

Employee Benefit Plans

Explanation No. 5A Safe Harbor Nondiscrimination Requirements Defined Benefit Plans

Note:

Plans submitted during the 2020 Required Amendment List submission period must satisfy the applicable changes in plan qualification requirements listed in Section IV of Notice 2020-83, 2020-50 I.R.B. 1597 (the 2020 RA List).

The Service's review of a determination letter application for a plan will not consider, and a determination letter may not be relied on with respect to, whether the plan satisfies the requirements of section 401(a)(4) (except as provided below), 401(a)(26), or 410(b).

However, for an individually-designed plan the Service will determine whether a plan's benefit formula satisfies the requirements of a nondiscriminatory design-based safe harbor under 1.401(a)(4)-3(b).

This publication is to be used in conjunction with:
Form 9638, Worksheet 5A
Form 9640, Deficiency Checksheet 5A

These forms are included as examples only and should not be completed and returned to the Internal Revenue Service.

The purpose of Form 9638, Worksheet Number 5A and this explanation is to determine whether a defined benefit plan satisfies the nondiscrimination safe harbor requirements of section 1.401(a)(4)-3(b)(3) of the Regulations and associated requirements such as the nondiscriminatory compensation requirements of section 414(s). (Certain related requirements, such as the limitation on compensation under section 401(a)(17) of the Code, are addressed in other worksheets.)

If the plan is intended to satisfy safe harbor requirements of section 1.401(a)(4)-3(b)(3) of the Regulations and the plan provides for permitted disparity, Worksheet Number 5B may be used to determine whether the disparity satisfies the requirements of section 401(l) of the Code

Generally, a "Yes" answer to a question on the worksheet indicates a favorable conclusion while a "No" answer signals a problem concerning plan qualification. This rule may be altered by specific instructions for a given question. Please explain any "No" answer in the space provided on the worksheet.

References at the end of each paragraph in the explanation are to the Internal Revenue Code and the Income Tax Regulations unless otherwise noted.



The technical principles in this publication may be changed by future regulations or guidelines.

I. Design-Based Safe Harbors

This part of the worksheet deals with the safe harbor requirements of section 1.401(a)(4)-3(b) of the Regulations. Satisfaction of the safe harbor requirements under section 1.401(a)(4)-3(b) does not mean that the plan complies with all of the requirements of IRC section 401(a)(4).

Line a. The determination letter application requires that the employer must indicate whether the plan is intended to satisfy one of the design-based safe harbors under the section 401(a)(4) regulations, and whether the employer elects to have the plan reviewed to determine if it meets the safe harbor requirements. A design-based safe harbor allows for a determination that the plan, by design, satisfies the nondiscrimination in amount requirement of 1.401(a)(4)-1(b)(2) but is not a determination whether the plan satisfies the requirements of 1.401(a)(4)-1(b)(3) and (4). The remainder of the worksheet should be completed only in the case of design-based safe harbor plans.

Line b. In order to satisfy any of the defined benefit safe harbors, a defined benefit plan must generally satisfy certain uniformity requirements.

- 1) **Uniform Normal Retirement Benefit:** All employees in the plan are subject to the same benefit formula providing the same annual benefit payable in the same form commencing at the same uniform normal retirement age. Under the formula, the annual benefit is the same percentage of average annual compensation or the same dollar amount for all employees with the same years of service at NRA.

(In the case of an employee continuing in service past NRA, the employee's benefit at any later age (prior to any actuarial increase for late retirement) must equal the benefit (as a percentage of average annual compensation or as a dollar amount) payable to an employee commencing to receive benefits at NRA with the same number of years of service.)

Because social security retirement age (SSRA) is a uniform retirement age under section 401(a)(5)(F), differences in employees' benefits that are attributable solely to differences in such employees' SSRAs will not cause a plan to fail to be a safe harbor plan.

If the benefit formula is based on average annual compensation, the compensation formula must be uniform for all employees and nondiscriminatory under section 414(s) (see Part III). In addition, the formula must base benefits on a period of at least three consecutive 12-month periods, or the participant's entire period of service if shorter, during which the employee's average section 414(s) compensation was the highest. (If the plan does not provide for permitted disparity and does not base average compensation, for purposes of calculating benefits, on consecutive 12-month periods, the "consecutive" requirement for average annual compensation does not apply.)

In determining average annual compensation, the plan must look to the employee's compensation history for a continuous period that ends in the current plan year and is no shorter than the averaging period. The plan can disregard 12-month periods in which the employee terminates employment, performs no service, or performs service for a number of hours that is less than a number of hours specified by the employer (not to exceed 3/4 of full-time hours for the 12-month period.) Similar rules allow months to be disregarded when average annual compensation uses 12-month periods that do not end on a fixed date, such as the 60 consecutive months producing the highest average.

If the plan is an accumulation plan, it may use plan year compensation instead of average annual compensation. An accumulation plan (also referred to as a career average plan) separately calculates the compensation and benefit each year and then totals the benefit. Plan year compensation is section 414(s) compensation for the plan year or a 12-month period ending within the plan year. For the year in which participation in the plan begins or ends, the plan may limit plan year compensation to the period of participation provided the plan year is also the period for determining accruals and the use of period of participation is done in a nondiscriminatory and reasonably consistent manner from year to year.

- 2) **Uniform Subsidies:** All subsidized optional forms of benefit under the plan (other than those that have been prospectively eliminated) are available to substantially all employees in the plan, determined using current availability criteria. (A plan that provides an early retirement window benefit may fail this requirement. However, in this case it may be possible to restructure the plan so that each restructured component separately satisfies the current year availability criteria and the other safe harbor requirements.)
- 3) **Contributory plans:** If the plan is a contributory plan, it meets the requirements in Part II of the worksheet.
- 4) **Accrual period:** The years of service over which the benefit accrues are the same as those taken into account under the plan's benefit formula.
1.401(a)(4)-3(b)(2) and (6)
1.401(a)(4)-3(e)

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A plan will not fail to satisfy a safe harbor merely because:

- 1) The plan provides for permitted disparity in a manner that satisfies section 401(l) and Worksheet 5B.
- 2) Accruals are limited in accordance with section 415, or the plan provides for increases in accrued benefits based solely on adjustments to the dollar limit under section 415(b)(1).

- 3) Accruals are limited to a maximum dollar amount or a maximum percentage of compensation, or the amount of compensation or service taken into account is limited, provided these limits apply uniformly to either all employees or only to some or all highly compensated employees.
- 4) Employees receive reduced accruals for less than a full year of service of participation.
- 5) The plan has one or more entry dates during the plan year.
- 6) The plan determines benefits for service after a fresh-start date for all employees under a benefit formula or accrual method that differs from the formula or method previously used to determine benefit accruals for employees in a fresh-start group for service before the fresh-start date, provided the plan satisfies the fresh-start rules in the regulations (see line c.). This, for example, allows a non-safe harbor plan to transition into a safe harbor.
- 7) The plan provides that an employee's benefit is the greater of, or the sum of, two or more formulas, each of which satisfies the safe harbor. Formulas that are available solely to some or all nonhighly compensated employees, but not available to any highly compensated employees, fall within this exception, as do the following types of top-heavy formulas: formulas available solely to all non-key employees on the same terms as other formulas and formulas conditioned on the plan being top-heavy.
- 8) The plan provides benefits to highly compensated employees that are inherently less valuable than the benefits provided to nonhighly compensated employees.
- 9) The plan provides a subsidized optional form of benefit that is available to fewer than substantially all employees because the optional form of benefit has been eliminated prospectively.
1.401(a)(4)-3(b)(6)

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Certain other special rules may apply to particular plans intended to satisfy a safe harbor. Among these are the following:

- 1) **Early retirement window benefits:** If the plan provides an early retirement window benefit that consists of a temporary change in the plan's benefit formula (i.e., with respect to those electing to retire during the window), the plan must satisfy the safe harbor requirements both taking the temporary change into account and disregarding the change. If such a provision is encountered, the specialist should refer to the example in section 1.401(a)(4)-3(f)(4)(iv) of the regulations that shows how a plan may be restructured to satisfy this requirement.
- 2) **Post-NRA Accruals:** If the plan provides for increases in an employee's accrued benefit solely because of a delay past NRA in commencement of benefits, the increase may be disregarded if the increase factor (percentage) is no greater than the percentage that would be obtained using a standard mortality table and an interest rate between 7.5 percent and 8.5 percent, compounded annually. Thus, where a plan that satisfies all the other safe harbor requirements provides such an increase and offsets the post-NRA accrual by the increase, both the increase and the offset may be disregarded so that the plan will continue to satisfy the safe harbor.

Floor-offset arrangements: If the benefits under the defined benefit plan are offset by benefits under another plan, 1.401(a)(4)-3(f)(9) may allow the offset to be disregarded so that the plan may still satisfy a safe harbor. An offset to the accrued benefit that may be disregarded can be from another defined benefit plan or be the actuarial equivalent of all or part of the account balance attributable to employer contributions under a defined contribution plan maintained by the same employer.

The offset must be for benefits under a qualified DB or DC plan (whether or not terminated), or for benefits under a foreign plan that are reasonably expected to be paid.

Vested benefits may be offset only by other vested nonforfeitable benefits.

- 3) If the plan is a multiemployer plan that includes a requirement to complete up to five years of future service in order to be entitled to an increase in benefits for prior service, this requirement may be disregarded if the requirement applies to all employees in the plan.
1.401(a)(4)-3(f)
Rev. Rul. 76-259

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i. Unit credit safe harbor:

A plan will satisfy the unit credit safe harbor if it meets the following requirements:

- 1) The plan satisfies the 133^{1/3} percent accrual rule (see Alert Guidelines 2A).
- 2) Under the plan, each employee's accrued benefit, as of any plan year, is determined by applying the plan's benefit formula to the employee's years of service and average annual compensation (if applicable) for that plan year.
1.401(a)(4)-3(b)(3)

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ii. Fractional rule unit credit safe harbor:

A plan will satisfy the fractional rule unit credit safe harbor if it meets the following requirements:

- 1) The plan satisfies the fractional accrual rule (see Alert Guidelines 2A).
- 2) Under the plan, each employee's accrued benefit, as of any plan year before NRA, is determined by multiplying the fractional rule benefit by this fraction: years of service as of the plan year over years of service projected to NRA.
- 3) Under the plan, no employee can accrue, in any one year, a part of the normal retirement benefit that is more than one third larger than the benefit that any other employee (or potential employee) could accrue, disregarding employees with projected service of more than 33 years at NRA. Solely for the purpose of this requirement, a plan that provides for permitted disparity may treat participants as having received benefits on all compensation at the excess rate or at the rate prior to application of the offset so that the disparity alone does not cause the plan to fail to meet this requirement. If the plan's unit credit benefit formula does not limit the service taken into account to less than 25 years of credited service, and the formula does not provide for a rate increase after a specified number of years of participation, the plan will satisfy this requirement because 33 years does not exceed $133^{1/3}$ percent of 25 years.
1.401(a)(4)-3(b)(4)(i)(C)(1)

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iii. Fractional rule flat benefit safe harbor:

A plan will satisfy the fractional rule flat benefit safe harbor if it meets the following requirements:

- 1) The plan satisfies the fractional accrual rule (see Alert Guidelines 2A).
- 2) Under the plan, each employee's accrued benefit, as of any plan year before NRA, is determined by multiplying the fractional rule benefit by this fraction: years of service as of the plan year over years of service projected to NRA.
- 3) The plan provides a flat benefit at normal retirement age as a percentage of average annual compensation or a flat dollar amount (e.g., 50 percent of average annual compensation) that is the same for all employees in the plan who have a minimum number of years of service at NRA, with a pro rata reduction in the benefit for employees with less than that minimum number of years of service at NRA. (The definition of years of service for this fraction and for the benefit formula must be the same; e.g., the plan cannot use years of service (including pre-plan participation service) for the benefit formula and years of participation for the accrual.)
- 4) The plan requires at least 25 years of service at NRA for the unreduced flat benefit, determined without regard to the section 415 limitations.

This safe harbor operates to ensure that no employee can accrue the maximum benefit at a rate faster than four percent a year. However, a plan may be designed so that the maximum section 415 benefit accrues over less than 25 years. This is done by having the plan provide for a benefit in excess of the section 415 limits, limiting the accrual of that benefit to four percent a year, and capping the participant's accruals at the section 415 limits.

1.401(a)(4)-3(b)(4)(i)(C)(2)

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iv. Insurance contract plan safe harbor:

A plan will satisfy the fractional rule unit credit safe harbor if it meets the following requirements:

- 1) The plan satisfies the accrual rule of section 411(b)(1)(F) (see Alert Guidelines 2A).
- 2) The plan is an insurance contract plan within the meaning of section 412(e)(3) (see below).
- 3) The benefit formula under the plan would satisfy the fractional rule unit credit or flat benefit safe harbor if the stated normal retirement benefit accrued ratably over each employee's period of plan participation through normal retirement age. The plan's benefit formula may not recognize years of service prior to plan participation unless the plan was adopted and in effect on September 19, 1991, and then only to the extent then provided in the plan and only to employees who participated on or before that date.
- 4) Scheduled premium payments under the contract used to fund the employee's retirement benefit are level annual payments to NRA and may not cease before then.
- 5) Premium payments for an employee who continues to benefit after NRA equal the amount necessary to fund additional benefits that accrue for the plan year.
- 6) Dividends and forfeitures, etc., are used solely to reduce future premiums.
- 7) All benefits are funded through contracts of the same series (e.g., with cash values based on the same terms, including interest and mortality assumptions, and with the same conversion rights). A change in the series or insurer that applies on the same terms to all employees will not violate this rule.

A plan that uses permitted disparity must satisfy the permitted disparity regulations under section 401(l) in order to be a safe-harbor plan (see Worksheet 5B for a special adjustment that applies).

A 412(e)(3) plan is one funded exclusively by insurance contracts providing for level annual premium payments from participation (or benefit increase) through NRA. Plan benefits equal contract benefits at NRA and are guaranteed by a state licensed insurance carrier to the extent premiums have been paid. Premiums are payable before lapse or there is reinstatement of the policy. No contract rights are subject to a security interest and there are no outstanding policy loans.

1.401(a)(4)-3(b)(5)

Line c. In order to satisfy a safe harbor, a defined benefit plan is generally required to provide a uniform normal retirement benefit. See line b.

1). A plan that has a benefit formula and accrual method for service after a given date that is different from the formula and method for service before that date will not fail the safe harbor requirements provided the plan satisfies the fresh-start requirements. Thus, when a defined benefit plan is amended to change its benefit formula or accrual method, benefits that are subsequently accrued under the plan must satisfy the fresh-start rules in order for the plan to satisfy a safe-harbor.

The fresh-start rules operate to freeze the accrued benefit generally as of the last day of the plan year preceding the year in which the new formula or accrual method first applies. (This date is referred to as the fresh-start date and the accrued benefit as of that date is referred to as the frozen accrued benefit. A plan may use a date other than the last day of the plan year as the fresh-start date, provided the plan satisfied a safe harbor from the beginning of the plan year through the fresh-start date, or under certain other circumstances that are described below.) The frozen accrued benefit is then either added to the accruals based on the new formula (or method) as applied to service after the fresh-start date or "worn away" (under one of two methods) by accruals under the new formula as applied to all service.

The fresh-start formula generally must apply to all employees with accrued benefits as of the fresh-start date and an hour of service after that date (the "fresh-start group"). However, the fresh-start group may be limited to:

- 1) section 401(a)(17) employees (see Alert Guidelines #4),
- 2) members of an acquired group of employees, or
- 3) employees with frozen accrued benefits attributable to transferred assets and liabilities.

If the fresh-start is limited to the acquired group, the fresh-start date must be the date selected by the employer as the last date of hire or transfer for employees to be included in the acquired group.

If the fresh-start is limited to employees with transferred benefits, the fresh-start date must be the date on which these employees begin accruing benefits under the plan.

The frozen accrued benefit can be increased to comply with the average compensation requirement of section 416(c)(1)(D)(i), or, if the requirements described below are satisfied, to reflect employees' future compensation increases.

A plan that is required to include a fresh-start formula must contain one of the following formulas for all employees in the fresh-start group:

- 1) Each employee's accrued benefit is equal to the sum of:
 - a) the employee's frozen accrued benefit, and
 - b) the employee's accrued benefit under the new formula as applied to years of service after the fresh-start date.

This is referred to as the formula "without wear away."

- 2) Each employee's accrued benefit is equal to the greater of:
 - a) the employee's frozen accrued benefit, or
 - b) the employee's accrued benefit under the new formula as applied to the employee's total years of service.

This is referred to as the "wear away" formula.

- 3) Each employee's accrued benefit is equal to the greater of:
 - a) the sum determined under formula 1., above or
 - b) the amount described in line b. of formula 2., above

This is referred to as the "extended wear away" formula.

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A plan may adjust a participant's frozen accrued benefit in the preceding formulas to take into account compensation increases after the fresh-start date provided the following conditions are satisfied:

- 1) The plan's benefit formula as of the fresh-start date must have provided for the pre-fresh-start accrued benefits of the employees in the fresh-start group to be adjusted for later compensation (e.g., final average pay plans).

- 2) The plan's terms must provide that the accrued benefits of each employee in the fresh-start group after the fresh-start date be at least equal to the employee's adjusted accrued benefit (see below).
- 3) The group of employees with accrued benefits under the plan on the fresh-start date must have satisfied the minimum coverage requirements as of that date.
- 4) The fresh-start group must satisfy one of the following requirements:
 - a) it must satisfy the minimum coverage requirements for all years from the first year beginning after the fresh-start date through the current year;
 - b) it must have satisfied the minimum coverage requirements for the first five years beginning after the fresh-start date;
 - c) it must have satisfied the ratio percentage test as of the fresh-start date;
 - d) it must have consisted of an acquired group that satisfied minimum coverage as of the fresh-start date; or
 - e) the fresh-start date must have been on or before the effective date of these rules (generally the first day of the 1994 plan year).
- 5) The plan must provide benefit accruals (other than compensation increases to pre-fresh-start accrued benefits) to the fresh-start group at a rate that is meaningful in comparison to the rate of accrual for the fresh-start group in pre-fresh start years.
- 6) If the plan provides for permitted disparity, it must make the minimum benefit adjustment that is described below. This minimum benefit adjustment ensures that the benefit in the fresh-start formula satisfies the 2 to 1 rule of section 401(l).

The adjustment is not needed if the frozen accrued benefit already satisfies section 401(l).

(In most situations, the specialist will not be able to determine that some of the requirements described above, particularly those relating to meaningful coverage, have been satisfied. This is because these requirements pertain to the plan's ongoing operation. Consequently, these requirements need not be considered when making a determination of whether a plan satisfies the fresh-start rules.)

If the plan meets the foregoing requirements, it may substitute for the frozen accrued benefit in the fresh-start formulas the "adjusted accrued benefit." The adjusted accrued benefit is determined as follows:

First, if the plan provides for permitted disparity as of the fresh-start date, make the following adjustment, if necessary:

- 1) in an excess plan, adjust the employee's frozen accrued benefit so that the base benefit percentage is not less than 50 percent of the excess benefit percentage; or
- 2) in a PIA offset plan, adjust each employee's offset so that it does not exceed 50 percent of the benefit determined before the offset.

Second, multiply the frozen accrued benefit (as adjusted in the first step, if applicable) by the following fraction (not less than one):

$$\frac{\text{the employee's compensation for the current plan year}}{\text{the employee's compensation as of the fresh-start date (determined under the same definition)}}$$

Compensation must either be the definition used in determining the frozen accrued benefit or average annual compensation.

Where the fresh-start occurs before the effective date of these rules (generally the first day of the 1994 plan year), the plan may use a different method to adjust the frozen compensation. Under this method, the employee's frozen accrued benefit is multiplied by the following fraction (not less than one):

$$\frac{\text{employee's average annual compensation for current year}}{\text{the employee's reconstructed average annual compensation as of the fresh-start date}}$$

For this purpose, an employee's "reconstructed compensation" is equal to the average annual compensation determined for a pre-1995, post fresh-start date plan year calculated in accordance with the same method which is in effect for the current year, multiplied by a fraction, the numerator of which is the employee's compensation as of the fresh-start date determined under the same compensation definition and formula used to determine the employee's frozen accrued benefit, and the denominator of which is the employee's compensation for the selected post-fresh-start date plan year, determined under the same definition of compensation and formula used to determine the employee's frozen accrued benefit.

Compensation in the above fractions is subject to the annual compensation limit under section 401(a)(17). However, see Alert Guidelines #4 for special rules concerning "section 401(a)(17) employees".

As an alternative to applying the foregoing fractions to determine an employee's adjusted accrued benefit, the plan may use the following "plug-in" method. Under this method, the plan determines the adjusted accrued benefit by substituting in the benefit formula used to determine the frozen accrued benefit the employee's compensation for the current plan year, determined under the same compensation formula and definition used to determine the frozen accrued benefit. This method may be used only if it is reasonable to expect as of the fresh-start date that, over time, the use of this method rather than the fraction method will not discriminate significantly in favor of HCEs.

1.401(a)(4)-13(c) and (d)

II. Employee Contributions Not Allocated To Separate Accounts

Line a. A defined benefit plan that provides for employee contributions not allocated to separate accounts (i.e., a contributory defined benefit plan) will not satisfy a safe harbor unless it would do so if the plan's benefit formula provided benefits at employee's employer-provided benefit rates, as determined under the nondiscrimination regulations. In other words, if the employer-provided benefit would satisfy a safe harbor, the plan will satisfy the safe harbor irrespective of the contributory feature.

Generally, the employer-provided benefit in a contributory plan is to be determined under the rules in section 411(c). See Alert Guidelines #2A. However, the regulations provide several alternative methods that can be used by a safe harbor plan:

- 1) the composition-of-workforce method
- 2) the minimum benefit method
- 3) the grandfather rule
- 4) the government plan method
- 5) the cessation of contributions method

The employer must indicate the method it is using. If the plan is a fractional accrual rule safe harbor plan or an insurance contract plan, only the last three methods may be used. The requirements of each of these methods are as follows:

- 1) In order to satisfy the composition-of-workforce method, the employer must demonstrate that certain demographic and other requirements are satisfied.
- 2) The minimum benefit requirement is satisfied if all employees make contributions at the same rate of plan year compensation and, for plan years beginning after December 31, 1993, each employee accrues a benefit that equals or exceeds the sum of:
 - a) The accrued benefit derived from employee contributions made for plan years beginning after December 31, 1993, determined in accordance with section 411(c), and
 - b) Fifty percent of the participant's total benefit (derived from both employer and employee contributions) accrued in plan years beginning after December 31, 1993 (determined without regard to that portion of the benefit formula designed to satisfy the minimum benefit requirement.)

Note that this is just a minimum benefit. The participant is entitled to his or her vested accrued benefit determined under the plan's benefit formula if greater.

- 3) The grandfather rule, which applies to certain plans with graded employee contribution that were in existence on May 14, 1990 (as well as certain multiple employer plans), is satisfied if the employer demonstrates that the requirements described in line c. are satisfied.
- 4) The government plan method applies to any government plan.
- 5) The cessation of employee contributions method is satisfied if no employee contributions may be made to the plan after the last day of the 1994 plan year.

The determination of the employer-provided benefit under each of these methods is as follows:

- 1) Composition-of-workforce. If the plan is not a section 401(l) plan, treat the entire accrued benefit as employer-provided. If the plan is a section 401(l) plan, see Worksheet 5B.
- 2) Minimum benefit method. If the plan is not a section 401(l) plan, treat the entire accrued benefit as employer-provided. If the plan is a section 401(l) plan, see Worksheet 5B.
- 3) Grandfather method. Subtract from the total benefit the employee-provided benefit determined under a reasonable method in the plan that conforms to the demonstration described in line c.
- 4) Government plan method. Treat the entire accrued benefit as employer-provided.
- 5) Cessation of contributions method. Treat the entire accrued benefit as employer-provided.
1.401(a)(4)-3(b)(6)(viii)
1.401(a)(4)-6(b)

Line b. The employer may use the composition-of-workforce method to determine the employer-provided benefit if employee's make contributions at the same rate (percentage of plan year compensation) and the employer submits a demonstration that the plan satisfies certain demographics requirements

1.401(a)(4)-6(b)(2)

A plan can base allocations or benefits on employees' basic or regular rate of compensation using an:

- hourly pay scale,
- weekly salary, or
- similar unit of basic or regular compensation.

(Rate of compensation may not be used in a definition used for ADP or ACP testing in a section 401(k) or section 401(m) plan.)

A plan could also, for example, define compensation as basic or regular compensation, determined using a rate of compensation, plus irregular or additional compensation. The amount of basic or regular compensation must be determined using the rate of compensation as of a designated date or dates. Also, if the plan does not use the same date to determine employees' rates of compensation, the dates selected must be designed to determine such rates in a consistent manner. An employer may continue to credit an employee who has ceased performing services with compensation based on a rate of compensation for up to 31 days after the event causing the cessation.

A defined benefit plan can include imputed compensation or prior-employer compensation in an alternative definition of compensation. Prior-employer compensation is compensation from another employer credited for periods prior to the employee's employment with the employer. Imputed compensation is compensation credited for periods after commencement of participation in the plan while the employee receives no compensation or reduced compensation because no services or reduced services are performed for the employer. Included in this definition of imputed compensation would be compensation credited while the employee is performing services for a joint venture.

If the employer is including prior-employer or imputed compensation in the plan's definition of compensation,

- the provisions must apply to all similarly situated employees,
- there must be a legitimate business purpose for crediting the service, and
- the provisions must not by design or operation significantly favor highly compensated employees.

A definition of compensation that credits prior-employer compensation or imputed compensation must actually be used to calculate benefits under the plan.

1.414(s)-1(e) and (f)

Line c. The plan must separately satisfy section 401(a)(4) with respect to the amount of employee-provided benefits.

Generally, the plan will satisfy this requirement if the contributions are made at the same rate, as a percentage of compensation, by all employees under the plan.

1.401(a)(4)-6(c)

III. Nondiscriminatory Compensation

Line a. If a design-based safe harbor plan bases benefits or contributions on compensation, it must use a definition of compensation that is nondiscriminatory under section 1.414(s)-1 of the regulations. (The requirement to use a nondiscriminatory definition of compensation would also apply in the case of the definition of compensation that a section 401(k) or 401(m) plan must use in its actual deferral percentage (ADP) or actual contribution percentage (ACP) test.) The regulations contain certain definitions that are automatically nondiscriminatory under section 414(s).

In addition, under certain circumstances a plan may use rate of compensation, imputed compensation, or prior-employer compensation under a definition of compensation that satisfies section 414(s). Section 414(s) and the accompanying regulations provide specific definitions of compensation that satisfy section 414(s). One of the definitions is compensation within the meaning of section 415(c)(3). See Explanation #6 for the full definition of compensation for section 415 purposes, (including other changes that are not reflected in the following summary).

The following definitions of compensation automatically satisfy section 414(s):

- 1) Compensation within the meaning of section 415(c)(3). This definition of compensation includes elective deferrals defined in section 402(g)(3) and amounts deferred under a section 125 cafeteria plan, section 132(f)(4), or under a section 457 plan. Under this definition, a self-employed person's compensation is earned income as defined in section 401(c)(2).
- 2) Wages as defined in section 3401(a) plus all other compensation required to be reported by the employer under sections 6041, 6051 and 6052, or wages as defined in 3401(a), both determined without regard to any rules that limit wages based on the nature or location of employment.
- 3) A safe-harbor definition that starts with 1 or 2, but excludes all of the following: reimbursements or other expense allowances, fringe benefits, moving expenses, deferred compensation, and welfare benefits. This safe harbor generally permits the following definition to fall within the scope of section 414(s): Regular or base salary or wages, plus commissions, tips, overtime and other premium pay, bonuses, and any other item of compensation includible in gross income not listed in the safe-harbor exclusions. If this definition is used, any self-employed individual's compensation is to be limited to earned income multiplied by the percentage of nonhighly compensated employees' total compensation (determined on a group basis) that is included under the plan definition.

1.414(s)-1

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If using an alternative definition of compensation to satisfy 414(s), the plan definition must also be reasonable and not designed to favor highly compensated employees. A definition is reasonable only if it is described in one of the four preceding numbered paragraphs and modified to exclude certain types of irregular or additional compensation or is limited to a dollar amount. For example, a plan's definition of compensation will not fail to satisfy section 414(s) merely because differential wage payments as defined in section 3401(h) are excluded from the plan's definition of compensation for purposes of determining benefits and contributions. (However, see below for rules allowing definitions of compensation that are based on rate of compensation or that include prior-employer compensation or imputed compensation.)

For this purpose, total compensation means compensation based on one of the definitions permissible under section 415(c)(3) (either including or excluding all elective contributions, etc.), limited to the amount described in section 401(a)(17). If the plan's alternative definition excludes amounts from the compensation of some (but not all) highly compensated employees, these amounts must also be excluded from the same employees' total compensation.

The employer may elect to consider either all employees in the plan (other than self-employed individuals) or all employees (other than self-employed individuals) in all the plans that use the same alternative definition of compensation in performing this calculation. Employees who have no total compensation are disregarded for purposes of testing a definition of compensation.

1.414(s)-1(d)

Line b. If the plan is using a definition of compensation permissible under section 415(c)(3), then it must define compensation for any self-employed individual as earned income within the meaning of section 401(c)(2). If the plan is using the alternative safe harbor definition that excludes certain expenses and other items or an alternative definition that requires a demonstration, then the terms of the plan must provide for an equivalent alternative definition for self-employed individuals, determined as follows.

The self-employed individual's earned income (increased by elective contributions, if any of these are included in the plan's alternative definition) is multiplied by the percentage of total compensation (including elective contributions, if any of these are included in the plan's alternative definition) that is included for the group of nonhighly compensated common-law employees. (This calculation is to be performed consistent with the rules for determining whether an alternative definition of compensation is nondiscriminatory, except that highly compensated common-law employees are disregarded.)

The plan's alternative definition may also limit the compensation of some or all self-employed individuals who are also highly compensated employees to a portion of the equivalent compensation.

Specialists are reminded that plans may have multiple definitions of compensation (one for section 415 purposes, one for allocation purposes, etc.). It is only the plan's administrable definition for purposes of providing allocations under the plan that must meet the section 414(s) requirements.

1.414(s)-1(g)

Employee Benefit Plan

Defined Benefit Plans Coverage and Nondiscrimination Requirements

(Worksheet Number 5A – Determination of Qualification)

Instructions – All items must be completed. A “Yes” answer generally indicates a favorable conclusion is warranted while a “No” answer indicates a problem exists. Please use the space on the worksheet to explain any “No” answer. If the employer has not requested a determination letter as to a particular item, the question related to that item should be answered “N/A.” See Explanation Number 5A for guidance in completing this form.

The technical principles in this worksheet may be changed by future regulations or guidelines.

Name of plan

I. Design-Based Safe Harbors	Plan Reference	Yes	No	N/A
a. Does the application request a determination regarding a design-based safe harbor? (If “No,” do not complete the remainder of this worksheet.)				
b. Does the plan satisfy the uniformity requirements and one of the following safe harbors: [0557]				
(i) Unit credit safe harbor; [0558]				
(ii) Fractional rule unit credit safe harbor; [0559]				
(iii) Fractional rule flat benefit safe harbor; [0560]				
(iv) Insurance contract plan safe harbor; or [0561]				
c. Does the plan satisfy the fresh-start requirements? [0563]				
II. Employee Contribution Not Allocated To Separate Accounts	Plan Reference	Yes	No	N/A
a. If this is a contributory plan, would the plan satisfy a safe harbor on the basis of employer-provided benefit rates? [0564]				
b. If the employer-provided benefit is determined under the composition-of-workforce method, has the employer demonstrated that the requirements are satisfied? [0565]				
c. Is the employee-provided benefit nondiscriminatory in amount? [0566]				
III. Nondiscriminatory Compensation	Plan Reference	Yes	No	N/A
a. Does this design-based safe harbor plan use a nondiscriminatory definition of compensation for purposes of computing benefits? [0567]				
b. In the case of a plan that covers self-employed individuals, does the plan define compensation for these individuals in a manner that satisfies section 414(s)? [0568]				

Employee Plan Deficiency Checklist
Attachment Number 5A
Coverage and Nondiscrimination Requirements Defined Benefit

For IRS Use	Please furnish the amendment(s) requested in the section(s) checked below.
557 I.a.	Section _____ of the plan should be amended to satisfy the uniformity requirements that apply to safe harbor plans under section 1.401(a)(4)-3(b)(2) of the regulations. IRC section 401(a)(4) and Regs. Section 1.401(a)(4)-3(b)(2).
558 I.a.(i)	Section _____ of the plan should be amended to satisfy the safe harbor for unit credit plans described in section 1.401(a)(4)-3(b)(3) of the regulations. IRC section 401(a)(4) and Regs. section 1.401(a)(4)-3(b)(3).
559 I.a.(ii)	Section _____ of the plan should be amended to satisfy the fractional rule unit credit plan safe harbor described in section 1.401(a)(4)-3(b)(4)(i)(C)(1) of the regulations. IRC section 401(a)(4) and Regs. section 1.401(a)(4)-3(b)(4)(i)(C)(1).
560 I.a.(iii)	Section _____ of the plan should be amended to satisfy the fractional rule flat benefit plan safe harbor described in section 1.401(a)(4)-3(b)(4)(i)(C)(2) of the regulations. IRC section 401(a)(4) and Regs. section 1.401(a)(4)-3(b)(4)(i)(C)(2).
561 I.a.(iv)	Section _____ of the plan should be amended to satisfy the insurance contract plan safe harbor described in section 1.401(a)(4)-(b)(5) of the regulations. IRC section 401(a)(4) and Regs. section 1.401(a)(4)(b)(5).
563 I.b.	To meet the safe harbor requirement of section 1.401(a)(4)-3(b)(6)(vii) of the regulations, the plan should be amended to satisfy the fresh-start requirements of section 1.401(a)(4)-13(c). Regs sections 1.401(a)(4)-3(b)(6)(vii) and 1.401(a)(4)-13(c).
564 II.a.	A contributory defined benefit plan will not satisfy a safe harbor unless it would do so if the plan's benefit formula provided benefits at employer-provided benefit rates determined under section 1.401(a)(4)-6(b) of the regulations. Please submit a demonstration that this requirement is satisfied. Alternatively, section _____ of the plan may be amended to satisfy this requirement. Regs. section 1.401(a)(4)-3(B)(6)(viii).
565 II.b.	Please submit a demonstration that the plan satisfies the requirements of the composition-of-workforce method for determining the employer-provided benefit in section 1.401(a)(4)-6(b)(2) of the regulations.
566 II.c.	Please submit a demonstration that benefits provided on account of employee contributions at lower levels of compensation are comparable to those provided on account of employee contributions at higher levels of compensation. Regs. section 1.401(a)(4)-6(c)(4)(ii)(D)
567 III.a.	The definition of compensation contained in section _____ of the plan should be amended to conform to one of the definitions described in sections 1.414(s)-1(c)(2) and 1.414(s)-1(c)(3) of the regulations. Alternatively, submit a demonstration that the plan's definition of compensation is nondiscriminatory. IRC section 414(s) and Regs. section 1.414(s)-1.
568 III.b.	Section _____ of the plan should be amended to define compensation for self-employed individuals in the manner described in section 1.414(s)-1(g)(1) of the regulations. IRC section 414(s) and Regs. section 1.414(s)-1(g)(1).