

specified in the notice for all plan years that begin in the testing year. The Commissioner may, in revenue procedures, notices, or other guidance of general applicability, provide for exceptions to the rule in this paragraph (c)(2) as well as for the effect that will be given to the employer's notice for purposes of any future testing year.

[T.D. 8376, 56 FR 63446, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32919, June 27, 1994]

§ 1.414(r)-5 Qualified separate line of business—administrative scrutiny requirement—safe harbors.

(a) *In general.* A separate line of business (as determined under § 1.414(r)-3) satisfies the administrative scrutiny requirement of § 1.414(r)-1(b)(2)(iv)(D) for a testing year if the separate line of business satisfies any of the safe harbors in paragraphs (b) through (g) of this section for the testing year. The safe harbor in paragraph (b) of this section implements the statutory safe harbor of section 414(r)(3). The safe harbors in paragraphs (c) through (g) of this section constitute the guidelines provided for under section 414(r)(2)(C). A separate line of business that does not satisfy any of the safe harbors in this section nonetheless satisfies the requirement of administrative scrutiny if the employer requests and receives an individual determination from the Commissioner under § 1.414(r)-6 that the separate line of business satisfies the requirement of administrative scrutiny.

(b) *Statutory safe harbor—(1) General rule.* A separate line of business satisfies the safe harbor in this paragraph (b) for the testing year only if the highly compensated employee percentage ratio of the separate line of business is—

- (i) At least 50 percent; and
- (ii) Non more than 200 percent.

(2) *Highly compensated employee percentage ratio.* For purposes of this paragraph (b), the highly compensated employee percentage ratio of a separate line of business is the fraction (expressed as a percentage), the numerator of which is the percentage of the employees of the separate line of business who are highly compensated employees, and the denominator of which is the percentage of all employees of

the employer who are highly compensated employees.

(3) *Employees taken into account.* For purposes of this paragraph (b), the employees taken into account are the same employees who are taken into account for purposes of applying section 410(b) with respect to the first testing day. For this purpose, employees described in section 410 (b)(3) and (b)(4) are excluded. However, section 410(b)(4) is applied with reference to the lowest minimum age requirement applicable under any plan of the employer, and with reference to the lowest service requirement applicable under any plan of the employer, as if all the plans were a single plan under § 1.410(b)-6(b)(2). The employees of the separate line of business are determined by applying § 1.414(r)-7 to the employees taken into account under this paragraph (b)(3). An employee is treated as a highly compensated employee for purposes of this paragraph (b) if the employee is treated as a highly compensated employee for purposes of applying section 410(b) with respect to the first testing day. For the definition of "first testing day," see § 1.414(r)-11(b)(7).

(4) *Ten-percent exception.* A separate line of business is deemed to satisfy paragraph (b)(1)(i) of this section for the testing year if at least 10 percent of all highly compensated employees of the employer provide services to the separate line of business during the testing year and do not provide services to any other separate line of business of the employer during the testing year within the meaning of § 1.414(r)-3(c)(5).

(5) *Determination based on preceding testing year.* A separate line of business that satisfied this safe harbor for the immediately preceding testing year (without taking into account the special rule in this paragraph (b)(5)) is deemed to satisfy the safe harbor for the current testing year. The preceding sentence applies to a separate line of business only if the employer designated the same line of business in the immediately preceding testing year as in the current testing year and either—

- (i) The highly compensated employee percentage ratio of the separate line of business for the current testing year

§ 1.414(r)-5

26 CFR Ch. I (4-1-02 Edition)

does not deviate by more than 10 percent (not 10 percentage points) from the highly compensated employee percentage ratio of the separate line of business for the immediately preceding testing year; or

(ii) No more than five percent of the employees of the separate line of business for the current testing year were employees of a different separate line of business for the immediately preceding testing year, and no more than five percent of the employees of the separate line of business for the immediately preceding testing year are employees of a different separate line of business for the current testing year.

(6) *Examples.* The following examples illustrate the application of the safe harbor in this paragraph (b).

Example 1. (i) Employer A operates three separate lines of business as determined under §1.414(r)-3, that respectively consist of a railroad, an insurance company, and a newspaper. Employer A employs a total of 400 employees, 100 of whom are highly compensated employees. Thus, the percentage of all employees of Employer A who are highly compensated employees is 25 percent. After applying §1.414(r)-7, the distribution of highly and nonhighly compensated employees among Employer A's separate lines of business is as follows:

	Employer-wide	Railroad	Insurance company	Newspaper
Number of Employees	400	100	150	150
Number of HCEs	100	20	50	30
Number of Non-HCEs	300	80	100	120
HCE Percentage	25%	20%	33%	20%
	(100/400)	(20/100)	(50/150)	(30/150)
HCE Percentage Ratio	N/A	80%	133%	80%
		(20%/25%)	(33%/25%)	(20%/25%)

(i) Because the highly compensated employee percentage ratio of each separate line of business is at least 50 percent and no more than 200 percent, each of Employer A's separate lines of business satisfies the requirements of the safe harbor in this paragraph (b).

Example 2. (i) Employer B operates three separate lines of business as determined under §1.414(r)-3, that respectively consist of a dairy products manufacturer, a candy man-

ufacturer, and a chain of housewares stores. Employer B employs a total of 1,000 employees, 100 of whom are highly compensated employees. Thus, the percentage of all employees of Employer B who are highly compensated employees is 10 percent. After applying §1.414(r)-7, the distribution of highly and nonhighly compensated employees among Employer B's separate lines of business is as follows:

	Employer-wide	Dairy products	Candy	Housewares stores
Number of Employees	1,000	200	500	300
Number of HCEs	100	5	50	45
Number of Non-HCEs	900	195	450	255
HCE Percentage	10%	2.5%	10%	15%
	(100/1,000)	(5/200)	(50/500)	(45/300)
HCE Percentage Ratio	N/A	25%	100%	150%
		(2.5%/10%)	(10%/10%)	(15%/10%)

(ii) Because the highly compensated employee percentage ratio for the dairy products line of business is less than 50 percent, it does not satisfy the requirements of the statutory safe harbor in this paragraph (b). However, because Employer B's other two separate lines of business (candy manufacturing and housewares stores) each has a highly compensated employee percentage ratio that is no less than 50 percent and no greater than 200 percent, they each satisfy

the statutory safe harbor in this paragraph (b).

Example 3. (i) The facts are the same as in *Example 2*, except that Employer B operates only two separate lines of business as determined under §1.414(r)-3, one consisting of the dairy products manufacturer and the candy manufacturer, and the other consisting of the chain of housewares stores. After applying §1.414(r)-7, the distribution of highly and nonhighly compensated employees among

Internal Revenue Service, Treasury

§ 1.414(r)-5

Employer B's separate lines of business is as follows:

	Employer-Wide	Candy/Dairy Products	Housewares Stores
Number of Employees	1,000	700	300
Number of HCEs	100	55	45
Number of Non-HCEs	900	645	255
HCE Percentage	10%	7.9%	15%
	(100/1,000)	(55/700)	(45/300)
HCE Percentage Ratio	N/A	79%	150%
		(7.9%/10%)	(15%/10%)

(ii) Because the highly compensated employee percentage ratio for both of Employer B's separate lines of business is at least 50 percent and no more than 200 percent, they each satisfy the requirements of the statutory safe harbor in this paragraph (b).

(c) *Safe harbor for separate lines of business in different industries*—(1) *In general.* A separate line of business satisfies the safe harbor in this paragraph (c) for the testing year if it is in a different industry or industries from every other separate line of business of the employer. For this purpose, a separate line of business is in a different industry or industries from every other separate line of business of the employer only if—

(i) The property or services provided to customers of the employer by the separate line of business (as designated by the employer for the testing year under §1.414(r)-2) fall exclusively within one or more industry categories established by the Commissioner for purposes of this paragraph (c); and

(ii) None of the property or services provided to customers of the employer by any of the employer's other separate lines of business (as designated by the employer for the testing year under §1.414(r)-2) falls within the same industry category or categories.

(2) *Optional rule for foreign operations.* For purposes of satisfying this paragraph (c), an employer is permitted to disregard any property or services provided to customers of the employer during the testing year by a foreign corporation or foreign partnership (as defined in section 7701(a)(5)), to the extent that income from the provision of the property or services is not effectively connected with the conduct of the trade or business within the United States within the meaning of section 864(c). Thus, for example, an employer

is permitted to take into account only property and services provided to customers of the employer by its domestic subsidiaries and property and services provided by its foreign subsidiaries that generate income effectively connected with the conduct of a trade or business within the United States in determining whether the property or services provided to customers of the employer by a separate line of business fall exclusively within one or more industry categories and also whether the property or services provided by any other separate line of business fall within the same industry category or categories.

(3) *Establishment of industry categories.* The Commissioner shall, by revenue procedure or other guidance of general applicability, establish industry categories for purposes of this paragraph (c).

(4) *Examples.* The following examples illustrate the application of the safe harbor in this paragraph (c). For purposes of these examples, it is assumed that, pursuant to paragraph (c)(3) of this section, the Commissioner has established the following industry categories (among others): transportation equipment and services; banking, insurance, and finance; machinery and electronics; and entertainment, sports, and hotels.

Example 1. Among its other business activities, Employer C operates a commercial airline that constitutes a separate line of business under §1.414(r)-3. In addition, no other separate line of business of Employer C provides to customers of Employer C any property or services in the transportation equipment and services industry category. Under these facts, the separate line of business described in this example satisfies the safe harbor in this paragraph (c).

Example 2. The facts are the same as in *Example 1*, except that Employer C also operates a trucking company that constitutes another separate line of business of Employer C under § 1.414(r)-3. Because the commercial airline and the trucking company both provide to customers of Employer C services in the transportation equipment and services industry category, neither separate line of business satisfies the safe harbor in this paragraph (c).

Example 3. Among its other business activities, Employer D operates a commercial bank and luxury hotel that together constitute a single separate line of business under § 1.414(r)-3. No other separate line of business of employer D provides to customers of Employer D property or services in either the banking, insurance, or financial industry category, or the entertainment, sports, or hotel industry category. Under these facts, the separate line of business described in this example satisfies the safe harbor in this paragraph (c).

Example 4. The facts are the same as in *Example 3*, except that Employer D also manufactures computers in the United States and abroad. Employer D apportions its computer operations by designating these operations between two separate lines of business, one consisting of its domestic operations located in the United States and the second consisting of its foreign operations by a foreign subsidiary. Because both lines of business provide property and services in the machinery and electronics industry category to customers of Employer D, neither separate line of business would satisfy the safe harbor in this paragraph (c). However, pursuant to the optional rule in paragraph (c)(2) of his section, Employer D disregards the property and services provided by its foreign computer subsidiary. As a result, no other separate line of business of Employer D provides to customers of Employer D any property or services in the machinery and electronics industry category. Under these facts, Employer D's domestic computer operations separate line of business satisfies the safe harbor in this paragraph (c).

(d) *Safe harbor for separate lines of business that are acquired through certain mergers and acquisitions—(1) General rule.* A portion of the employer that is acquired through a transaction described in section 410(b)(6)(C) and § 1.410(b)-2(f) (i.e., an asset or stock acquisition, merger, or other similar transaction involving a change in the employer of the employees of a trade or business) (the “acquired line of business”) satisfies the safe harbor in this paragraph (d) for each testing year in the transition period provided in para-

graph (d)(3) of this section if each of the following requirements is satisfied—

(i) For each testing year within the transition period the employer designates the acquired line of business as a line of business within the meaning of § 1.414(r)-2;

(ii) On the first testing day in each testing year in the transition period:

(A) The acquired line of business constitutes a separate line of business within the meaning of § 1.414(r)-3 (taking into account § 1.414(r)-1(d)(4));

(B) No more than 10 percent of the employees who are substantial-service employees with respect to the acquired line of business were substantial-service employees with respect to a different separate line of business for the immediately preceding testing year; and

(C) No more than 10 percent of the employees who were substantial-service employees with respect to the acquired line of business for the immediately preceding testing year are substantial-service employees with respect to a different separate line of business in the respective testing year.

(iii) If the transaction described in paragraph (d)(1) of this section occurs after the first testing day in a testing year, the determinations required by paragraphs (d)(1)(ii) (B) and (C) of this section with respect to that testing year are made as of the date of the transaction.

(2) *Employees taken into account.* For purposes of this paragraph (d), the employees taken into account are the same employees who are taken into account for purposes of applying section 410(b) with respect to the first testing day. For this purpose, employees described in section 410(b)(3) and (b)(4) are excluded. However, section 410(b)(4) is applied with reference to the lowest minimum age requirement, and with reference to the lowest service requirement applicable under any plan of the employer that benefits employees of the separate line of business, as if all the plans were a single plan under § 1.410(b)-6(b)(2). The employees of the separate line of business are determined by applying § 1.414(r)-7 to the employees taken into account under this paragraph (d)(2).

(3) *Transition period.* The transition period for purposes of this safe harbor is the period that begins with the first testing year beginning after the date that the transaction described in paragraph (d)(1) of this section occurs. The employer is permitted, but not required, to extend the transition period to include one, two, or three of the testing years immediately succeeding that first testing year.

(4) *Examples.* The following examples illustrate the application of the safe harbor in this paragraph (d).

Example 1. Employer E is treated as operating three qualified separate lines of business pursuant to § 1.414(r)-1(b). In 1996, Employer E acquires a company that employs 4,000 employees who manufacture and sell pharmaceutical supplies, and designates that portion as a line of business under § 1.414(r)-2. Under § 1.414(r)-1(d)(4), the pharmaceutical supplies line of business is deemed to satisfy the requirements to be a qualified separate line of business (other than the 50-employee and notice requirements) for testing year 1996. In addition, the determination of whether Employer E's remaining three lines of business constitute qualified separate lines of business for testing year 1996 is made without taking into account the acquired employees and by disregarding the property and services provided to customers of Employer E by the pharmaceutical supplies line of business.

Example 2. The facts are the same as in *Example 1* except that, by the first testing day in 1997 (Transition Year 1), there are 300 additional substantial-service employees with respect to the pharmaceutical supplies line of business, increasing the total number to 4,300. Of those 300 employees, 250 were substantial-service employees with respect to a different separate line of business for testing year 1996 and 50 are new hires. Assume that, on the first testing day in Transition Year 1, the pharmaceutical supplies line of business satisfies the requirements of § 1.414(r)-3 (taking into account § 1.414(r)-1(d)(4)) and therefore constitutes a separate line of business. Because 250 is 6 percent of 4,300, no more than ten percent of the employees who are substantial-service employees with respect to the pharmaceutical supplies line of business were substantial-service employees with respect to a different separate line of business for the immediately preceding testing year. The 50 newly hired employees are disregarded in making this determination. Under these facts, the pharmaceutical supplies separate line of business satisfies the safe harbor in this paragraph (d) for Transition Year 1.

Example 3. The facts are the same as in *Example 2*, except that, before the first day of the next testing year ("Transition Year 2"), Employer E permanently transfers 200 of the 4,300 employees who were substantial-service employees with respect to the pharmaceutical line of business on the first testing day in Transition Year 1 to a different line of business and does not hire any additional employees for the pharmaceutical supplies line of business. Therefore, by the first testing day in Transition Year 2, the number of employees who are substantial-service employees with respect to the pharmaceutical line of business of Employer E has decreased from 4,300 to 4,100. Assume that, on that first testing day in Transition Year 2, the pharmaceutical supplies line of business constitutes a separate line of business within the meaning of § 1.414(r)-3. Because 200 is approximately 5 percent of 4,300, no more than 10 percent of the employees who were substantial-service employees of the pharmaceutical line of business for Transition Year 1 are not substantial-service employees of the pharmaceutical line of business in Transition Year 2. Under these facts, the pharmaceutical supplies separate line of business continues to satisfy the safe harbor in this paragraph (d) for Transition Year 2.

(e) *Safe harbor for separate lines of business reported as industry segments—*

(1) *In general.* A separate line of business satisfies the safe harbor in this paragraph (e) for the testing year if, for the employer's fiscal year ending latest in the testing year, the separate line of business is reported as one or more industry segments on its annual report required to be filed in conformity with either—

(i) Form 10-K, annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 ("Form 10-K"); or

(ii) Form 20-F, Annual Report Pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 with Item 18 financials ("Form 20-F"), and the employer timely files either the Form 10-K or Form 20-F with the Securities and Exchange Commission ("SEC").

(2) *Reported as an industry segment in conformity with Form 10-K or Form 20-F.* For purposes of this paragraph (e), a separate line of business is reported as one or more industry segments in conformity with either Form 10-K or Form 20-F only if—

(i) The separate line of business consists of one or more industry segments within the meaning of paragraphs 10(a),

11(b), and 12 through 14 of the Statement of Financial Accounting Standards No. 14, Financial Reporting for Segments of a Business Enterprise (“FAS 14”); and

(ii) The property or services provided to customers of the employer by the separate line of business (as designated by the employer for the testing year under § 1.414(r)-2) is identical to the property or services provided to customers of the employer by the industry segment or segments (as determined under paragraphs 10(a), 11(b), and 12 through 14 of FAS 14).

(3) *Timely filing of Form 10-K or Form 20-F.* For purposes of this paragraph (e), a Form 10-K of Form 20-F is timely filed with the SEC if it is filed within the required period as provided under 17 CFR 240.12b-25(b)(2)(ii). Therefore, the required period for timely filing of the Form 10-K is the 90-day period after the end of the fiscal year covered by the annual report (including the 15-day extension), and the required period for timely filing of the Form 20-F is the 6-month period after the end of the fiscal year covered by the annual report (including the 15-day extension).

(4) *Examples.* The following examples illustrate the application of the safe harbor in this paragraph (e).

Example 1. Among its other business activities, Employer F operates a bearing manufacturing firm that constitutes a separate line of business under § 1.414(r)-3. Employer F is required to file an annual Form 10-K with the SEC. On its timely filed Form 10-K, Employer F reports its bearing manufacturing operations as an industry segment in accordance of FAS 14 (as determined under paragraphs 10(a), 11(b), and 12 through 14 of FAS 14). The group of bearing products provided by the separate line of business (as designated by Employer F under § 1.414(r)-2) is identical to the group of bearing products provided by the industry segment (as determined under paragraphs 10(a), 11(b), and 12 through 14 of FAS 14). Under these facts, the separate line of business described in this example satisfies the safe harbor in this paragraph (e).

Example 2. The facts are the same as in *Example 1*, except that Employer F has apportioned its bearing manufacturing operations between two separate lines of business as determined under § 1.414(r)-3, one engaged in the manufacture of bearings for use in the automotive industry, and a second engaged in the manufacture of bearings for use in the aerospace industry. Because neither separate

line of business provides a group of property or services to customers of Employer F that is identical to the group of bearing products provided by the industry segment reported on Employer F’s annual Form 10-K, neither separate line of business described in this example satisfies the safe harbor in this paragraph (e).

(f) *Safe harbor for separate lines of business that provide the same average benefits as other separate lines of business—(1) General rule.* A separate line of business satisfies the safe harbor in this paragraph (f) for the testing year only if the level of benefits provided to employees of the separate line of business satisfies paragraph (f)(2) or (f)(3) of this section, whichever is applicable.

(2) *Separate lines of business with a disproportionate number of nonhighly compensated employees—(i) Applicability of safe harbor.* This paragraph (f)(2) applies to a separate line of business that for the testing year has a highly compensated employee percentage ratio of less than 50 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement.* A separate line of business satisfies this paragraph (f)(2) only if the actual benefit percentage of the group of nonhighly compensated employees of the separate line of business for the testing period that ends with or within the testing year is at least as great as the actual benefit percentage of the group of all other nonhighly compensated employees of the employer for the same testing period. See § 1.410 (b)-5(c) and (d)(3)(ii) for the definitions of actual benefit percentage and testing period, respectively. In determining actual benefit percentages for purposes of this paragraph (f)(2)(ii), the special rule in § 1.410(b)-5(e)(3) (permitting an employer to determine employee benefit percentages separately for defined contribution and defined benefit plans) may not be used.

(3) *Separate lines of business with a disproportionate number of highly compensated employees—(i) Applicability of safe harbor.* This paragraph (f)(3) applies to a separate line of business that for the testing year has a highly compensated employee percentage ratio of more than 200 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement.* A separate line of business satisfies this paragraph (f)(3) only if the actual benefit percentage of

the group of highly compensated employees of the separate line of business for the testing period that ends with or within the testing year is no greater than the actual benefit percentage of the group of all other highly compensated employees of the employer for the same testing period. See § 1.410 (b)-5(c) and (d)(3)(ii) for the definitions of actual benefit percentage and testing period, respectively. In determining actual benefit percentages for purposes of this paragraph (f)(3)(ii), the special rule in § 1.410(b)-5(e)(3) (permitting an employer to determine employee benefit percentages separately for defined contribution and defined benefit plans) may not be used.

(4) *Employees taken into account.* An employee of a separate line of business (as determined under § 1.414(r)-7) is taken into account for a testing period for purposes of this paragraph (f) only if the employee is an employee of the separate line of business on the first testing day, and would not be an excludable employee for purposes of applying the average benefit percentage test of § 1.410(b)-5 to a plan for a plan year included in that testing period. In determining whether an employee is an excludable employee for purposes of the average benefit percentage test, the employer is assumed not to be operating qualified separate lines of business under § 1.414(r)-1(b). An employee is treated as a highly compensated employee for purposes of this paragraph (f) if the employee is treated as a highly compensated employee for purposes of applying section 410(b) on the first testing day. See § 1.414(r)-11(b)(7) for the definition of "first testing day".

(5) *Example.* The rules of this paragraph (f) are illustrated by the following example.

Example. (i) Employer G is treated as operating two separate lines of business, Line 1 and Line 2, in accordance with § 1.414(r)-1(b). Employer G maintains three qualified plans. Plan A is a calendar-year profit-sharing plan that benefits all employees of Employer G. Plan B is a defined benefit plan with a plan year ending March 31 that benefits all employees of Line 1. Plan C is a defined benefit plan with a plan year ending November 30 that benefits all employees of Line 2.

(ii) In 1995, Line 1 has a highly compensated employee percentage ratio of 25 percent. Employer G's first testing day is

March 31. After applying the rules of § 1.414(r)-7, the nonhighly compensated employees of Line 1 and Line 2 on March 31, 1995, are N1-N80 and N81-N100, respectively. N1 is an excludable employee under § 1.410(b)-6 for purposes of the average benefit percentage test during the testing period that includes the plan years of Plans A, B, and C that end in 1995 (the "1995 testing period"), and would therefore not be taken into account in determining whether any of those plans satisfied the average benefit percentage test of § 1.410(b)-5 for plan years included in that testing period, because N1 does not satisfy the minimum age and service conditions under any plan of the employer. All other employees of Line 1 and Line 2 on March 31, 1995 are nonexcludable employees for purposes of the average benefit percentage test during the 1995 testing period.

(iii) In order for Line 1 to satisfy the requirements of this paragraph (f) for 1995, the actual benefit percentage of N2-N80 for the 1995 testing period under Plans A, B and C must be at least as great as the actual benefit percentage of N81-N100 for the same testing period under the same plans. N1 is not taken into account because N1 is an excludable employee for purposes of the average benefit percentage test for the 1995 testing period. Any other employees who were taken into account for purposes of the average benefit percentage test for the 1995 testing period are excluded because they are not employees of Line 1 or Line 2 on March 31, 1995.

(g) *Safe harbor for separate lines of business that provide minimum or maximum benefits.* —(1) *In general.* A separate line of business satisfied the safe harbor in this paragraph (g) for the testing only if the level of benefits provided to employees of the separate line of business satisfies paragraph (g)(2) or (g)(3) of this section, whichever is applicable. For this purpose, the level of benefits is determined with respect to all qualified plans of the employer that benefit employees of the separate line of business for plan years that begin in the testing year.

(2) *Minimum benefit required*—(i) *Applicability.* This paragraph (g)(2) applies to a separate line of business that for the test year has a highly compensated employee percentage ratio of less than 50 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement.* A separate line of business satisfies this paragraph (g)(2) only if one of the following requirements is satisfied—

(A) At least 80 percent of all nonhighly compensated employees of the

separate line of business either accrue a benefit for the plan year that equals or exceeds the defined benefit minimum in paragraph (g)(2)(iii) of this section, receive all allocation for the plan year that equal or exceeds the defined contribution minimum in paragraph (g)(2)(iv) of this section, or accrue a benefit and receive an allocation that together equal or exceed the combined plan minimum in paragraph (g)(4) of this section. The defined benefit minimum must be provided in a defined plan, and the defined contribution minimum must be provided in a defined contribution plan.

(B) The separate line of business would satisfy the requirements of paragraph (g)(2)(ii)(A) of this section if the 80 percent threshold were reduced to 60 percent, and the average of the accrual rates or allocation rates of all non-highly compensated employees in the separate line of business equals or exceeds the minimum amount described for each individual employee in paragraph (g)(2)(ii)(A) of this section.

(iii) *Defined benefit minimum*—(A) *In general.* The defined benefit minimum for a plan year is the employer-derived accrual that would result in a normal accrual rate for the plan year equal to 0.75 percent of compensation. For purposes of this paragraph (g)(2)(iii), the normal accrual rate is the percentage (not less than 0) determined by subtracting the employee's normalized accrued benefit as of the end of the prior plan year (expressed as a percentage of average annual compensation as of the end of the prior plan year) from the employee's normalized accrued benefit as of the end of the plan year (expressed as a percentage of average annual compensation as of the end of the plan year).

(B) *Normal form and equivalent benefits.* The benefit that is tested for purposes of this paragraph (g)(2)(iii) is the accrued retirement benefit commencing at normal retirement age. If the normal form of benefit for a plan being tested is other than a straight life annuity beginning at a normal retirement age of 65, the benefit must be normalized (within the meaning of § 1.401(a)(4)-12) to a straight life annuity commencing at age 65. No adjustment is permitted for early retirement

benefits or for any ancillary benefit, including disability benefits.

(C) *Compensation definition.* The underlying definition of compensation used for purposes of determining accrual rates under this paragraph (g)(2)(iii) must be a definition of compensation that automatically satisfies section 414(s) without a test for non-discrimination (see § 1.414(s)-1(c)).

(D) *Average compensation requirement.* For purposes of determining accrual rates, compensation must be average annual compensation within the meaning of § 1.401(a)(4)-3(e)(2) determined using a five-year averaging period. The compensation history to be taken into account are all years beginning with the first year in which the employee benefits under the plan, and ending with the last plan year in which the employee participates in the plan. However, a plan may disregard in a reasonable and consistent manner: years before the effective date of these regulations as set forth in § 1.414(r)-1(d)(9)(i), years more than 10 years preceding the current plan year, and years for which the employer does not use this paragraph (g)(2) to satisfy this safe harbor with respect to the separate line of business. If a plan provides a defined benefit minimum that uses three consecutive years (in lieu of five) for calculating average annual compensation, the 0.75 percent annual accrual in paragraph (g)(2)(iii)(A) of this section is multiplied by 93.3 percent, resulting in a normal accrual rate equal to 0.70 percent. If a plan provides a defined benefit minimum that uses more than five consecutive years for calculating average annual compensation or the plan is an accumulation plan as defined in § 1.401(a)(4)-12, the 0.75 percent annual accrual rate in paragraph (g)(2)(iii)(A) of this section is multiplied by 133.3 percent, resulting in a normal accrual rate equal to 1.0 percent.

(E) *Special rules.* The special rules of § 1.401(a)(4)-3(f) apply for purposes of determining whether a benefit accrual satisfies the minimum benefit requirement. For example, benefits may be determined on other than a plan year basis as permitted by § 1.401(a)(4)-3(f)(6). A plan described in section 412(i)

may be used to provide the defined benefit minimum described in this paragraph (g)(2). In such case, the rules in § 1.416-1, M-17, apply to such a plan. For purposes of this paragraph (g)(2)(iii) an employee is treated as accruing a benefit equal to the minimum benefit in paragraph (g)(2)(iii)(A) of this section if the reason that the employee does not accrue such a benefit is either—

(1) The application of a plan provision that applies uniformly to all employees in the plan and limits the service used for purposes of benefit accrual to a specified maximum no less than 25 years, or

(2) The employee has attained normal retirement age and fails to accrue a benefit solely because of the provisions of section 411(b)(1)(H)(iii) regarding adjustments for delayed retirement.

(iv) *Defined contribution minimum*—(A) *In general.* The defined contribution minimum for a plan year is an allocation that results in an allocation rate for the plan year (within the meaning of § 1.401(a)(4)-2(c)) equal to three percent of an employee's plan year compensation. Plan year compensation must be based on a definition of compensation that automatically satisfies section 414(s) without a test for non-discrimination (see § 1.414(s)-1(c)). For this purpose, allocations that are taken into account to do not include matching contributions described in § 1.401(m)-1(f)(12), elective contributions described in § 1.401(k)-1(g)(3), any adjustment in allocation rates permitted under section 401(l) or imputed disparity under § 1.401(a)(4)-7.

(B) *Modified allocation definition for averaging.* For purposes of determining whether the average allocation rates for all nonhighly compensated employees of the separate line of business satisfy the minimum benefit requirement in paragraph (g)(2)(ii)(B) of this section, matching contributions described in § 1.401(m)-1(f)(12) are treated as employer allocations.

(3) *Maximum benefit permitted*—(i) *Applicability.* This paragraph (g)(3) applies to a separate line of business that for the testing year has a highly compensated employee percentage ratio that exceeds 200 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement.* A separate line of business satisfies this paragraph (g)(3) only if one of the following requirements is satisfied—

(A) No highly compensated employee of the separate line of business accrues a benefit for the plan year that results in an accrual rate that exceeds the defined benefit maximum in paragraph (g)(3)(iii) of this section, receives an allocation that exceeds the defined contribution maximum in paragraph (g)(3)(iv) of this section, or accrues a benefit and receives an allocation that together exceed the combined plan maximum in paragraph (g)(4) of this section. All benefits provided by qualified defined benefit plans are subject to the defined benefit maximum, and all benefits provided by qualified defined contribution plans are subject to the defined contribution maximum.

(B) The average of the accrual rates or allocation rates of all highly compensated employees of the separate line of business is no more than 80 percent of the maximum amount described for any individual employee in paragraph (g)(3)(ii)(A) of this section.

(iii) *Defined benefit maximum*—(A) *In general.* The defined benefit maximum is the employer-derived accrued benefit that would result from calculating a normal accrual rate equal to 2.5 percent of compensation.

(B) *Determination of defined benefit maximum.* The accrual rate used for the defined benefit maximum is determined in the same manner as the normal accrual rate used for the defined benefit minimum is determined under paragraph (g)(2)(iii) of this section, except as provided below. Thus, a defined benefit plan may provide, in addition to the defined benefit maximum, any benefit the value of which is not taken into account under paragraph (g)(2)(iii) of this section. For example, a plan may provide qualified disability benefits described in section 411(a)(9) or ancillary benefits described in § 1.401(a)(4)-4(e)(2).

(C) *Adjustment for different compensation definitions.* If a plan subject to the defined benefit maximum determines accrual rates by using three consecutive years (in lieu of five) for purposes

of determining average annual compensation, the 2.5 percent annual accrual rate in paragraph (g)(3)(iii)(B) of this section is multiplied by 93.3 percent, resulting in a maximum accrual rate equal to 2.33 percent. Compensation may be less inclusive than the compensation described in paragraph (g)(2)(iii)(C) of this section. However, no adjustment is made to the maximum normal accrual rate because of the use of a definition of compensation that is less inclusive than the compensation described in paragraph (g)(2)(iii)(C) of this section. In addition, no adjustment is made to the maximum normal accrual rate because the plan uses more than five consecutive years for calculating average annual compensation or the plan is an accumulation plan as defined in § 1.401(a)(4)-12.

(D) *Adjustment for certain subsidies.* If the plan provides subsidized optional forms of benefit, the accrual rate for purposes of this paragraph (g)(3) must be determined by taking those subsidies into account. An optional form of benefit is considered subsidized if the normalized optional form of benefit is larger than the normalized normal retirement benefit under the plan. In the case of a plan with subsidized optional forms, the determination of accrual rate for the plan year under paragraph (g)(2)(iii)(A) of this section is the percentage (not less than 0) determined by subtracting the largest of the sums of the employee's normalized QJSAs and QSUPPs determined for each age under § 1.401(a)(4)-3(d)(1)(ii) as of the end of the prior plan year (expressed as a percentage of average annual compensation as of the end of the prior plan year) from the largest of the sums of the employee's normalized QJSAs and QSUPPs determined for each age under § 1.401(a)(4)-3(d)(1)(ii) as of the end of the plan year (expressed as a percentage of average annual compensation as of the end of the plan year).

(iv) *Defined contribution maximum.* The defined contribution maximum is an allocation that results in an allocation rate for the plan year (within the meaning of § 1.401(a)(4)-2(c)) equal to 10 percent of an employee's plan year compensation. Compensation may be

less inclusive than the compensation described in paragraph (g)(2)(iv)(A) of this section. However, no adjustment is made to the defined contribution maximum because of the use of a definition of compensation that is less inclusive than the compensation described in paragraph (g)(2)(iv)(A) of this section. For this purpose, allocations that are taken into account do not include elective contributions described in § 1.401(K)-1(g)(3), any adjustment in allocation rates permitted under section 401(l) or imputed disparity under § 1.401(a)(4)-7 but do include employer matching contributions under § 1.401(m)-1(f)(12).

(4) *Duplication of benefits or contributions—(i) Plans of the same type.* In the case of an employee who benefits under more than one defined benefit plan, the defined benefit minimum required or the defined benefit maximum permitted under this paragraph (g) is determined by reference to the employee's aggregate employer-provided benefit under all qualified defined benefit plans of the employer. In the case of an employee who benefits under more than one defined contribution plan, the defined contribution minimum required or the defined contribution maximum permitted under this paragraph (g) is determined by reference to the employee's aggregate employer-provided allocations under all qualified defined contribution plans of the employer.

(ii) *Plans of different types.* In the case of an employee who benefits under both a defined benefit plan and a defined contribution plan, a percentage of the minimum benefit required or the maximum benefit permitted under this paragraph (g) may be provided in each type of plan as long as the combined percentage equals at least 100 percent in the case of the minimum benefit required and does not exceed 100 percent in the case of the maximum benefit permitted. Thus, for example, if a highly compensated employee benefits under both types of plans and accrues an aggregate adjusted normal accrual rate equal to 1.25 percent of average annual compensation under all defined benefit plans of the employer (i.e., 50 percent of the defined benefit maximum described in paragraph (g)(3)(iii)

of this section), in order to comply with the maximum benefit safe harbor, the employee may not receive an aggregate allocation under all defined contribution plans of the employer in excess of five percent of plan year compensation (i.e., 50 percent of the defined contribution maximum described in paragraph (g)(3)(iv) of this section).

(iii) *Special rule for floor-offset arrangements.* In the case of a floor-offset arrangement (as described in § 1.401(a)(4)-8(d)), the minimum or maximum benefit rules are applied to each plan as if the other plan did not exist. Thus, the defined benefit plan must provide at least 100 percent of the defined benefit minimum (or no more than 100 percent of the defined benefit maximum) based on the gross benefit prior to offset, and the defined contribution plan must provide at least 100 percent of the defined contribution minimum (or no more than 100 percent of the defined contribution maximum).

(5) *Certain contingency provisions ignored.* For purposes of this paragraph (g), an employee's accrual or allocation rate is determined without regard to any minimum benefit or any maximum benefit limitation that is applicable to the employee only if the separate line of business fails otherwise to satisfy the requirement of administrative scrutiny.

(6) *Employees taken into account.* For purposes of this paragraph (g), an employee is taken into account if the employee is taken into account for purposes of applying section 410(b) with respect to any testing day for the testing year. For this purpose, employees described in section 410 (b)(3) and (b)(4) are excluded. However, section 410(b)(4) is applied with reference to the lowest minimum age requirement applicable, and with reference to the lowest service requirement applicable under any plan of the employer that benefits employees of the separate line of business, as if all the plans were a single plan under § 1.410(b)-6(b)(2). For purposes of the minimum benefit requirement of paragraph (g)(2) of this section, section 410(b)(4) may be applied with reference to the lowest minimum age requirement, and with reference to the lowest minimum service requirement, applicable under any plan of the employer

that benefits highly compensated employees of the separate line of business, as if all the plans were a single plan under § 1.410(b)-6(b)(2), or, if no plan of the employer benefits highly compensated employees of the separate line of business, with reference to the greatest age and service requirements permitted under section 410(a)(1)(A). The employees of the separate line of business are determined by applying § 1.414(r)-7 to the employees taken into account under this paragraph (g)(6). An employee is treated as a highly compensated employee for purposes of this paragraph (g) if the employee is treated as a highly compensated employee for purposes of applying section 410(b) on any testing day for the testing year. For the definition of "testing day," see § 1.414(r)-11(b)(6).

[T.D. 8376, 56 FR 63446, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32919, June 27, 1994]

§ 1.414(r)-6 Qualified separate line of business—administrative scrutiny requirement—individual determinations.

(a) *In general.* A separate line of business (as determined under § 1.414(r)-3) that does not satisfy any of the safe harbors in § 1.414(r)-5 for a testing year nonetheless satisfies the administrative scrutiny requirement of § 1.414(r)-1(b)(2)(iv)(D) if the employer requests and receives from the Commissioner an individual determination under this section that the separate line of business satisfies the requirement of administrative scrutiny for the testing year. This section implements the individual determinations provided for under section 414(r)(2)(C). The Commissioner shall issue such an individual determination only when it is consistent with the purpose of section 414(r), taking into account the non-discrimination requirements of sections 401(a)(4) and 410(b). Paragraph (b) of this section authorizes the Commissioner to establish procedures for requesting and granting individual determinations.

(b) *Authority to establish procedures.* The Commissioner may, in revenue rulings and procedures, notices, and other guidance, published in the Internal Revenue Bulletin (see