(4) *State and local government plans.* A governmental plan described in section 414(d), including a plan subject to section 403(b)(12)(A)(i) (nonelective plan) is treated as satisfying section 401(m) for plan years beginning before the later of January 1, 1996, or 90 days after the opening of the first legislative session beginning on or after January 1, 1996, of the governing body with authority to amend the plan, if that body does not meet continuously. For purposes of this paragraph (g)(4), the term *governing body with authority to amend the plan* means the legislature, board, commission, council, or other governing body with authority to amend the plan.

(5) *Transition rule for plan years beginning before 1992*—(i) *General rule.* For plan years beginning 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 plan was qualified during those years.

(ii) *Restructuring*—(A) *General rule.* In determining whether the requirements of section 401(m) 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(m) are applied separately with respect to each component plan for the plan year. Thus, for example, the actual contribution ratio and the amount of excess aggregate 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(m). 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(m)–1(f)(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 contribution 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 contribution ratios, or another attribute having substantially the same effect as the same or similar actual contribution 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).

[T.D. 8357, 56 FR 40534, Aug. 15, 1991, as amended by T.D. 8376, 56 FR 63432, Dec. 4, 1991; T.D. 8357, 57 FR 10290, Mar. 25, 1992; T.D. 8581, 59 FR 66175, Dec. 23, 1994; TD 8581, 60 FR 12416, Mar. 7, 1995]

§1.401(m)–2 Multiple use of alternative limitation.

(a) *In general.* The rules in this section prevent the multiple use of the alternative methods of compliance with sections 401 (k) and (m) contained in section 401(k)(3)(A)(ii)(II) and 401(m)(2)(A)(ii) respectively. Paragraph (b) of this section discusses the scope of this section and contains the general rule for determination of a multiple use of the alternative limitation. Paragraph (c) of this section contains rules for the correction of multiple use. The consequences of multiple use of the alternative methods of compliance are described in §1.401(m)–1(a)(1).

(b) *General rule for determination of multiple use*—(1) *In general.* (i) Multiple use of the alternative limitation occurs

if all of the conditions of this paragraph (b)(1) are satisfied:

(A) One or more highly compensated employees of the employer are eligible employees in both a cash or deferred arrangement subject to section 401(k) and a plan maintained by the employer subject to section 401(m).

(B) The sum of the actual deferral percentage of the entire group of eligible highly compensated employees under the arrangement subject to section 401(k) and the actual contribution percentage of the entire group of eligible highly compensated employees under the plan subject to section 401(m) exceeds the aggregate limit of paragraph (b)(3) of this section.

(C) The actual deferral percentage of the entire group of eligible highly compensated employees under the arrangement subject to section 401(k) exceeds the amount described in section 401(k)(3)(A)(ii)(I).

(D) The actual contribution percentage of the entire group of eligible highly compensated employees under the arrangement subject to section 401(m) exceeds the amount described in section 401(m)(2)(A)(i).

(ii) The actual deferral percentage and actual contribution percentage of the group of eligible highly compensated employees are determined after use of qualified nonelective contributions and qualified matching contributions to meet the requirements of section 401(k)(3)(A)(ii) and after use of qualified nonelective contributions and elective contributions to meet the requirements of section 401(m)(2)(A). The actual deferral percentage and actual contribution percentage of the group of eligible highly compensated employees are determined after any corrective distribution or forfeiture of excess deferrals, excess contributions, or excess aggregate contributions and after any recharacterization of excess contributions required without regard to this section. Only plans and arrangements maintained by the same employer are taken into account under this paragraph (b)(1). If the employer maintains two or more plans after application of the rules under §1.401(k)– 1(g)(11), multiple use is tested separately with respect to each plan. Thus, for example, if an employer maintains a cash or deferred arrangement with matching contributions, under which elective contributions may be made under either an ESOP or a non-ESOP, multiple use is tested separately with respect to elective contributions and matching contributions under the ESOP, and with respect to elective contributions and matching contributions under the non-ESOP.

(2) *Alternative limitation.* For purposes of this section, the term ''alternative limitation'' means the 200 percent or 2 percentage point limits in sections 401(k)(3)(A)(ii)(ii) and 401(m)(2)(A)(ii).

(3) *Aggregate limit*—(i) *In general.* For purposes of this section, the aggregate limit is the greater of:

(A) The sum of—

(*1*) 1.25 times the greater of the relevant actual deferral percentage or the relevant actual contribution percentage, and

(*2*) Two percentage points plus the lesser of the relevant actual deferral percentage or the relevant actual contribution percentage. In no event, however, may this amount exceed twice the lesser of the relevant actual deferral percentage or the relevant actual contribution percentage; or

(B) The sum of—

(*1*) 1.25 times the lesser of the relevant actual deferral percentage or the relevant actual contribution percentage, and

(*2*) Two percentage points plus the greater of the relevant actual deferral percentage or the relevant actual contribution percentage. In no event, however, may this amount exceed twice the greater of the relevant actual deferral percentage or the relevant actual contribution percentage.

(ii) *Relevant actual deferral percentage and relevant actual contribution percentage defined.* For purposes of paragraph (b)(3)(i) of this section, the term ''relevant actual deferral percentage'' means the actual deferral percentage of the group of nonhighly compensated employees eligible under the arrangement subject to section 401(k) for the plan year, and the term ''relevant actual contribution percentage'' means the actual contribution percentage of the group of nonhighly compensated employees eligible under the plan subject to section 401(m) for the plan year

beginning with or within the plan year of the arrangement subject to section 401(k).

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

Example 1. (i) Assume that Employer G maintains a plan that contains a cash or deferred arrangement under which the actual deferral percentages of highly compensated and nonhighly compensated employees are 5.5 and four percent respectively. The plan also permits employee contributions, and the actual contribution percentages for the two groups are 4.2 and three percent respectively. The multiple use of the alternative limitation is tested as follows:

(1) Greater of the relevant actual deferral percentage or the relevant actual contribution percentage	4.00
(2) 1.25 times (1)	5.00
(3) Lesser of the relevant actual deferral percentage or the relevant actual contribution percentage	3.00
(4) (3) plus two percentage points	5.00
(5) (2)+(4)	10.00
(6) 1.25 times (3)	3.75
(7) (1) plus two percentage points	6.00
(8) (6)+(7)	9.75
(9) Aggregate limit greater of (5) or (8)	10.00

(ii) In this case, the sum of the actual deferral percentage and the actual contribution percentage of highly compensated employees is 9.70 percent, which is less than the aggregate limit. Therefore, there is no multiple use of the alternative limitation.

Example 2. Employer F maintains a plan subject to section 401(k) with a plan year beginning January 1, and a plan subject to section 401(m) with a plan year beginning July 1. The plan subject to section 401(k) does not correct excess contributions by recharacterization. The first actual deferral percentage taken into account is that for the plan year beginning January 1, 1989. The first actual contribution percentage taken into account is that for the plan year beginning July 1, 1989.

Example 3. (i) Employer E maintains a plan that contains a cash or deferred arrangement and provides for matching contributions. The actual deferral and contribution percentages for a plan year are as follows:

	Actual deferral percentage	Actual contribution percentage
Highly compensated	3.6	1.69
Nonhighly compensated	1.8	1.35

(ii) The actual deferral percentage of the highly compensated employees exceeds the normal limit (1.25 times 1.8, or 2.25%) but not the alternative limit (two plus 1.8, but not more than twice 1.8, or 3.6%). The actual contribution percentage of the highly compensated employees does not exceed the normal limit (1.25 times 1.35, or 1.69%). Accordingly, the plan satisfies both the actual deferral and contribution percentage tests. Since the actual contribution percentage of the highly compensated employees does not exceed the normal limit, condition (iv) of paragraph (b)(1) of this section is not satisfied. Therefore, there is no multiple use of the alternative limitation.

(c) *Correction of multiple use*—(1) *In general.* If multiple use of the alternative limitation occurs with respect to two or more plans or arrangements maintained by an employer, it must be corrected by reducing the actual deferral percentage, the actual contribution percentage of highly compensated employees, or a combination of the two, in the manner described in paragraph (c)(3) of this section. Instead of making this reduction, the employer may eliminate the multiple use of the alternative limitation by making qualified nonelective contributions in accordance with §1.401(k)–1(b)(5) and (f)(1) or §1.401(m)–1(b)(5) and (e)(1).

(2) *Treatment of required reduction.* The required reduction is treated as an excess contribution under the arrangement subject to section 401(k) or excess aggregate contribution under the plan subject to section 401(m). However, if an excess contribution arising under this section is recharacterized as an employee contribution, the recharacterized amount is treated as an excess aggregate contribution.

(3) *Required reduction.* The amount of the reduction of the actual deferral percentage of the entire group of highly compensated employees eligible in the arrangement subject to section 401(k) is calculated in the manner described in §1.401(k)–1(f)(2) or the amount of the reduction of the actual contribution percentage of the entire group of highly compensated employees eligible in the plan subject to section 401(m) is calculated in the manner described in §1.401(m)–1(e)(2), as designated in the plan, so that there is no multiple use of the alternative limitation. The employer may elect to reduce the actual deferral ratios or the actual contribution ratios, as designated in the plan, either for all highly compensated employees under the plan or arrangements subject to reduction or

for only those highly compensated employees who are eligible in both the arrangement subject to section 401(k) and the plan subject to section 401(m).

(4) *Examples.* The principles of this paragraph (c) are illustrated by the following examples. In all cases, the employer maintains both an arrangement subject to section 401(k) and a plan subject to section 401(m). Assume that there is no income or loss allocable to the elective, employee, or matching contributions.

Example 1. (i) All employees of Employer Q are eligible in both an arrangement subject to section 401(k) and a plan subject to section 401(m). Both plans have a calendar plan year. The plans provide that multiple use of the alternative limitation will be corrected in the plan subject to section 401(m) and that any required reduction in actual contribution ratios will apply only to employees eligible to participate in both arrangements. Employer Q includes elective contributions in compensation as permitted under §1.414(s)–1(c)(4)(i). See §1.401(k)–1(g)(2)(i). Employees X and Y are highly compensated. Each received compensation of $100,000, deferred $6,000, received a $3,000 matching contribution, and made employee contributions of $3,000. Actual deferral and contribution percentages under the arrangement and plan for the 1989 plan year are shown below. No excess deferrals, excess contributions, or excess aggregate contributions have yet been required to be distributed, forfeited, or recharacterized under the plan.

	Actual deferral percentage	Actual contribution percentage
Highly compensated	6	6
Nonhighly compensated	4	4

(ii) The aggregate limit and amount required, to be corrected are determined as follows:

Step 1: Determination of Aggregate Limit

(1) Greater of relevant actual deferral percentage or relevant actual contribution percentage	4.0
(2) 1.25 times (1)	5.0
(3) Lesser of relevant actual deferral percentage or relevant actual contribution percentage	4.0
(4) (3) plus two percentage points	6.0
(5) (2)+(4)	11.0
(6) 1.25 times (3)	5.0
(7) (1) plus two percentage points	6.0
(8) (6)+(7)	11.0
(9) Aggregate limit Greater of (5) or (8)	11.0

Step 2: Calculation of Correction Amount

(10) Actual deferral percentage of highly compensated	6.0
(11) Maximum permitted actual contribution percentage of highly compensated ((9)–(10))	5.0
(12) Amount taken into account in determining actual contribution percentage of highly compensated Employee X	$6,000
(13) Maximum amount permitted without use of alternative limitation ((11)×compensation of Employee X)	$5,000
(14) Excess aggregate contribution ((12)–(13))	$1,000

(iii) A similar correction must be made for Employee Y.

Example 2. Same as *Example 1,* but the plan corrects the multiple use in the arrangement subject to section 401(k) and provides that excess contributions are recharacterized. In this case, the aggregate limit for the plans will be 11 percent. Similarly, the excess contributions for Employees X and Y, determined in a manner analogous to that used in *Example 1,* will be $1,000. When this is recharacterized, the actual contribution percentage for these employees will increase to seven percent, resulting in an excess aggregate contribution of $1,000 that must be distributed.

Example 3. Same as *Example 1,* except that Employee Y is not eligible to participate in the arrangement subject to section 401(k). No reduction of Y's actual contribution ratio is required because Y is only in the plan subject to section 401(m). In order to reduce the actual contribution percentage of the entire group of highly compensated employees eligible for the plan subject to section 401(m) to five percent, the plan must reduce X's actual contribution percentage to four percent. X's employee and matching contributions are limited to $4,000. Therefore X has an excess aggregate contribution of $2,000.

(d) *Effective date*—(1) *General rule.* This section is effective for plan years beginning after December 31, 1988, or such later date provided in §1.402(m)–1(g).

(2) *Transition rule.* For plan years beginning before January 1, 1992, a reasonable interpretation of the rules set forth in sections 401 (k) and (m) of the Internal Revenue Code (as in effect during those years) may be relied upon to determine whether a plan was qualified during those years. For plan years beginning before January 1, 1992, a plan

may be restructured only in accordance with §1.401(k)–1(h)(3)(iii) or §1.401(m)–1(g)(5)(ii).

[T.D. 8357, 56 FR 40543, Aug. 15, 1991, as amended at 57 FR 10290, Mar. 25, 1992; T.D. 8581, 59 FR 66179, Dec. 23, 1994]

§ 1.402(a)–1 Taxability of beneficiary under a trust which meets the requirements of section 401(a).

(a) *In general.* (1)(i) Section 402 relates to the taxation of the beneficiary of an employees' trust. If an employer makes a contribution for the benefit of an employee to a trust described in section 401(a) for the taxable year of the employer which ends within or with a taxable year of the trust for which the trust is exempt under section 501(a), the employee is not required to include such contribution in his income except for the year or years in which such contribution is distributed or made available to him. It is immaterial in the case of contributions to an exempt trust whether the employee's rights in the contributions to the trust are forfeitable or nonforfeitable either at the time the contribution is made to the trust or thereafter.

(ii) The provisions of section 402(a) relate only to a distribution by a trust described in section 401(a) which is exempt under section 501(a) for the taxable year of the trust in which the distribution is made. With two exceptions, the distribution from such an exempt trust when received or made available is taxable to the distributee to the extent provided in section 72 (relating to annuities). First, for taxable years beginning before January 1, 1964, section 72(e)(3) (relating to the treatment of certain lump sums), as in effect before such date, shall not apply to such distributions. For taxable years beginning after December 31, 1963, such distributions may be taken into account in computations under sections 1301 through 1305 (relating to income averaging). Secondly, certain total distributions described in section 402(a)(2) are taxable as long-term capital gains. For the treatment of such total distributions, see subparagraph (6) of this paragraph. Under certain circumstances, an amount representing the unrealized appreciation in the value of the securities of the employer is excludable from gross income for the year of distribution. For the rules relating to such exclusion, see paragraph (b) of this section. Furthermore, the exclusion provided by section 105(d) is applicable to a distribution from a trust described in section 401(a) and exempt under section 501(a) if such distribution constitutes wages or payments in lieu of wages for a period during which an employee is absent from work on account of a personal injury or sickness. See §1.72–15 for the rules relating to the tax treatment of accident or health benefits received under a plan to which section 72 applies.

(iii) Except as provided in paragraph (b) of this section, a distribution of property by a trust described in section 401(a) and exempt under section 501(a) shall be taken into account by the distributee at its fair market value.

(iv) If a trust is exempt for the taxable year in which the distribution occurs, but was not so exempt for one or more prior taxable years under section 501(a) (or under section 165(a) of the Internal Revenue Code of 1939 for years to which such section was applicable), the contributions of the employer which were includible in the gross income of the employee for the taxable year when made shall, in accordance with section 72(f), also be treated as part of the consideration paid by the employee.

(v) If the trust is not exempt at the time the distribution is received by or made available to the employee, see section 402(b) and paragraph (b) of §1.402(b)–1.

(vi) For the treatment of amounts paid to provide medical benefits described in section 401(h) as defined in paragraph (a) of §1.401–14, see paragraph (h) of §1.72–15.

(2) If a trust described in section 401(a) and exempt under section 501(a) purchases an annuity contract for an employee and distributes it to the employee in a year for which the trust is exempt, the contract containing a cash surrender value which may be available to an employee by surrendering the contract, such cash surrender value will not be considered income to the employee unless and until the contract is surrendered. For the rule as to nontransferability of annuity contracts