.

Example 3. (a) For the 1990 plan year, Plan O provides a normal retirement benefit of 2 percent of average annual compensation, minus a percentage of final average compensation up to $48,000, for each year of service up to 35. The plan satisfies paragraph (d)(8) of this section. As permitted under paragraph (d)(9) of this section, the plan provides that each employee's offset percentage is determined by comparing $48,000 to the employee's covered compensation and by rounding the result up to the next highest percentage of covered compensation.

(b) Employee A has a social security retirement age of 66 and covered compensation of $40,000. Because the plan provides for commencement of Employee A's benefit at age 65, the 0.75-percent factor in the maximum offset allowance is reduced to 0.7 percent under paragraph (e)(1) of this section (the "paragraph (e) factor"). In addition, because $48,000 is rounded up to 125 percent of Employee A's covered compensation, the 0.75-percent factor in the maximum offset allowance is reduced to 0.69 percent under paragraph (d)(9) of this section (the "paragraph

(d) factor"). The reductions are cumulative under paragraph (b)(3)(ii) of this section.

(c) The cumulative reductions can be made by multiplying the paragraph (e) facdtor by the ratio of the paragraph (d) factor to 0.75 percent or by multiplying the paragraph (d) factor by the ratio of the paragraph (e) factor to 0.75 percent. The disparity factor for Employee A is therefore 0.64 percent ((0.7 percent × 0.69 percent/0.75 percent) or (0.69 percent x 0.7 percent/0.75 percent)).

Example 4. Plan P is an offset plan that uses the calendar year as the plan year and uses an offset level of each employee's final average compensation. Assume that the taxable wage bases for 1990–1992 are the following:

1990—$51,300
1991—$53.400
1992—$58,000

Employee B's final average compensation, determined as of the close of the 1992 plan year, is the average of Employee B's annual compensation for the period 1990–1992. Employee B's annual compensation for each year is the following:

1990—$47,000
1991—$59,000
1992—$65,000

For purposes of determining the offset applied to Employee B's employer-provided benefit under the plan. Employee's B's final average compensation as of the close of the 1992 plan year is $52,800 ($47,000 + $53,400 + $58,000/3). This is because annual compensation in excess of the taxable wage base in effect at the beginning of the year may not be taken into account in determining an employee's final average compensation or in determining the employee's offset. If the plan determines the offset applied to Employee B's benefit by reference to compensation in excess of $52,800, the plan fails to satisfy this paragraph (d).

(e) *Adjustments to the 0.75-percent factor for benefits commencing at ages other than social security retirement age*—(1) *In general.* The 0.75-percent factor in the maximum excess allowance and in the maximum offset allowance applies to a benefit commencing at an employee's social security retirement age. Except as provided in paragraph (g) of this section, if a benefit payable to an employee under a defined benefit excess plan or a defined benefit offset plan commences at an age before the employee's social security retirement age (including a benefit payable at the normal retirement age under the plan), the 0.75-percent factor in the maximum excess allowance or in the maximum

offset allowance, respectively, is reduced in accordance with paragraph (e)(2)(i) of this section. If a benefit payable to an employee under a defined benefit excess plan or a defined offset plan commences at an age after the employee's social security retirement age, the 0.75-percent factor in the maximum excess allowance or in the maximum offset allowance, respectively, may be increased in accordance with paragraph (e)(2)(ii) of this section. Paragraph (e)(4) of this section provides rules on the age at which a benefit commences. See paragraph (f) of this section for the requirements applicable to optional forms of benefit.

(2) *Adjustments*—(i) *Benefits commencing on or after age 55 and before social security retirement age.* If benefits commence before an employee's social security retirement age, the 0.75-percent factor in the maximum excess allowance and in the maximum offset allowance must be reduced for such early commencement of benefits in accordance with the tables set forth in paragraph (e)(3) of this section.

(ii) *Benefits commencing after social security retirement age and on or before age 70.* If benefits commence after an employee's social security retirement age, the 0.75-percent factor in the maximum excess allowance and in the maximum offset allowance may be increased for such delayed commencement of benefits in accordance with the tables set forth in paragraph (e)(3) of this section.

(iii) *Benefits commencing before age 55.* If benefits commence before the employee attains age 55, the 0.75-percent factor in the maximum excess allowance and in the maximum offset allowance is further reduced (on a monthly basis to reflect the month in which benefits commence) to a factor that is the actuarial equivalent of the 0.75-percent factor, as adjusted under the tables in paragraph (e)(3) of this section, applicable to a benefit commencing in the month in which the employee attains age 55. In determining actuarial equivalence for this purpose, a reasonable interest rate must be used. In addition, a reasonable mortality table must be used to determine the actuarial present value, as defined in § 1.401(a)(4)–12, of the benefits commencing at age 55 and at the earlier

commencement age, and a reasonable mortality table may be used to determine the actuarial present value at the earlier commencement age of the benefits commencing at age 55. A standard interest rate and a standard mortality table, as defined in § 1.401(a)(4)–12, are considered reasonable.

(iv) *Benefits commencing after age 70.* If benefits commence after the employee attains age 70, the 0.75-percent factor in the maximum excess allowance and in the maximum offset allowance may be further increased (on a monthly basis to reflect the month in which benefits commence) to a factor that is the actuarial equivalent of the 0.75-percent factor (as adjusted in accordance with this paragraph (e)) applicable to a benefit commencing in the month in which the employee attains age 70. In determining actuarial equivalence for this purpose, a reasonable interest rate must be used. In addition, a reasonable mortality table must be used to determine the actuarial present value, as defined in § 1.401(a)(4)–12, of the benefits commencing at age 70 and at the later commencement age, and a reasonable mortality table may be used to determine the value at the later commencement age of the benefits commencing at age 70. A standard interest rate and a standard mortality table, as defined in § 1.401(a)(4)–12, are considered reasonable.

(3) *Tables.* Tables I, II, and III provide the adjustments in the 0.75-percent factor in the maximum excess allowance and in the maximum offset allowance applicable to benefits commencing on or after age 55 and on or before age 70 to an employee who has a social security retirement age of 65, 66 or 67. Table IV is a simplified table for a plan that uses a single disparity factor of 0.65 percent for all employees at age 65. The factors in the following tables are applicable to benefits that commence in the month the employee attains the specified age. Accordingly, if benefits commence in a month other than the month in which the employee attains the specified age, appropriate adjustments in the 0.75-percent factor in the maximum excess allowance and the maximum offset allowance must be made. For this purpose, adjustments

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may be based on straight-line inter-polation from the factors in the tables or in accordance with the methods of adjustment specified in paragraphs (e)(2)(iii) and (iv) of this section.

TABLE I

[Social security retirement age 67]

Age at which benefits commence	Annual factor in maximum excess allowance and maximum offset allowance (percent)
70	1.002
69	0.908
68	0.825
67	0.750
66	0.700
65	0.650
64	0.600
63	0.550
62	0.500
61	0.475
60	0.450
59	0.425
58	0.400
57	0.375
56	0.344
55	0.316

TABLE II

[Social security retirement age 66]

Age at which benefits commence	Annual factor in maximum excess allowance and maximum offset allowance (percent)
70	1.101
69	0.998
68	0.907
67	0.824
66	0.750
65	0.700
64	0.650
63	0.600
62	0.550
61	0.500
60	0.475
59	0.450
58	0.425
57	0.400
56	0.375
55	0.344

TABLE III

[Social security retirement age 65]

Age at which benefits commence	Annual factor in maximum excess allowance and maximum offset allowance (percent)
70	1.209
69	1.096
68	0.996
67	0.905
66	0.824
65	0.750
64	0.700
63	0.650
62	0.600

TABLE III—Continued

[Social security retirement age 65]

Age at which benefits commence	Annual factor in maximum excess allowance and maximum offset allowance (percent)
61	0.550
60	0.500
59	0.475
58	0.450
57	0.425
56	0.400
55	0.375

TABLE IV

[Simplified table]

Age at which benefits commence	Annual factor in maximum excess allowance and maximum offset allowance (percent)
70	1.048
69	0.950
68	0.863
67	0.784
66	0.714
65	0.650
64	0.607
63	0.563
62	0.520
61	0.477
60	0.433
59	0.412
58	0.390
57	0.368
56	0.347
55	0.325

(4) *Benefit commencement date*—(i) *In general.* Except as provided in paragraph (e)(4)(ii) of this section, a benefit commences for purposes of this paragraph (e) on the first day of the period for which the benefit is paid under the plan.

(ii) *Qualified social security supplement.* If a plan uses a qualified social security supplement, as defined in §1.401(a)(4)–12, to provide an aggregate benefit at retirement before social security retirement age that is a uniform percentage of average annual compensation, benefits will be considered to commence on the first day of the period for which the qualified social security supplement is no longer payable. In order for this paragraph (e)(4)(ii) to apply, the uniform percentage must be equal to the excess benefit percentage in the case of an excess plan or the gross benefit percentage in the case of an offset plan.

(5) *Examples.* The following examples illustrate this paragraph (e). Unless otherwise provided, the following facts

apply. The plan is noncontributory and is the only plan ever maintained by the employer. The plan uses a normal retirement age of 65 and contains no provision that would require a reduction in the 0.75-percent factor under paragraph (b)(2) or (b)(3) of this section. In the case of a defined benefit excess plan, the plan uses each employee's covered compensation as the integration level; in the case of an offset plan, the plan uses each employee's covered compensation as the offset level and provides that an employee's final average compensation is limited to the employee's average annual compensation. Each example discusses the benefit formula applicable to an employee who has a social security retirement age of 65.

Example 1. Plan M is a defined benefit excess plan that, for an employee with a social security retirement age of 65, provides a normal retirement benefit of 1.25 percent of average annual compensation up to the integration level, plus 2.0 percent of average annual compensation in excess of the integration level, for each year of service up to 35. For an employee with at least 20 years of service, the plan provides a benefit commencing at age 55 that is equal to the benefit payable at age 65. For that employee, the disparity provided under the plan at age 55 is 0.75 percent (2 percent–1.25 percent). Because this disparity exceeds the 0.375 percent factor provided in the table for a benefit payable at age 55 to an employee with a social security retirement age of 65, the plan fails to satisfy paragraphs (b) and (e) of this section with respect to the early retirement benefit.

Example 2. Assume the same facts as in *Example 1*, except that the base benefit percentage under the plan is 1.75 percent. Thus, the disparity provided under the plan at age 55 is 0.25 percent (2 percent–1.75 percent). Because the disparity does not exceed the 0.375 percent factor provided in the table for a benefit payable at age 55 to an employee with a social security retirement age of 65, the plan does not fail to satisfy paragraphs (b) and (e) of this section with respect to the early retirement benefit.

Example 3. Plan N is an offset plan that, for an employee with a social security retirement age of 65, provides a normal retirement benefit of 1.75 percent of average annual compensation, minus 0.75 percent of final average compensation up to the offset level, for each year of service up to 35. For an employee with at least 20 years of service, the plan provides a benefit commencing at age 55 that is equal to the benefit payable at age 65. For that employee, the disparity provided

under the plan at age 55 is 0.75 percent. Because this disparity exceeds the 0.375–percent factor provided in the table for an offset applied to a benefit payable at age 55 to an employee with a social security retirement age of 65, the plan fails to satisfy paragraphs (b) and (e) of this section with respect to the early retirement benefit. The plan would not fail to satisfy paragraphs (b) and (e) of this section with respect to the early retirement benefit if the applicable factor for determining the offset applied to the benefit were reduced to 0.375 percent.

Example 4. Plan O is a defined benefit excess plan that, for an employee with a social security retirement age of 65, provides a normal retirement benefit of 1.25 percent of average annual compensation up to the integration level, plus 2.0 percent of average annual compensation in excess of the integration level, for each year of service up to 35. The plan provides benefits commencing before normal retirement age with the following reductions:

Age	Percentage of normal retirement benefit (%)
64	90
63	85
62	80

Under the plan, a benefit payable at age 64 is equal to 90 percent of the normal retirement benefit payable at age 65. Thus, the excess benefit percentage under the plan is 1.8 percent, the base benefit percentage under the plan is 1.125 percent, and the disparity provided under the plan at age 64 is 0.675 percent. Similarly, a benefit payable at age 63 is equal to 85 percent of the normal retirement benefit payable at age 65. Thus, the excess benefit percentage under the plan is 1.7 percent, the base benefit percentage under the plan is 1.0625 percent, and the disparity provided under the plan at age 63 is 0.6375 percent. Finally, a benefit payable at age 62 is equal to 80 percent of the normal retirement benefit payable at age 65. Thus, the excess benefit percentage under the plan is 1.6 percent, the base benefit percentage under the plan is 1.0 percent, and the disparity provided under the plan at age 62 is 0.6 percent. Because the disparities provided under the plan at each early commencement age do not exceed the factors provided in the applicable table in paragraph (e)(3) of this section, the plan does not fail to satisfy paragraphs (b) and (e) of this section with respect to the early retirement benefits.

Example 5. Plan P is a defined benefit excess plan that provides a normal retirement benefit of 0.75 percent of average annual compensation up to the integration level, plus 1.5 percent of average annual compensation in excess of the integration level, for each year of service up to 35. The plan does not provide any benefits, other than normal

retirement benefits, commencing before an employee's social security retirement age. Employee A, born in 1947, has a social security retirement age of 66. Because the plan provides for the distribution of normal retirement benefits before Employee A's social security retirement age, the 0.75-percent factor in the maximum excess allowance applicable to Employee A must be reduced to 0.70 percent in accordance with this paragraph (e). Accordingly, the disparity provided to A under the plan exceeds the maximum excess allowance because the excess benefit percentage (1.5 percent) exceeds the base benefit percentage (0.75 percent) by more than the maximum excess allowance of 0.70 percent, as reduced in accordance with this paragraph (e).

Example 6. Assume the same facts as in *Example 5*, except that the plan also provides an early retirement benefit, commencing at age 62, to an employee who satisfies the conditions for early retirement specified in the plan. The early retirement benefit is based upon the employee's accrued benefit at early retirement age and equals the amount that would have been paid commencing at the employee's normal retirement age based upon the employee's average annual compensation, covered compensation and years of service at the date of the employee's early retirement. Employee B, who has a social security retirement age of 65, meets the conditions for early retirement under the plan and retires at age 62 with 30 years of service. At the time of early retirement, Employee B has average annual compensation of $20,000 and covered compensation of $16,000. Under the plan's benefit formula, Employee B has accrued a normal retirement benefit, commencing at age 65, of $5,400 ((22.5 percent × $16,000) + (45 percent × $4,000)) based on Employee B's average annual compensation, covered compensation and years of service at early retirement. Accordingly, under the plan's early retirement provisions, Employee B is entitled to receive, commencing at early retirement, a benefit of $5,400. Because the early retirement benefit is a benefit commencing at age 62 (before Employee B's social security retirement age), the 0.75-percent factor in the maximum excess allowance must be reduced to 0.60 percent in accordance with this paragraph (e). Accordingly, the disparity provided to Employee B under the plan at early retirement exceeds the maximum excess allowance.

Example 7. (a) Plan Q is a defined benefit excess plan that provides a normal retirement benefit of 1.35 percent of average annual compensation up to the integration level, plus 2 percent of average annual compensation in excess of the integration level, for each year of service up to 35. The plan provides that an employee with 10 years of service at age 55 may receive an unreduced retirement benefit. The plan also provides

that employee with a supplemental benefit of 0.65 percent of average annual compensation up to the integration level for each year of service up to 35, payable from early retirement until age 65. The supplemental benefit is a qualified social security supplement under §1.401(a)(4)–12. The effect of the supplement is to provide an employee with a uniform benefit of 2 percent of average annual compensation from early retirement until age 65, when the supplement is no longer payable. Therefore, for purposes of this paragraph (e), the employee's benefit will be considered to commence at age 65.

(b) Assume that Plan Q is instead an offset plan that provides a normal retirement benefit of 2 percent of average annual compensation, minus 0.65 percent of final average compensation up to the offset level, for each year of service up to 35. The plan provides the same early retirement benefit on the same conditions, except that the supplement is 0.65 percent of an employee's final average compensation up to the offset level. An employee at age 55 thus receives a uniform benefit of 2 percent of average annual compensation until age 65, when the supplement is no longer payable. Therefore, for purposes of this paragraph (e), the employee's benefit will be considered to commence at age 65.

(f) *Benefits, rights, and features*—(1) *Defined benefit excess plan.* In the case of a defined benefit excess plan, each benefit, right, or feature provided under the plan with respect to employer-provided benefits attributable to average annual compensation above the integration level (an ''excess benefit, right, or feature'') must also be provided on the same terms with respect to employer-provided benefits attributable to average annual compensation up to the integration level (a ''base benefit, right, or feature''). Alternatively, an excess benefit, right, or feature may be provided on different terms than the base benefit, right, or feature, if the terms used to determine the base benefit, right, or feature produce a benefit, right, or feature of inherently equal or greater value than the benefit, right, or feature that would be produced under the terms used to determine the excess benefit, right, or feature.

(2) *Offset plan.* In the case of an offset plan, each benefit, right, or feature provided under the plan with respect to employer-provided benefits before application of the offset (a ''gross benefit, right, or feature'') must be provided on

the same terms as those used to determine the offset applied to the gross benefit, right, or feature. Alternatively, a gross benefit, right, or feature may be provided on different terms from those used to determine the offset applied to the gross benefit, right, or feature, if the terms used to determine the gross benefit, right, or feature produce a benefit, right, or feature of inherently equal or greater value than the benefit, right, or feature that would be produced under the terms used to determine the offset applied to the gross benefit, right, or feature. In addition, if benefits commence before an employee's normal retirement age, the gross benefit percentage under the plan must be reduced by a number of percentage points that is not less than the number of percentage points by which the offset percentage must be reduced, from normal retirement age to the age at which benefits commence, under the rules of paragraph (e) of this section.

(3) *Examples.* The following examples illustrate this paragraph (f). Unless otherwise provided, the following facts apply. The plan is noncontributory and is the only plan ever maintained by the employer. The plan uses a normal retirement age of 65 and contains no provision that would require a reduction in the 0.75-percent factor under paragraph (b)(2) or (b)(3) of this section. In the case of a defined benefit excess plan, the plan uses each employee's covered compensation as the integration level; in the case of an offset plan, the plan uses each employee's covered compensation as the offset level and provides that an employee's final average compensation is limited to the employee's average annual compensation. Each example discusses the benefit formula applicable to an employee who has a social security retirement age of 65. All optional forms of benefit under each plan are provided on the same terms.

Example 1. Plan M is a defined benefit excess plan that provides a normal retirement benefit of 1 percent of average annual compensation up to the integration level, plus 1.65 percent of average annual compensation above the integration level, for each year of service up to 35. The plan provides an early retirement benefit for any employee who terminates employment at or after age 55 with

10 or more years of service. In determining an employee's early retirement, the 1.65 percent excess benefit percentage is reduced in accordance with the table in paragraph (e)(3) of this section for a plan that uses a single disparity factor of 0.65 percent for all employees at age 65. However, a larger reduction factor is applied to determine the base benefit percentage at early retirement. The plan violates this paragraph (f) because the excess early retirement benefit is not provided on the same terms as the base early retirement benefit, nor do the terms used to determine the base early retirement benefit produce an early retirement benefit of inherently equal or greater value than the early retirement benefit that would be produced under the terms used to determine the excess benefit, right, or feature.

Example 2. The facts are the same as in *Example 1* except that the plan determines the early retirement benefit by applying the same reduction factors under paragraph (e)(3) of this section to the base and excess benefit percentages. Furthermore, if an employee terminates employment at or after age 55 with 30 or more years of service, the plan provides that the base benefit percentage of 1 percent is not reduced. Although the excess early retirement benefit is provided on different terms than the base early retirement benefit, the plan satisfies this paragraph (f) because the terms used to determine the base early retirement benefit produce an early retirement of inherently equal or greater value than the early retirement benefit that would be produced under the terms used to determine the excess benefit, right, or feature.

Example 3. Plan N is an offset plan that provides a normal retirement benefit of 2 percent of average annual compensation, minus 0.65 percent of final average compensation up to the offset level, for each year of service up to 35. In determining the qualified joint and survivor ("QJSA") form of the normal retirement benefit, the plan applies a factor of 80 percent to the gross benefit percentage and a factor of 100 percent to the offset percentage. Thus, the QJSA form is 1.6 percent of average annual compensation, minus 0.65 percent of final average compensation up to the offset level, for each year of service up to 35. The plan violates this paragraph (f) because the gross QJSA form is not provided on the same terms as the terms used to determine the offset applied to the QJSA, nor does it produce a QJSA benefit that is of inherently equal or greater value than the QJSA benefit that would be produced under the terms used to determine the offset under the plan.

Example 4. Plan O is a defined benefit excess plan that provides a normal retirement benefit of 1 percent of average annual compensation up to the integration level, plus 1.65 percent of average annual compensation

above the integration level, for each year of service up to 35. The plan also provides a single sum optional form of benefit determined by applying a single interest rate and mortality assumption to the entire normal retirement benefit. The plan satisfies this paragraph (f) because the excess optional form is provided on the same terms as the base optional form. The plan would also satisfy this paragraph (f) if it used a lower interest rate to determine the base optional form than used to determine the excess optional form because the lower interest rate would produce an optional form of inherently equal or greater value than the optional form produced by using the same interest rate.

Example 5. Plan R is a defined benefit excess plan that provides a normal retirement benefit of 1 percent of average annual compensation up to the integration level, plus 1.65 percent of average annual compensation above the integration level, for each year of service up to 35. If an employee continues to work after normal retirement age, the plan provides that the employee receives credit for additional years of service up to the service limit of 35. The plan also provides that the disparity provided under the plan will increase as permitted under paragraph (e) of this section for benefits commencing after social security retirement age. However, the plan does not provide an increase in the base benefit percentage to reflect the fact that the employee has delayed commencement of benefits past normal retirement age. Thus, for example, for an employee at age 68, the plan provides a benefit of 1 percent of average annual compensation up to the integration level, plus 1.86 percent of average annual compensation above the integration level, for each year of service up to 35. The plan violates this paragraph (f) because the excess benefit provided for an employee after normal retirement age is not provided on the same terms as the base benefit, nor do the terms used to determine the base benefit produce a benefit of inherently equal or greater value than the benefit that would be produced under the terms used to determine the excess benefit.

Example 6. Plan Q is an offset plan that provides a normal retirement benefit of 2 percent of average annual compensation, minus 0.65 percent of final average compensation up to the offset level, for each year of service up to 35. In accordance with paragraph (e) of this section, the plan reduces the offset percentage under the plan for early retirement and provides a benefit at age 55 of 2 percent of average annual compensation, minus 0.325 percent of final average compensation up to the offset level, for each year of service up to 35. However, the early retirement benefit does not meet this paragraph (f) because an employee's gross benefit percentage is not reduced for early retirement.

Example 7. The facts are the same as in *Example 6* except that the plan reduces the gross benefit percentage for early retirement at age 55 to 1.675 percent. Because the gross benefit percentage is reduced by 0.325 percent (from 2.0 percent to 1.675 percent), the same percentage point reduction made in the offset percentage (from 0.65 percent to 0.325 percent), the early retirement benefit meets this paragraph (f).

(g) *No reductions in 0.75-percent factor for ancillary benefits.* For purposes of applying the maximum excess allowance or the maximum offset allowance under paragraph (b)(2) or (3) of this section, no reduction is made to the 0.75-percent factor merely because the plan provides disparity in qualified disability benefits (within the meaning of section 411(a)(9)) or preretirement death benefits and the relevant benefits are payable before an employee's social security retirement age.

(h) *Benefits attributable to employee contributions not taken into account.* Benefits attributable to employee contributions to a defined benefit plan are not taken into account in determining whether the disparity provided under a defined benefit excess plan or an offset plan exceeds the maximum permitted disparity described in paragraph (b) of this section. See § 1.401(a)(4)–6(b) for methods of determining the employer-provided benefit under a plan that includes employee contributions not allocated to separate accounts (i.e., a contributory DB plan), including § 1.401(a)(4)–6(b)(2)(iii)(B) for adjustments to the base and excess benefit percentages or the gross benefit percentage under a section 401(l) plan. If, after adjustment, the employee's base benefit percentage or gross benefit percentage (whichever is applicable) is less than zero, such percentage is deemed to be zero for purposes of the maximum excess allowance or maximum offset allowance under paragraph (b)(2) or (3) of this section.

(i) *Multiple integration levels* [Reserved]

(j) *Additional rules.* The Commissioner may, in revenue rulings, notices or other documents of general applicability, prescribe additional rules as may be necessary or appropriate to carry out the purposes of this section,

including updated tables under paragraphs (d) and (e) of this section providing for reductions in the 0.75-percent factor in the maximum excess allowance and in the maximum offset allowance and rules in paragraph (h) of this section for determining the portion of an employee's benefit attributable to employee contributions.

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§ 1.401(l)–4 Special rules for railroad plans.

(a) *In general.* Section 401(l)(6) provides that, in the case of a plan maintained by a railroad employer that covers employees who are entitled to benefits under the Railroad Retirement Act of 1974, in determining whether such a plan satisfies section 401(l), rules similar to the rules under section 401(l) apply and such rules take into account the employer-derived portion of tier 2 and supplemental annuity benefits provided under the railroad retirement system. In general, for purposes of determining whether a defined contribution plan or a defined benefit plan maintained by a railroad employer and covering employees described in te preceding sentence, satisfies section 401(l), the employer-derived portion of an employee's tier 2 benefits and supplementary annuity benefits under the Railroad Retirement Act of 1974 are treated as though such benefits were provided by the railroad employer under a qualified plan. Paragraph (b) of this section contains rules for defined contribution plans. Paragraph (c) of this section contains rules for defined benefit excess plans. Paragraph (d) of this section contains rules for offset plans. Paragraph (e) of this section contains definitions and additional rules of application.

(b) *Defined contribution plans*—(1) *In general.* A defined contribution plan maintained by a railroad employer satisfies section 401(l) and § 1.401(l)–2 for a plan year only if the plan satisfies paragraph (b)(2) or (b)(3) of this section for the plan year.

(2) *Single integration level method*—(i) *In general.* A plan satisfies this paragraph (b)(2) if—

(A) The plan specifies a single integration level for all employees that does not exceed the railroad retirement taxable wage base in effect as of the beginning of the plan year,

(B) The plan uses the same base contribution percentage and the same excess contribution percentage for all employees, and

(C) The excess contribution percentage does not exceed the sum of 11.4 percentage points and the base contribution percentage.

(ii) *Definitions.* The following definitions govern for purposes of this paragraph (b)(2).

(A) *Base contribution percentage* means the rate at which employer contributions are allocated to the account of an employee under the plan with respect to the employee's plan year compensation at or below the railroad retirement taxable wage base (expressed as a percentage of such plan year compensation).

(B) *Excess contribution percentage* means the rate at which employer contributions are allocated to the account of an employee under the plan with respect to the employee's plan year compensation above the railroad retirement taxable wage base (expressed as a percentage of such plan year compensation).

(3) *Two integration level method*—(i) *In general.* A plan satisfies this paragraph (b)(3) if—

(A) The plan specifies two integration levels for all employees, equal to the railroad retirement taxable wage base in effect as of the beginning of the plan year and the taxable wage base in effect as of the beginning of the plan year, and

(B) The plan satisfies paragraphs (b)(3) (ii) and (iii) of this section.

(ii) *Total disparity requirement.* A plan satisfies this paragraph (b)(3)(ii) if—

(A) The plan uses the same base contribution percentage and the same excess contribution percentage for all employees, and

(B) The excess contribution percentage does not exceed the sum of 11.4 percentage points and the base contribution percentage.

(iii) *Intermediate disparity requirement.* A plan satisfies this paragraph (b)(3)(iii) if—

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