Proposed Rules

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–125761–14]

RIN 1545–BM58

Nondiscrimination Relief for Closed Defined Benefit Pension Plans and Additional Changes to the Retirement Plan Nondiscrimination Requirements

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that modify the nondiscrimination requirements applicable to certain retirement plans that provide additional benefits to a grandfathered group of employees following certain changes in the coverage of a defined benefit plan or a defined benefit plan formula. The proposed regulations also make certain other changes to the nondiscrimination rules that are not limited to these plans. These regulations would affect participants in, beneficiaries of, employers maintaining, and administrators of tax-qualified retirement plans.

DATES: Written or electronic comments and must be received by April 28, 2016. Outlines of topics to be discussed at the public hearing scheduled for May 19, 2016 at 10 a.m., must be received by April 28, 2016.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–125761–14), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington DC 20004. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–125761–14), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at http://www.regulations.gov (IRS REG–125761–14).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Kelly C. Scanlon and Linda S. F. Marshall at (202) 317–6700; concerning submissions of comments, the hearing, and/or being placed on the building access list to attend the hearing, Oluwafumilayo (Funmi) Taylor at (202) 317–6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 401(a)(4) provides generally that a plan is a qualified plan only if the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees. In 1991, the Treasury Department and the IRS issued comprehensive regulations under section 401(a)(4) (TD 8360, 56 FR 47524) setting forth several alternative methods for testing compliance with this statutory requirement. In 1993, the Treasury Department and the IRS made significant amendments to those regulations (TD 8485, 58 FR 46773).

Under the section 401(a)(4) regulations, a plan is permitted to demonstrate that either the contributions or the benefits provided under the plan are nondiscriminatory in amount, regardless of whether the plan is a defined benefit or defined contribution plan. See § 1.401(a)(4)–1(b)(2). In order to test a defined contribution plan on the basis of contributions or benefits provided under the plan must be converted to equivalent benefits. This conversion is done using an interest rate set forth in the regulations.

The 2001 amendments also prescribe rules regarding defined benefit replacement allocations (‘‘DBRAs’’) that provide higher allocation rates to an older and more highly compensated group of employees. This type of plan nonetheless satisfies the nondiscrimination requirements by testing the contributions on the basis of equivalent benefits because the conversion to equivalent benefits reflects assumed growth to normal retirement age and therefore results in relatively lower equivalent benefits for the highly compensated employees who are closer to normal retirement age. The Treasury Department and the IRS concluded that this type of plan was inconsistent with the intent behind the nondiscrimination regulations. Consequently, the Treasury Department and the IRS amended the section 401(a)(4) regulations in 2001 to require that a new comparability plan provide a higher minimum contribution to nonhighly compensated employees in order for the plan to be eligible to demonstrate compliance with the nondiscrimination requirements of section 401(a)(4) on the basis of equivalent benefits (TD 8954, 66 FR 34535) (the ‘‘2001 amendments’’).

This higher minimum contribution requirement was directed at the new comparability plans. Other defined contribution plans that provide ‘‘broadly available allocation rates’’ or allocation rates that are ‘‘based on a gradual age or service schedule’’ are not subject to the higher minimum contribution requirement even if they demonstrate compliance with the nondiscrimination requirements of section 401(a)(4) on the basis of equivalent benefits. In addition, under the 2001 amendments, defined benefit replacement allocations (‘‘DBRAs’’) may be disregarded when determining whether a defined contribution plan has broadly available allocation rates. The 2001 amendments also prescribe rules regarding DB/DC plans that provide for benefits in a manner similar to new comparability plans. Under these rules (contained in § 1.401(a)(4)–9(b)(2)(v)), in order for a DB/DC plan to be eligible to demonstrate compliance with the section 401(a)(4) nondiscrimination requirements on the basis of equivalent benefits, it must satisfy a minimum

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1 See § 1.401(a)(4)–6(c)(2)(ii) and § 1.401(a)(4)–12 (definition of standard interest rate). This standard interest rate is used to determine assumed growth of a defined contribution plan account and to convert the projected account balance to an annuity at normal retirement age.

2 This higher minimum contribution rate is required under § 1.401(a)(4)–8(b)(1)(ii)(B)(3) and (b)(1)(vi).

3 See § 1.401(a)(4)–8(b)(1)(iii) and (b)(1)(iv).
aggregate allocation gateway unless the
DB/DC plan either fits within the
definition of “primarily defined benefit
in character” or consists of “broadly
available separate plans.” This
minimum aggregate allocation gateway
requires a minimum allocation rate (or
equivalent allocation rate) for each
nonhighly compensated employee.

Since 2001, a number of employers have
moved away from providing retirement benefits through traditional
defined benefit plans. In many of these
cases, employers have either
significantly changed the type of benefit
formula provided under the plan (such as in the case of a conversion to a cash
balance plan), or have prohibited new
employees from entering the plan
entirely. The employers may then have
allowed employees who had already
begun participation in the defined
benefit plan (or who are older or have
been credited with longer service under the
plan) to continue to earn pension
benefits under the defined benefit plan
while closing the plan or formula to all
other employees. The defined benefit
plans are sometimes referred to as
“closed plans,” and the employees who
continue to earn pension benefits under the
closed plan are often known as a
“grandfathered group of employees.” In
situations in which new employees continue
to earn benefits under the
defined benefit plan, but are under a
new formula, any formula that
continues to apply to a grandfathered
group of employees is sometimes
referred to as a “closed formula.”
Closed plans are required to meet the
coverage rules under section 410(b)
and the nondiscrimination rules under
section 401(a)(4) (including a
nondiscrimination requirement regarding the availability of benefits,
rights, and features). Many closed plans,
however, may eventually find it difficult
to meet these requirements because the
proportion of the grandfathered group of
employees who are highly compensated
employees compared to the employer’s
total workforce increases over time. This
occurs because members of the
grandfathered group of employees
usually continue to receive pay raises
(and so may become highly
compensated employees), and new
employees (who are generally nonhighly
compensated employees) are not
covered by the closed plan.

When a closed defined benefit plan
can no longer meet the
nondiscrimination requirements on a
stand-alone basis because of the
demographic changes previously
described, it can demonstrate
compliance with section 401(a)(4) by
aggregating with the employer’s defined
contribution plan. In general, it is easier
to meet the nondiscrimination
requirements if the resulting DB/DC
plan demonstrates compliance with
section 401(a)(4) based on the benefits or equivalent benefits provided to the
employees (rather than based on
contributions).

On January 6, 2014, the Treasury
Department and the IRS published
Notice 2014–5 provided temporary
nondiscrimination relief for certain
closed plans. Specifically, under Notice
2014–5, if certain criteria are satisfied,*
a plan sponsor is permitted to test a DB/
DC plan that includes a closed plan that
was closed before December 13, 2013,
on a benefits basis for plan years
beginning before January 1, 2016,
without complying with the minimum
aggregate allocation gateway, even if
that would otherwise be required under
the current regulations. Notice 2015–28,
2015–14 I.R.B. 848, extended that relief
for an additional year by applying it to
plan years beginning before 2017
provided the conditions of Notice
2014–5 are satisfied.

Notice 2014–5 also requested
comments on whether the section
401(a)(4) regulations should be
amended to provide additional
alternatives that would allow a DB/DC
plan to satisfy the nondiscrimination
in amount requirements on the basis of
equivalent benefits, and whether certain
other permanent changes should be
made to the nondiscrimination
regulations, such as modifications to the
rules regarding nondiscriminatory
benefits, rights, and features. The
comments received in response to
Notice 2014–5 generally supported
these types of changes. In addition, all
of the commenters requested permanent
changes to the nondiscrimination
rules regarding the existence of a
DB/DC plan that includes a closed plan
that was closed during the
Aggregation period.

Under the proposed regulations, the
eligibility conditions set forth in the
modified DBRA rules (described in
section II.A of this part of the
preamble) provide a framework for the
elegibility conditions for the snapshot
rule related to closed plans in a DB/DC
plan (described in section II.B of this
portion of the preamble). The modified
DBRA rules are also used as a basis for
the special testing rule for benefits,
rights, and features provided to a
grandfathered group of employees
(described in section II.C of this portion
of the preamble). For example, the
special testing rule for a benefit, right,
or feature provided to a grandfathered
group of employees under a defined
contribution plan establishes
nondiscrimination relief for matching
contributions provided to a

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4 Generally, in order to be eligible for the relief
provided by Notice 2014–5, each defined benefit
plan that is part of an aggregated DB/DC plan must
have satisfied the requirements of section 401(a)(4)
without using the minimum aggregate allocation
gateway under § 1.401(a)(4)–9(b)(2)(v)(D). Thus, the
defined benefit plan must have either been
primarily defined benefit in character (within the
meaning of § 1.401(a)(4)–9(b)(2)(v)(B)), consisted of
broadly available separate plans (within the
meaning of § 1.401(a)(4)–9(b)(2)(v)(C)), or satisfied
the applicable nondiscrimination rules without
being aggregated with a DC plan.

5 Section 1.401(a)(4)–4 provides rules for
determining whether the benefits, right, and
features provided under a plan are made available in
a nondiscriminatory manner. Under these rules, each
benefit, right, or feature must satisfy the
current availability requirement of § 1.401(a)(4)–
4(b) (which requires testing of the group to which
the benefit, right, or feature is currently available)
and the effective availability requirement of
§ 1.401(a)(4)–4(c) (which requires that the group of
employees to whom the benefit, right, or feature is
effectively available must not substantially favor
highly compensated employees).
grandfathered group of employees who formerly participated in a defined benefit plan that is intended to be consistent with the nondiscrimination relief provided by the modified DBRA rules for nonselective contributions provided to such a grandfathered group of employees.

A. Modifications to the DBRA Rules Under § 1.401(a)(4)–8

The proposed regulations modify the rules applicable to DBRAs under § 1.401(a)(4)–8, which allow certain defined contribution plan allocations to be disregarded when determining whether a defined contribution plan has broadly available allocation rates. The rules applicable to DBRAs allow employers to provide, in a nondiscriminatory manner, certain allocations to replace defined benefit plan retirement benefits without having to satisfy the minimum aggregate allocation gateway. The modifications in the proposed regulations are intended to allow more allocations to fit within the DBRA rules. For example, under the existing regulations a DBRA must be reasonably designed to replace the benefits that would have been provided under the closed defined benefit plan. The proposed regulations provide greater flexibility in this respect and allow the allocations to be reasonably designed to replace some or all of the benefits that would have been provided under the closed plan, subject to a requirement that the allocations be provided in a consistent manner to all similarly situated employees.

The proposed regulations incorporate a modified version of the conditions for an allocation to be a DBRA that were reflected in Rev. Rul. 2001–30, 2001–2 C.B. 46. For example, under one of the conditions set forth in Rev. Rul. 2001–30, in order for an allocation to be a DBRA, the defined benefit plan’s benefit formula for the group of employees who formerly benefited under that plan must have generated equivalent normal allocation rates that increased from year to year as employees attained higher ages. The proposed regulations ease this restriction on the types of defined benefit plans with respect to which a DBRA can be provided by allowing a DBRA also to replace the benefit provided under a defined benefit plan with a benefit formula that generated equivalent normal allocation rates that increased from year to year as employees were credited with additional years of service (rather than only as the employees attained higher ages).

The existing regulation also requires that the group of employees who receive a DBRA must be a nondiscriminatory group of employees, and Rev. Rul. 2001–30 interprets this rule as requiring that the group of employees satisfy the minimum coverage requirements of section 410(b) (determined without regard to the average benefit percentage test). The proposed regulations incorporate this interpretation, but limit its application so that the rule only applies for the first 5 years after the closure date. In addition, the proposed regulations provide an exception to the interpretation in Rev. Rul. 2001–30 regarding whether the defined benefit plan was an established nondiscriminatory defined benefit plan by requiring that the closed plan be in effect for 5 years before the closure date (with one year substituted for 5 years, as provided by Rev. Rul. 2001–30, in the case of a defined benefit plan maintained by a former employer) with no substantial change to the closed plan during that time (except for certain permitted amendments allowed by the proposed regulations).

In addition, the proposed regulations expand the list of permitted amendments to a closed plan that do not prevent allocations under a plan from being DBRAs. For example, the proposed regulations permit an amendment to a closed plan that does not increase the accrued benefit or future accruals for any employee, does not expand coverage, and does not reduce the ratio percentage under any applicable nondiscrimination test. In addition, under the proposed regulations, an amendment during this period could extend coverage to an acquired group of employees provided that all similarly situated employees within that group are treated in a consistent manner.

As under the existing regulations, the proposed regulations contain a general requirement that plan amendments relating to a DBRA; however, the proposed regulations expand the list of plan amendments that are excepted from this rule. The proposed regulations retain the exception from this restriction on plan amendments for an amendment that makes de minimis changes in the calculation of a DBRA and for an amendment that adds or removes a “greater-of” plan provision (under which a participant receives the greater of the otherwise applicable allocation and the DBRA). In addition, the proposed regulations provide an exception from this restriction for any plan amendment modifying a DBRA that does not reduce the ratio percentage under any applicable nondiscrimination test.

B. Closed Plan Rule Added to the Plan Aggregation and Restructuring Rules Under § 1.401(a)(4)–9

The proposed regulations add a new exception to the requirement that a DB/DC plan must satisfy the minimum aggregate allocation gateway once the other conditions under § 1.401(a)(4)–9 are not met (the “closed plan rule”). This closed plan rule, which applies to a DB/DC plan that includes a closed plan, provides an exception to the minimum aggregate allocation gateway that would otherwise apply, but only if the closed plan was in effect for 5 years before the closure date and no significant change was made to the closed plan during or since that time (except for certain permitted amendments).

The DB/DC plan may use this closed plan rule for a plan year that begins on or after the fifth anniversary of the closure date. To be eligible for the closed plan rule, during the 5-year period following the closure date, either the DB/DC plan must satisfy the nondiscrimination in amount requirement of section 401(a)(4) without using the minimum aggregate allocation gateway, or the closed plan must satisfy that requirement without aggregation with any defined contribution plan. This requirement is comparable to the requirement that the group of employees who receive DBRAs must be a group of employees who satisfy the minimum coverage requirements of section 410(b).

Under the proposed regulations, certain amendments to a closed defined benefit plan do not prevent the plan from using the closed plan rule. These plan amendments are intended to allow a plan sponsor of a closed plan to address changed circumstances. For example, under the proposed regulations, a plan amendment during the 5-year period ending on the closure date does not prevent the plan from later using the closed plan rule, provided that the plan amendment does not increase the accrued benefit or future accruals for any employee, does not expand coverage, and does not reduce the ratio percentage under any applicable nondiscrimination test. Similarly, an amendment to the closed plan is permitted after the closure date, provided that the amendment does not reduce the ratio percentage under any applicable nondiscrimination test. Thus, for example, under the proposed regulations, a plan sponsor may add nonhighly compensated employees to a coverage group after it is closed in order to satisfy the nondiscrimination rules.
accrue benefits under the prior benefit
group of employees who continue to
available only to the grandfathered
formula has been changed, but the prior
special rule is to accommodate a plan
This is because the purpose of the
defined benefit plan, then it must be
to facilitate preservation of any
employee who continue to benefit
under the prior benefit formula. By
contrast, in the case of a benefit formula
has a significant change in the type of benefit formula, so
that the special testing rule would apply
to facilitate preservation of any
subsidized early retirement factors for
the employees who continue to benefit
under the prior benefit formula. The
rate of matching contributions under
a grandfathered group under a defined
contribution plan.
If the eligibility conditions are
satisfied, the special testing rule treats a
benefit, right, or feature that is provided
only to a grandfathered group of
employees as satisfying the current and
effective availability tests of
§ 1.401(a)(4)–(b) and (c). The special
testing rule applies to plan years
beginning on or after the fifth
anniversary of the closure date and
applies on a plan-year by plan-year
basis. To be eligible for the special
testing rule, the benefit, right or feature
must be currently available to a group
of employees that satisfies the minimum
coverage requirements of section 410(b)
for plan years that begin within 5
years after the closure date. Once the
special testing rule applies to a benefit,
right, or feature, the special testing rule
continues to apply for purposes of that
benefit, right, or feature indefinitely
(unless a later amendment changes the
eligibility for the benefit, right, or feature).
If a plan amendment changes
the eligibility for the benefit, right,
or feature after the closure date, then
the special testing rule will cease to apply
(subject to certain specified exceptions).
If the benefit, right, or feature that is
available solely to a grandfathered group
of employees is provided under a
defined benefit plan, then it must be
provided under the closed plan (rather
than a different defined benefit plan).
This is because the purpose of the
special rule is to accommodate a plan
amendment under which the benefit
formula has been changed, but the prior
benefit formula has been preserved for
a grandfathered group of employees and
the benefit, right, or feature is made
available only to the grandfathered
group of employees who continue to
accrue benefits under the prior benefit
formula. Accordingly, the special
testing rule is available only if the
amendment restricting the availability
of the benefit, right, or feature also
resulted in a significant change in the type
of the defined benefit plan’s
formula. For example, a conversion to a
cash balance plan would be a significant
change in the type of benefit formula, so
that the special testing rule would apply
by contrast, in the case of a benefit formula
that determines benefits as a percentage
of compensation, a change in that
formula to reduce that percentage would
not be considered a significant change
in the type of benefit formula, even if
the reduction is large.
The special testing rule for a benefit,
right, or feature provided under the
closed plan also requires that the
benefit, right, or feature has been in
effect without being amended for a 5-
year period before the closure date
(subject to a limited exception for
acquired employees). This rule is
designed to ensure that the special
treatment is available only for a long-
standing provision and cannot be used
for a benefit, right, or feature that has
not been provided long enough for
participants to have established a
reasonable expectation that it will
continue. In addition, this rule prevents
a plan sponsor from obtaining special
treatment for a benefit, right, or feature
added shortly before and in anticipation
of the closure of the plan. The proposed
regulations set forth a list of permitted
plan amendments that do not result in
the loss of this special testing rule that
are generally comparable to the list of
permitted amendments for other closed
plan arrangements.
The special testing rule also applies to
the rate of matching contributions under
a defined contribution plan that meets
certain requirements. In order to be
eligible for this testing rule, the rate
of matching contributions must be
reasonably designed so that the
matching contributions will replace
some or all of the value of the benefit
accruals that each employee in the
grandfathered group of employees
would have been provided under the
closed plan in the absence of a closure
amendment. In addition, the rate of
matching contributions for the
grandfathered group of employees must

6 The existing regulations provide a special rule
for current availability testing for a benefit, right, or
feature that applies solely to benefits accrued before
the amendment date. See § 1.401(a)(4)–(d)(2).

III. Modification of Testing Options
Under § 1.401(a)(4)–9 for DB/DC Plans,
Including DB/DC Plans That Do Not
Include a Closed Plan
In addition to providing a special rule
for closed plans and similar
arrangements, the proposed regulations
generally ease the rules under which
any DB/DC plan can satisfy the
 nondiscrimination in amount
requirement on the basis of benefits.
These changes are intended to facilitate
the ongoing maintenance of a defined
benefit plan that provides coverage to a
group of employees that is determined
using a reasonable business
classification.
The proposed regulations expand the
ability to use the average of the
equivalent allocation rates under the
defined benefit plan for purposes of
satisfying the minimum aggregate
allocation gateway by permitting the
averaging of allocation rates for
nonhighly compensated employees
under the defined contribution plan for
this purpose. This modification is
intended to better accommodate plan
sponsors that have a defined
contribution plan with service- or age-
base allocation formulas. The Treasury
Department and the IRS have
determined that it is appropriate, in this
case, to allow shorter-service
nonhighly compensated employees to
be provided less than the minimum
aggregate allocation gateway rate, as
long as longer-service nonhighly
compensated employees are provided
allocation rates that are sufficiently
higher than the minimum aggregate
allocation gateway rate. The Treasury
Department and the IRS are considering
whether any restrictions on this rule are
appropriate so that the rule serves its
intended purpose of facilitating
formulas that provide higher allocation
rates to longer-service nonhighly
compensated employees, and invite
comments on ways to permit
appropriate flexibility while ensuring
the provision is not used to circumvent
the purpose of the nondiscrimination
rules.
The proposed regulations also include
a limitation on the averaging of rates
that applies to both defined contribution
and defined benefit plans in order to
minimize the impact of outliers. In
general, this special rule applies a cap
under which any equivalent normal
allocation rate or allocation rate in
excess of 15% is treated as equal to
5%. However, this cap is increased to 25% for
any allocation rate or equivalent
normal allocation rate that results solely
from a plan design providing allocation rates or generating equivalent normal allocation rates that are a function of age or service under which higher rates are provided to older or longer-service employees.

In addition, under the proposed regulations, the average of the matching contributions actually made for nonhighly compensated employees may be used to a limited extent (up to 3 percent of compensation) for purposes of determining whether each nonhighly compensated employee satisfies the minimum aggregate allocation gateway test. Thus, for example, if the minimum aggregate allocation gateway is 7% and the average of the matching contributions actually made for nonhighly compensated employees is 3%, then a non-elective contribution of 4% for each individual would be needed in order to satisfy the minimum aggregate allocation gateway under the proposed regulations. The regulations use the average matching contributions, rather than matching contributions allocated for each employee, in order to avoid diluting the incentive effect of an employer match.

The proposed regulations also provide a new alternative to the minimum aggregate allocation gateway. Under this alternative, a DB/DC plan is not required to satisfy the minimum aggregate allocation gateway if it can satisfy the nondiscrimination in amount requirement on the basis of equivalent benefits using an interest rate of 6%, rather than the current standard interest rate of between 7.5% and 8.5%.

IV. Benefit Formulas for Individual Employees or Groups Without a Reasonable Business Purpose; Modifications to the Amounts Testing Rules Under § 1.401(a)(4)–2 and § 1.401(a)(4)–3

The proposed regulations also include changes to address certain arrangements that take advantage of the flexibility in the existing nondiscrimination rules 7 to provide a special benefit formula for selected employees without extending that formulation a classification of employees that is reasonable and is established under objective business criteria. A plan satisfies the minimum coverage requirements of section 410(b) if the plan’s ratio percentage is 70% or higher or the plan satisfies the average benefit test. To satisfy the average benefit test, pursuant to § 1.410(b)–4, the group of employees must be determined using a classification that is reasonable and that is established under objective business criteria pursuant to § 1.410(b)–4(b) and must have a ratio percentage that is described in § 1.410(b)–4(c) (which includes safe harbor and unsafe harbor percentages). A classification of employees that is reasonable and is established under objective business criteria is referred to in this preamble as a “reasonable business classification.” To the extent that a plan provides a special benefit formula and can still pass the nondiscrimination requirements, the plan sponsor can use a qualified retirement plan to provide benefits that would otherwise be provided under a nonqualified plan. These arrangements are sometimes referred to as qualified supplemental executive retirement plans (or QSERPs).

Under the general test in the existing regulations, if a plan satisfies the minimum coverage requirements of section 410(b) using the average benefit percentage test, then the rate group for each highly compensated employee is treated as satisfying the minimum coverage requirements if the ratio percentage for the rate group is equal to the midpoint between the safe harbor and the unsafe harbor percentages (or the ratio percentage for the plan as a whole, if less). This rule recognizes that the composition of a rate group may be unpredictable and so the rate group should not be subject to a reasonable business classification standard. However, that same consideration is not relevant if the group of employees to whom the allocation formula under a defined contribution plan (or benefit formula under a defined benefit plan) applies is not a reasonable business classification.

Accordingly, the proposed regulations limit the existing rule under which a rate group with respect to a highly compensated employee is treated as satisfying the average benefit percentage test to those situations in which the allocation formula (or benefit formula) that applies to the highly compensated employee also applies to a reasonable business classification. For example, if a benefit formula applies solely to a highly compensated employee who is identified by name, it does not apply to a reasonable business classification. See § 1.410(b)–4(b). In such a case, the proposed regulations would require that the rate group with respect to that individual satisfy the ratio percentage test.

Proposed Applicability Date

Except as described below, these regulations are proposed to be applicable to plan years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register. Taxpayers are permitted to apply the provisions of these proposed regulations except for those described in section III of the Explanation of Provisions portion of the preamble for plan years beginning before this proposed applicability date, but not for plan years earlier than those beginning on or after January 1, 2014. Accordingly, the ability to rely on a provision of these proposed regulations for periods prior to the proposed applicability date for these regulations applies to the disregard of certain defined benefit replacement allocations in cross-testing; the exception from the minimum aggregate allocation gateway with respect to certain closed plans; the special testing rule for benefits, rights, and features with respect to certain closed plans; and the rule applying the ratio percentage test to a rate group in the case of a benefit formula that does not apply to a reasonable business classification. Taxpayers may rely on these provisions (that is, the provisions that the proposed regulations would permit a taxpayer to apply before the proposed applicability date for these regulations) in order to satisfy the nondiscrimination requirements of section 401(a)(4) for plan years beginning on or after January 1, 2014, and until the corresponding final regulations become applicable.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

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7 Under the existing regulations, the nondiscrimination requirements of section 401(a)(4) and the coverage rules of section 410(b) are coordinated. The general test under the section 401(a)(4) regulations is applied by determining whether each rate group under the plan (that is, for each highly compensated employee, the group of employees with a benefit or contribution rate that is greater than or equal to the benefit or contribution rate for the highly compensated employee) satisfies section 410(b) as if it were a plan.
Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the ADDRESSES heading. Treasury and the IRS request comments on all aspects of the proposed rules, including the proposed applicability date. Treasury and the IRS also request comments on the following issues:

- Whether guidance needs to be developed for a plan that has more than one closure or closure amendment?
- Whether the rules regarding transition allocations and successor employers are still needed in light of the modifications to the DBRA rules?

All comments will be available for public inspection and copying at www.regulations.gov or upon request.

A public hearing has been scheduled for May 19, 2016, beginning at 10 a.m. in the Auditorium, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Because of building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Due to access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by April 28, 2016 and an outline of the topics to be discussed and the time to be devoted to each topic by April 28, 2016. A signed paper or electronic copy of the outline should be submitted as prescribed in this preamble under the ADDRESSES heading. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Statement of Availability for IRS Documents

For copies of recently issued Revenue Procedures, Revenue Rulings, notices, and other guidance published in the Internal Revenue Bulletin, please visit the IRS Web site at http://irs.gov.

Drafting Information

The principal authors of these proposed regulations are Kelly C. Scanlon and Linda S. F. Marshall, IRS Office of Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Department of Treasury participated in the development of the proposed regulations.

List of Subjects in 26 CFR Part 1

Income taxes, reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Paragraph 2. Section 1.401(a)(4)–0 is amended by:

1. Adding paragraph (c)(5) to the entry for § 1.401(a)(4)–2.
2. Adding paragraph (d)(8) to the entry for § 1.401(a)(4)–4.
3. Adding paragraph (a)(4) to the entry for § 1.401(a)(4)–13.

The additions read as follows:

§ 1.401(a)(4)–0 Table of contents.
* * * * *
§ 1.401(a)(4)–2 Nondiscrimination in amount of employer contributions under a defined contribution plan.
* * * * *
(c) * * *
(5) Effective/applicability date.
* * * * *
§ 1.401(a)(4)–4 Nondiscriminatory availability of benefits, rights, and features
* * * * *
(d) * * *
(8) Special testing rule for grandfathered group of employees.
* * * * *
§ 1.401(a)(4)–13 Effective dates and fresh-start rules.
(a) * * *
(4) Effective/applicability date.
* * * * *

Paragraph 3. Section 1.401(a)(4)–2 is amended by:

1. Revising paragraph (c)(3)(ii).
2. Revising Examples 4 and 5 in paragraph (c)(4).
3. Adding Examples 6 and 7 to paragraph (c)(4).
4. Adding paragraph (c)(5).

The revisions and additions read as follows:

§ 1.401(a)(4)–2 Nondiscrimination in amount of employer contributions under a defined contribution plan.

Example 4. (a) The facts are the same as in Example 3, except that N4 has an allocation rate of 8.0 percent. In addition, the formula that is used to determine the allocation for H2 is the same formula that is used to determine the allocation for all other employees in Plan D.

(b) There are two rate groups in Plan D. Rate group 1 consists of H1 and all those employees who have an allocation rate greater than or equal to H1’s allocation rate (5.0 percent). Thus, rate group 1 consists of H1, H2 and N1 through N4. Rate group 2 consists of H2, and all those employees who have an allocation rate greater than or equal to H2’s allocation rate (7.5 percent). Thus, rate group 2 consists of H2 and N4.

(c) Rate group 1 satisfies the ratio percentage test under § 1.410(b)–2(b)(2) because the ratio percentage of the rate group is 100 percent—that is, 100 percent (the percentage of all nonhighly compensated nonexempt employees who are in the rate group) divided by 100 percent (the percentage of all highly compensated nonexempt employees who are in the rate group).

(d) Rate group 2 does not satisfy the ratio percentage test of § 1.410(b)–2(b)(2) because the ratio percentage of the rate group is 50 percent—that is, 25 percent (the percentage of all nonhighly compensated nonexempt employees who are in the rate group) divided by 50 percent (the percentage of all highly compensated nonexempt employees who are in the rate group).

(e) However, under paragraph (c)(3)(ii) of this section rate group 2 satisfies the nondiscriminatory classification test of § 1.410(b)–4 because (i) the formula that is used to determine the allocation for H2 applies to a group of employees that satisfies the reasonable classification requirement of § 1.410(b)–4(b) (in this case, because it applies to all the employees) and (ii) the ratio percentage of the rate group (50 percent) is greater than the midpoint between the safe harbor and unsafe harbor percentages.
applicable to the plan under §1.410(b)–4(c)(4) (40.5 percent).

(f) Under paragraph (c)(3)(iii) of this section, rate group 2 satisfies the average benefit percentage test if Plan D satisfies the average benefit percentage test. The requirement that Plan D satisfy the average benefit percentage test applies even though Plan D satisfies the ratio percentage test and would ordinarily not need to run the average benefit percentage test. If Plan D satisfies the average benefit percentage test, then rate group 2 satisfies §1.410(b)–4; thus, Plan D satisfies the general test in paragraph (c)(1) of this section because each rate group under the plan satisfies section 410(b).

Example 5. (a) Plan E satisfies section 410(b) by satisfying the nondiscriminatory classification test of §1.410(b)–4 and the average benefit percentage test of §1.410(b)–5 (without regard to §1.410(b)–5(f)). See §1.410(b)–2(b)(3). Plan E uses the facts-and-circumstances requirements of §1.410(b)–4(c)(3) to satisfy the nondiscriminatory classification test of §1.410(b)–4. The safe and unsafe harbor percentages applicable to the plan under §1.410(b)–4(c)(4) are 29 and 20 percent, respectively. Plan E has a ratio percentage of 22 percent. Rate group 1 under Plan E has a ratio percentage of 23 percent.

The formula that is used to determine the allocation for the HCE with respect to whom rate group 1 was formed applies to all other employees.

(b) Under paragraph (c)(3)(iii) of this section, rate group 1 satisfies the nondiscriminatory classification requirement of §1.410(b)–4 because (i) the formula that is used to determine the allocation for the HCE with respect to whom the rate group was formed applies to a group of employees that satisfies the reasonable classification requirement of §1.410(b)–4(b)(1) (in this case, because it applies to all the employees) and (ii) the ratio percentage of the rate group (23 percent) is greater than the lesser of—

(1) The ratio percentage for the plan as a whole (22 percent); and

(2) The midpoint between the safe and unsafe harbor percentages (24.5 percent).

(c) Under paragraph (c)(3)(iii) of this section, the rate group satisfies section 410(b) because the plan satisfies the average benefit percentage test of §1.410(b)–5.

Example 6. (a) Employer Z maintains a defined contribution plan, Plan F. Employer Z has six nonexcludable employees, all of whom benefit under Plan F. There is one HCE (H1) and five NHCEs (N1 through N5). There is one rate group under Plan F. The formula that is used to determine the allocation for H1 is the greater of $20,000 or 10% of compensation for the year. The formula that applies to determine the allocation for N1 through N5 is 10% of compensation.

(b) Under paragraph (c)(3)(ii) of this section, the rate group with respect to H1 does not satisfy the nondiscriminatory classification test under §1.410(b)–4 because the formula that is used to determine the allocation for H1 (with respect to whom the rate group is established) only applies to H1. Therefore, the rate group will satisfy paragraph (c)(3) of this section only if the ratio percentage of the rate group is greater than or equal to 70 percent. This ratio percentage test applies even if H1’s compensation is greater than $200,000. In such a case, the rate group will pass the ratio percentage test (and accordingly the plan will satisfy the general test of this paragraph (c)) because each employee receives an allocation of 10% of compensation and therefore the ratio percentage for the rate group is equal to 100%.

Example 7. The facts are the same as in Example 6, except that the classification of employees who are entitled to benefit under the formula that applies to H1 includes N1 and N2, who are identified by name. Under paragraph (c)(3)(iii) of this section, the rate group with respect to H1 does not satisfy the nondiscriminatory classification test under §1.410(b)–4 because the classification of N1 and N2 by name does not satisfy the reasonable classification requirement of §1.410(b)–4(b). Therefore, the rate group with respect to H1 will satisfy paragraph (c)(3) of this section only if the ratio percentage of the rate group is greater than or equal to 70 percent.

(5) Effective/applicability date. See §1.401(a)(4)–13(a)(4) for rules on the effective/applicability date of this paragraph (c).

Par. 5. In §1.401(a)(4)–3, paragraph (c)(2) is revised to read as follows:

§1.401(a)(4)–3 Nondiscrimination in amount of employer-provided benefits under a defined benefit plan.

* * * * *

(c) * * *

(2) Satisfaction of section 410(b) by a rate group. For purposes of determining whether a rate group satisfies section 410(b), the rules of §1.410(a)(4)–2(c)(3) apply except that §1.410(a)(4)–2(c)(3)(i)[A] is applied by substituting “benefit formula” for “formula that is used to determine the allocation.” See paragraph (c)(4) of this section and §1.410(a)(4)–2(c)(4), Example 3 through Example 6, for examples of this rule. See §1.410(a)(4)–13(a)(4) for rules on the effective/applicability date of this paragraph (c).

* * * * *

Par. 5. In §1.401(a)(4)–4, paragraph (d)(8) is added to read as follows:

§1.401(a)(4)–4 Nondiscrimination availability of benefits, rights, and features.

* * * * * *(d) * * *

(8) Special testing rule for grandfathered group of employees—(i) General rule. For a plan year that begins on or after the fifth anniversary of the closure date with respect to a closed defined benefit plan, a benefit, right, or feature under a defined benefit or defined contribution plan that is available only to a grandfathered group of employees with respect to the closed defined benefit plan is treated as satisfying paragraphs (b) and (c) of this section for the plan year, provided that—

(A) No plan amendment that affects the availability of the benefit, right, or feature (other than the closure amendment) has an applicable amendment date (within the meaning of §1.411(d)–3(g)(4)) that is within the period that begins on the closure date and ends on the last day of the plan year; and

(B) The additional requirements of paragraph (d)(8)(ii) or (iii) of this section, whichever is applicable, are satisfied.

(ii) Additional requirements in the case of a benefit, right, or feature provided under a defined benefit plan. If the benefit, right, or feature is provided under a defined benefit plan, then the following additional requirements apply—

(A) The defined benefit plan under which the benefit, right, or feature is provided is the closed defined benefit plan;

(B) No plan amendment that affects the availability of the benefit, right, or feature (other than the closure amendment) has an applicable amendment date that is within the 5-year period ending on the closure date; and

(C) The closure amendment that restricted the availability of the benefit, right, or feature, making it available only to the grandfathered group of employees, must also have provided for a significant change in the type of benefit formula under the plan (such as a change from a benefit formula that is not a statutory hybrid benefit formula to a lump sum-based benefit formula).

(iii) Additional requirements in the case of a benefit, right, or feature provided under a defined contribution plan. If the benefit, right, or feature is provided under a defined contribution plan, then the following additional requirements apply—

(A) The benefit, right, or feature must be a right to a rate of matching contributions provided under the defined contribution plan;

(B) The rate of matching contributions must be reasonably designed so that the matching contributions will replace some or all of the value of the benefit accruals that each employee in the grandfathered group of employees would have been provided under the closed defined benefit plan in the absence of a closure amendment (based on the terms of that plan and the section 415(b)(1)(A) dollar limit in effect immediately prior to the closure date).
(C) The closed defined benefit plan must satisfy the conditions set forth in § 1.401(a)(4)–8(b)(1)(iii)(D)(3); and

(D) The rate of matching contributions must be provided in a consistent manner to all similarly situated employees.

(iv) Certain amendments not taken into account. For purposes of applying the rules under this paragraph (d)(8), the following plan amendments are not taken into account (and, in the case of an amendment described in paragraph (d)(8)(iv)(C) or (D) of this section, the rules of this paragraph (d)(8)) are applied as if the benefit, right, or feature provided after the amendment were the benefit, right, or feature provided before the amendment:

(A) An amendment adopted during the 5-year period ending on the closure date that extends eligibility for the benefit, right, or feature to an acquired group of employees provided that all similarly situated employees within that group are treated in a consistent manner.

(B) An amendment adopted after the closure date that expands or restricts the eligibility for the benefit, right, or feature, provided that, as of the applicable amendment date, the ratio percentage of the group of employees eligible for the benefit, right, or feature (taking into account the plan amendment) is not less than the ratio percentage of the group of employees eligible for the benefit, right, or feature provided before the amendment.

(C) An amendment adopted after the closure date that results in a replacement of the benefit, right, or feature with another benefit, right, or feature that is available to the same group of employees as the original benefit, right, or feature, provided that the original benefit, right, or feature is of inherently equal or greater value (within the meaning of paragraph (d)(4)(ii)(A) of this section) than the benefit, right, or feature that replaces it.

(D) An amendment adopted after the closure date that results in a replacement of the benefit, right, or feature with another benefit, right, or feature that is available to the same group of employees as the original benefit, right, or feature, provided that there is only a de minimis difference between the amount payable under the original benefit, right, or feature and the amount payable under the benefit, right, or feature that replaces it.

(E) An amendment that is permitted by guidance published by the Commissioner in the Internal Revenue Bulletin.

(v) Examples. The following examples illustrate the rules in this paragraph (d)(8):

Example 1—(i) Pre-amendment defined benefit plan. Employer A maintains Plan P, a defined benefit plan that provides for an annual benefit equal to 2% of an employee’s average annual compensation multiplied by the employee’s years of service. Plan P also provides for a subsidized early retirement benefit available to employees who retire between the ages of 55 and 65 with 20 years of service. Plan P was established in 2003. The plan year is a calendar year. For the 2015 plan year, Plan P satisfied the nondiscrimination requirements under sections 410(b) and 401(a)(4) without regard to the special rules under section 410(b)(6)(C) and without aggregation with any other plan.

(ii) Plan conversion amendment. On November 1, 2015, Employer A amends Plan P to cease future accruals under its benefit formula effective as of the close of the plan year ending December 31, 2015 and to provide future benefit accruals under a cash balance formula. The cash balance formula provides for pay credits equal to 5% of compensation and annual interest credits at an interest crediting rate of 6%. Early retirement benefits payable with respect to benefits accrued under the cash balance formula are determined as the actuarial equivalent of the hypothetical account balance, determined using reasonable actuarial assumptions that are specified in Plan P. Under the terms of the conversion amendment, an employee’s benefit is equal to the employee’s benefit under the prior benefit formula as of the close of the plan year ending December 31, 2015, plus the amount determined under the cash balance formula. However, any employee who had attained the age of 50 and had completed 15 years of service on or before December 31, 2015 is entitled to the enhanced rate of matching contributions established.

On December 31, 2015, Employer A amends Plan P to provide, effective January 1, 2016, for additional matching contributions of up to 3% of compensation and annual interest credits at an interest crediting rate of 6% for employees who (1) were previously covered under the defined benefit plan, and (2) had attained the age of 50 and had 15 years of service on or before December 31, 2015. This enhanced rate of matching contributions is reasonably designed so that the matching contributions will replace some or all of the value of the benefit accruals that would have otherwise been provided to this subgroup of employees.

Example 2—(i) Plan amendment to profit-sharing plan that provides enhanced rate of matching contributions. Employer A has a profit-sharing plan that includes a qualified cash or deferred arrangement and matching contributions with respect to elective deferrals of up to 3% of compensation. On November 1, 2015, Employer A amends the plan to provide, effective January 1, 2016, for an additional 4% of compensation contribution for employees who (1) were previously covered under the defined benefit plan, and (2) had attained the age of 50 and 15 years of service on or before December 31, 2015. This enhanced rate of matching contributions is reasonably designed so that the matching contributions will replace some or all of the value of the benefit accruals that would have otherwise been provided to this subgroup of employees.

(ii) Plan amendment to profit-sharing plan that provides enhanced rate of matching contributions. Employer A has a profit-sharing plan that includes a qualified cash or deferred arrangement and matching contributions with respect to elective deferrals of up to 3% of compensation. On November 1, 2015, Employer A amends the plan to provide, effective January 1, 2016, for an additional 4% of compensation contribution for employees who (1) were previously covered under the defined benefit plan, and (2) had attained the age of 50 and 15 years of service on or before December 31, 2015. This enhanced rate of matching contributions is reasonably designed so that the matching contributions will replace some or all of the value of the benefit accruals that would have otherwise been provided to this subgroup of employees.

(iii) Applicability of special testing rule. The plan amendment is a closure amendment with a closure date of December 31, 2015. The enhanced rate of matching contributions that is available solely to the grandfathered group of employees is a separate benefit, right, or feature that must be tested for current and effective availability under paragraphs (b) and (c) of this section. For a plan year that begins on or after January 1, 2021, Plan P’s enhanced rate of matching contributions is eligible for the relief provided by the special testing rule of this paragraph (d)(8) because all applicable requirements are satisfied. The requirement under paragraph (d)(8)(i)(A) of this section is satisfied because no change was made to the enhanced rate of matching contribution that is applicable to the plan amendment that is on or after December 31, 2015. The following applicable additional requirements are also satisfied: The benefit, right, or feature provided under the defined contribution plan is a rate of matching contribution as required by paragraph (d)(8)(iii)(A) of this section; the enhanced rate of matching contributions is subject to the same applicable additional requirements as the plan amendment that is on or after December 31, 2015; and the plan amendment that is on or after December 31, 2015 is a closure amendment with a closure date that is on or after December 31, 2015.
rate of matching contribution is reasonably designed so that the matching contributions will replace some of the value of the benefit accruals that each employee in the grandfathered group of employees would have otherwise been provided under Plan P immediately prior to the closure date as required by paragraphs (d)(8)(iii)(B) of this section; and the rate of matching contributions is provided in a consistent manner to all similarly situated employees as required by paragraph (d)(8)(iii)(D) of this section.

(iv) Applicability of § 1.401(a)(4)–8(b)(1)(iii)(D)(2). In addition to the requirements described in paragraph (iii) of this Example 2, Plan P meets the conditions for a closed defined benefit plan specified in § 1.401(a)(4)–8(b)(1)(iii)(D)(3) as required by paragraph (d)(8)(iii)(C) of this section because Plan P’s prior benefit formula generated equivalent normal allocation rates that increased as employees attained higher ages; Plan P satisfied the minimum coverage and nondiscrimination requirements under sections 410(b) and 401(a)(4) without regard to the special rules under section 410(b)(6)(C) and without aggregating with any other plan for the plan year preceding the closure date; and Plan P was in effect for the five-year period ending on the closure date and neither the benefit formula nor the coverage of the plan was significantly changed during this period.

(vi) Effective/applicability dates. The rules of this paragraph (d)(8) apply to plan years beginning on or after the date of publication of the Treasury decision adopting these rules as final in the Federal Register. Taxpayers may apply the rules of this paragraph (d)(8) for plan years beginning on or after January 1, 2014.

* * * * *  
Par. 6. Section 1.401(a)(4)–8 is amended by:
1. Revoking paragraphs (b)(1)(iii)(B) through (E).
2. Removing paragraph (b)(1)(iii)(F).

The revisions and additions read as follows:

§ 1.401(a)(4)–8 Cross-testing.

(a) * * * * *
(b) * * * *
1. * * * *
(iii) * * * *
(B) Defined benefit replacement allocations disregarded. In determining whether a plan has broadly available allocation rates for the plan year within the meaning of paragraph (b)(1)(iii)(A) of this section, the following rules in paragraphs (b)(1)(iii)(B)(1) and (2) of this section apply:

1. If an employee receives a defined benefit replacement allocation (within the meaning of paragraph (b)(1)(iii)(D) of this section) for the plan year in addition to the employee’s otherwise applicable allocation under the plan for the plan year, then the employee’s allocation rate is determined without regard to the defined benefit replacement allocation.

2. If an employee receives an allocation for the plan year that is the greater of the allocation for which the employee would otherwise be eligible and the defined benefit replacement allocation (within the meaning of paragraph (b)(1)(iii)(D) of this section), then the allocation for which the employee would otherwise be eligible is considered currently available to the employee, even if the employee’s defined benefit replacement allocation is greater. See paragraph (b)(1)(iii)(C)(2) of this section for additional rules relating to “greater-of” plan provisions.

(C) Plan provisions—(1) In general. Plan provisions providing for defined benefit replacement allocations (within the meaning of paragraph (b)(1)(iii)(D) of this section) for the plan year must specify both the group of employees who are eligible for the defined benefit replacement allocations and the amount of the defined benefit replacement allocations.

(2) “Greater-of” plan provisions. An allocation does not fail to be a defined benefit replacement allocation within the meaning of paragraph (b)(1)(iii)(D) of this section merely because the plan provides that each employee who is eligible for a defined benefit replacement allocation receives the greater of that allocation and the allocation for which the employee would otherwise be eligible under the plan.

(3) Limited plan amendments. Except as provided in paragraph (b)(1)(iii)(D)(5) of this section, an allocation is not a defined benefit replacement allocation within the meaning of paragraph (b)(1)(iii)(D) of this section if the plan year if the plan provisions relating to the allocation are amended after the date those plan provisions are both adopted and effective.

(D) Defined benefit replacement allocation—(1) In general. A defined benefit replacement allocation is an allocation under a defined contribution plan provided only to a grandfathered group of employees with respect to a closed defined benefit plan. An allocation is treated as a defined benefit replacement allocation if—

(i) The allocation satisfies the conditions to be a replacement allocation with respect to a closed defined benefit plan in paragraph (b)(1)(iii)(D)(2) of this section;

(ii) The closed defined benefit plan satisfies the conditions in paragraphs (b)(1)(iii)(D)(3) of this section; and

(iii) For each plan year that begins before the fifth anniversary of the closure date of the closed defined benefit plan, the grandfathered group of employees is a nondiscriminatory group of employees within the meaning of paragraph (b)(1)(iii)(D)(4) of this section.

(2) Replacement allocation. An allocation is a replacement allocation with respect to a closed defined benefit plan under this paragraph (b)(1)(iii)(D)(2) if—

(i) The allocation is designed so that it is reasonably expected to replace some or all of the value of the benefit accruals that each employee in the grandfathered group of employees would have been provided under the closed defined benefit plan in the absence of a closure amendment (based on the terms of that plan and the section 415(b)(1)(A) dollar limit in effect immediately prior to the closure date); and

(ii) The allocation is provided in a consistent manner to all similarly situated employees.

(3) Closed defined benefit plan. A closed defined benefit plan satisfies the conditions in this paragraph (b)(1)(iii)(D)(3) if—

(i) The closed defined benefit plan’s benefit formula applicable to the grandfathered group of employees generated equivalent normal allocation rates that increased from year to year as employees attained higher ages or were credited with additional years of service;

(ii) The closed defined benefit plan satisfied the minimum coverage and nondiscrimination requirements under sections 410(b) and 401(a)(4) without regard to the special rules under section 410(b)(6)(C) and without aggregating with any other plan, for the plan year preceding the closure date; and

(iii) The closed defined benefit plan was in effect for the 5-year period ending on the closure date and neither the benefit formula nor the coverage of the plan was significantly changed during this period.

(4) Nondiscriminatory group of employees. A group of employees is a nondiscriminatory group of employees for purposes of this paragraph (b)(1)(iii)(D)(4) if the group of employees satisfies section 410(b) for the plan year (without regard to § 1.410(b)–5).

(5) Certain amendments not taken into account. For purposes of determining whether the requirements of paragraphs (b)(1)(iii)(C)(3) and (b)(1)(iii)(D)(3) of this section are satisfied, the following plan amendments are not taken into account:
(j) An amendment to the closed defined benefit plan adopted during the 5-year period ending on the closing date, provided that the accrued benefit or future accruals for any employee are not increased, coverage is not expanded, and the amendment is not discriminatory within the meaning of paragraph (b)(1)(iii)(D)(6) of this section.

(ii) An amendment to the defined contribution plan under which the defined benefit replacement allocation is provided makes de minimis changes in the calculation of that allocation (such as a change in the definition of compensation to include section 132(f) elective reductions).

(ii) An amendment to the defined contribution plan under which the defined benefit replacement allocation is provided that makes changes in the calculation of that allocation in a manner that is not discriminatory within the meaning of paragraph (b)(1)(iii)(D)(6) of this section.

(v) Eligibility for testing on a benefits basis—(A) General rule—(1) In general. Unless, for the plan year, a DB/DC plan is primarily defined benefit in character (within the meaning of paragraph (b)(2)(v)(B) of this section) or consists of broadly available separate plans (within the meaning of paragraph (b)(2)(v)(C) of this section), in order to be permitted to demonstrate satisfaction of the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the benefits basis, the DB/DC plan must satisfy the minimum aggregate allocation gateway (as described in paragraph (b)(2)(v)(D) of this section) except as provided in paragraph (b)(2)(v)(A)(2) of this section.

(2) Additional testing options. A DB/DC plan that is not eligible to demonstrate satisfaction of the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits under paragraph (b)(2)(v)(A)(1) of this section is permitted to demonstrate satisfaction of that requirement on the basis of benefits if the DB/DC plan satisfies either the closed plan rule of paragraph (b)(2)(v)(F) of this section or the lower interest rate rule of paragraph (b)(2)(v)(G) of this section.

(3) Effective/applicability date. See §1.401(a)(4)–13(a)(4) for rules on the effective/applicability date of this paragraph (b)(2)(v)(A).

* * * * *

(D) * * * *

(3) Averaging of rates for NHCEs—(i) Defined benefit plan. For purposes of paragraph (b)(2)(v)(D), a plan is permitted to treat each NHCE who benefits under a defined benefit plan that is part of the DB/DC plan as having an equivalent normal allocation rate equal to the average of the equivalent normal allocation rates under the defined benefit plan for all NHCEs benefitting under that plan.

(ii) Defined contribution plan. For purposes of paragraph (b)(2)(v)(D), a plan is permitted to treat each NHCE who benefits under a defined contribution plan that is part of the DB/DC plan as having an allocation rate equal to the average of the allocation rates under the defined contribution plan for all NHCEs benefitting under that plan.

(iii) Limitations on the averaging of rates. For purposes of applying paragraphs (b)(2)(v)(D)(3)(i) and (ii) of this section, any equivalent normal allocation rate or allocation rate in excess of 15% of plan year compensation is treated as being 15%.

The preceding sentence is applied by substituting 25% for 15% each time it
appears, but only if any allocation rate or equivalent normal allocation rate higher than 15% results solely from a plan design providing allocation rates or generating equivalent normal allocation rates that are a function of age or service under which higher rates are provided to older or longer-service employees.

(4) Use of matching contributions. For purposes of this paragraph (b)(2)(v)(D), if an NHCE is eligible for a matching contribution under a defined contribution plan that is part of the DB/DC plan, then the lesser of 3% and the average matching contribution percentage for the group of eligible NHCEs in that plan is permitted to be added to the allocation rate for that NHCE. For this purpose, the average matching contribution percentage for the group of eligible NHCEs in a plan is the actual contribution percentage (within the meaning of §1.401(m)–5) for that group, determined without taking into account any employee contributions.

Effective/applicability date. See §1.401(a)(4)–13(a)(4) for rules on the effective/applicability date of this paragraph (b)(2)(v)(D).

(F) Closed plan rule—(1) In general. For a plan year that begins on or after the fifth anniversary of the closure date with respect to a closed defined benefit plan, a DB/DC plan that includes a closed defined benefit plan satisfies the closed plan rule of this paragraph (b)(2)(v)(F) for the plan year if—

(i) The closed defined benefit plan was in effect for the 5-year period ending on the closure date and neither the benefit formula nor the coverage of the plan was significantly changed by plan amendment (other than the closure amendment) with an effective date during the period that begins five years before the closure date and ends on the last day of the plan year; and

(ii) For each plan year that begins on or after the closure date and before the fifth anniversary of the closure date, one of the requirements in paragraph (b)(2)(v)(E)(2) of this section is satisfied.

(2) Tests post-closure. A DB/DC plan meets the requirements of this paragraph (b)(2)(v)(F)(2) if—

(i) Each defined benefit plan that is part of the DB/DC plan satisfies the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits without aggregation with any defined contribution plan; or

(ii) The DB/DC plan satisfies the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of contributions; or

(iii) The DB/DC plan satisfies the primarily defined benefit in character requirement of paragraph (b)(2)(v)(B) of this section, or the broadly available separate plans requirement of paragraph (b)(2)(v)(C) of this section.

(3) Certain amendments not taken into account. For purposes of this paragraph (b)(2)(v)(F), the following plan amendments are not taken into account:

(i) An amendment to the closed defined benefit plan adopted during the 5-year period ending on the closure date, provided that the accrued benefit or future accruals for any employee are not increased, coverage is not expanded, and the amendment is not discriminatory within the meaning of §1.401(a)(4)–8(b)(1)(iii)(D)(6).

(ii) An amendment adopted during the 5-year period ending on the closure date that extends the benefit formula with respect to the closed defined benefit plan to an acquired group of employees provided that all similarly situated employees within that group are treated in a consistent manner.

(iii) An amendment to the closed defined benefit plan that is adopted after the closure date that is not discriminatory within the meaning of §1.401(a)(4)–8(b)(1)(iii)(D)(6).

(4) Lower interest rate rule. A DB/DC plan satisfies the lower interest rate rule of this paragraph (b)(2)(v)(G) if the plan can demonstrate satisfaction of the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits, provided that benefits are normalized using an interest rate of 6% rather than a standard interest rate.

Effective/applicability date. See §1.401(a)(4)–13(a)(4) for rules on the effective/applicability date of this paragraph (b)(2)(v)(G).

(A) Grandfathered group of employees. A grandfathered group of employees with respect to a closure amendment means the group of employees who, after the closure date, either continue accruals under the closed defined benefit plan’s benefit formula or are entitled to an allocation formula under a defined contribution plan because those employees previously participated in the closed defined benefit plan.

(B) Par. 9. In §1.401(a)(4)–13, paragraph (a)(4) is added to read as follows:

§1.401(a)(4)–13 Effective dates and fresh-start rules.

(a) * * *

(4) Effective/applicability date—(i) In general. Except as otherwise provided in this paragraph (a), the rules of §1.401(a)(4)–2(c), §1.401(a)(4)–3(c)(2), §1.401(a)(4)–8(b), and §1.401(a)(4)–9(b)(2)(v)(A) and (D) apply to plan years beginning on or after the date of publication of the Treasury decision adopting these rules as final in the Federal Register.

(ii) Application for earlier plan years. Except as provided in paragraph (a)(4)(iii) of this section, taxpayers may apply §1.401(a)(4)(ii) and §§1.401(a)(4)–3(c)(2), §1.401(a)(4)–8(b), or §1.401(a)(4)–9(b)(2)(v)(A) and (D) for plan years beginning on or after January 1, 2014 and before the effective/applicability date specified under paragraph (a)(4)(i) of this section. Alternatively, for these plan years, taxpayers may apply §1.401(a)(4)–2(c), §1.401(a)(4)–3(c)(2), §1.401(a)(4)–8(b), or §1.401(a)(4)–9(b)(2)(v)(A) and (D) as contained in 26 CFR part 1 revised April 1, 2015.

(iii) Certain rules not applicable until finalized. The rules of §1.401(a)(4)–9(b)(2)(v)(D)(3)(ii), (b)(2)(v)(D)(4), and (b)(2)(v)(G) are not permitted to be applied for plan years before the effective/applicability date specified in paragraph (a)(4)(i) of this section.

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John Dalrymple,
Deputy Commissioner for Services and Enforcement.

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