

§ 1.410(b)-4 Nondiscriminatory classification test.

(a) *In general.* A plan satisfies the nondiscriminatory classification test of this section for a plan year if and only if, for the plan year, the plan benefits the employees who qualify under a classification established by the employer in accordance with paragraph (b) of this section, and the classification of employees is nondiscriminatory under paragraph (c) of this section.

(b) *Reasonable classification established by the employer.* A classification is established by the employer in accordance with this paragraph (b) if and only if, based on all the facts and circumstances, the classification is reasonable and is established under objective business criteria that identify the category of employees who benefit under the plan. Reasonable classifications generally include specified job categories, nature of compensation (i.e., salaried or hourly), geographic location, and similar bona fide business criteria. An enumeration of employees by name or other specific criteria having substantially the same effect as an enumeration by name is not considered a reasonable classification.

(c) *Nondiscriminatory classification*—(1) *General rule.* A classification is nondiscriminatory under this paragraph (c) for a plan year if and only if the group of employees included in the classification benefiting under the plan satisfies the requirements of either paragraph (c)(2) or (c)(3) of this section for the plan year.

(2) *Safe harbor.* A plan satisfies the requirement of this paragraph (c)(2) for a plan year if and only if the plan's ratio percentage is greater than or equal to the employer's safe harbor percentage, as defined in paragraph (c)(4)(i) of this section. See § 1.410(b)-9 for the definition of a plan's ratio percentage.

(3) *Facts and circumstances*—(i) *General rule.* A plan satisfies the requirements of this paragraph (c)(3) if and only if—

(A) The plan's ratio percentage is greater than or equal to the unsafe harbor percentage, as defined in paragraph (c)(4)(ii) of this section, and

(B) The classification satisfies the factual determination of paragraph (c)(3)(ii) of this section.

(ii) *Factual determination.* A classification satisfies this paragraph (c)(3)(ii) if and only if, based on all the relevant facts and circumstances, the Commissioner finds that the classification is nondiscriminatory. No one particular fact is determinative. Included among the facts and circumstances relevant in determining whether a classification is nondiscriminatory are the following—

(A) The underlying business reason for the classification. The greater the business reason for the classification, the more likely the classification is to be nondiscriminatory. Reducing the employer's cost of providing retirement benefits is not a relevant business reason.

(B) The percentage of the employer's employees benefiting under the plan. The higher the percentage, the more likely the classification is to be nondiscriminatory.

(C) Whether the number of employees benefiting under the plan in each salary range is representative of the number of employees in each salary range of the employer's workforce. In general, the more representative the percentages of employees benefiting under the plan in each salary range, the more likely the classification is to be nondiscriminatory.

(D) The difference between the plan's ratio percentage and the employer's safe harbor percentage. The smaller the difference, the more likely the classification is to be nondiscriminatory.

(E) The extent to which the plan's average benefit percentage (determined under § 1.410(b)-5) exceeds 70 percent.

(4) *Definitions*—(i) *Safe harbor percentage.* The safe harbor percentage of an employer is 50 percent, reduced by $\frac{3}{4}$ of a percentage point for each whole percentage point by which the nonhighly compensated employee concentration percentage exceeds 60 percent. See paragraph (c)(4)(iv) for a table that illustrates the safe harbor percentage and unsafe harbor percentage.

(ii) *Unsafe harbor percentage.* The unsafe harbor percentage of an employer

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is 40 percent, reduced by $\frac{3}{4}$ of a percentage point for each whole percentage point by which the nonhighly compensated employee concentration percentage exceeds 60 percent. However, in no case is the unsafe harbor percentage less than 20 percent.

(iii) *Nonhighly compensated employee concentration percentage.* The nonhighly compensated employee concentration percentage of an employer is the percentage of all the employees of the employer who are nonhighly compensated employees. Employees who are excludable employees for purposes of the average benefit test are not taken into account.

(iv) *Table.* The following table sets forth the safe harbor and unsafe harbor percentages at each nonhighly compensated employee concentration percentage:

| Nonhighly compensated employee concentration percentage | Safe harbor percentage | Unsafe harbor percentage |
|---|------------------------|--------------------------|
| 0-60 | 50.00 | 40.00 |
| 61 | 49.25 | 39.25 |
| 62 | 48.50 | 38.50 |
| 63 | 47.75 | 37.75 |
| 64 | 47.00 | 37.00 |
| 65 | 46.25 | 36.25 |
| 66 | 45.50 | 35.50 |
| 67 | 44.75 | 34.75 |
| 68 | 44.00 | 34.00 |
| 69 | 43.25 | 33.25 |
| 70 | 42.50 | 32.50 |
| 71 | 41.75 | 31.75 |
| 72 | 41.00 | 31.00 |
| 73 | 40.25 | 30.25 |
| 74 | 39.50 | 29.50 |
| 75 | 38.75 | 28.75 |
| 76 | 38.00 | 28.00 |
| 77 | 37.25 | 27.25 |
| 78 | 36.50 | 26.50 |
| 79 | 35.75 | 25.75 |
| 80 | 35.00 | 25.00 |
| 81 | 34.25 | 24.25 |
| 82 | 33.50 | 23.50 |
| 83 | 32.75 | 22.75 |
| 84 | 32.00 | 22.00 |
| 85 | 31.25 | 21.25 |
| 86 | 30.50 | 20.50 |
| 87 | 29.75 | 20.00 |
| 88 | 29.00 | 20.00 |
| 89 | 28.25 | 20.00 |
| 90 | 27.50 | 20.00 |
| 91 | 26.75 | 20.00 |
| 92 | 26.00 | 20.00 |
| 93 | 25.25 | 20.00 |
| 94 | 24.50 | 20.00 |
| 95 | 23.75 | 20.00 |
| 96 | 23.00 | 20.00 |
| 97 | 22.25 | 20.00 |
| 98 | 21.50 | 20.00 |
| 99 | 20.75 | 20.00 |

(5) *Examples.* The following examples illustrate the rules in this paragraph (c).

Example 1. Employer A has 200 nonexcludable employees, of whom 120 are nonhighly compensated employees and 80 are highly compensated employees. Employer A maintains a plan that benefits 60 nonhighly compensated employees and 72 highly compensated employees. Thus, the plan's ratio percentage is 55.56 percent ($[60/120]/[72/80] = 50\%/90\% = 0.5556$), which is below the percentage necessary to satisfy the ratio percentage test of § 1.410(b)-2(b)(2). The employer's nonhighly compensated employee concentration percentage is 60 percent ($120/200$); thus, Employer A's safe harbor percentage is 50 percent and its unsafe harbor percentage is 40 percent. Because the plan's ratio percentage is greater than the safe harbor percentage, the plan's classification satisfies the safe harbor of paragraph (c)(2) of this section.

Example 2. The facts are the same as in *Example 1*, except that the plan benefits only 40 nonhighly compensated employees. The plan's ratio percentage is thus 37.03 percent ($[40/120]/[72/80] = 33.33\%/90\% = 0.3703$). Under these facts, the plan's classification is below the unsafe harbor percentage and is thus considered discriminatory.

Example 3. The facts are the same as in *Example 1*, except that the plan benefits 45 nonhighly compensated employees. The plan's ratio percentage is thus 41.67 percent ($[45/120]/[72/80] = 37.50\%/90\% = 0.4167$), above the unsafe harbor percentage (40 percent) and below the safe harbor percentage (50 percent). The Commissioner may determine that the classification is nondiscriminatory after considering all the relevant facts and circumstances.

Example 4. Employer B has 10,000 nonexcludable employees, of whom 9,600 are nonhighly compensated employees and 400 are highly compensated employees. Employer B maintains a plan that benefits 600 nonhighly compensated employees and 100 highly compensated employees. Thus, the plan's ratio percentage is 25.00 percent ($[600/9,600]/[100/400] = 6.25\%/25\% = 0.2500$), which is below the percentage necessary to satisfy the ratio percentage test of § 1.410(b)-2(b)(2). Employer B's nonhighly compensated employee concentration percentage is 96 percent ($9,600/10,000$); thus, Employer B's safe harbor percentage is 23 percent, and its unsafe harbor percentage is 20 percent. Because the plan's ratio percentage (25.00 percent) is greater than the safe harbor percentage (23.00 percent), the plan's classification satisfies the safe harbor of paragraph (c)(2) of this section.

Example 5. The facts are the same as in *Example 4*, except that the plan benefits only 400 nonhighly compensated employees. The plan's ratio percentage is thus 16.67 percent ($[400/9,600]/[100/400] = 4.17\%/25\% = 0.1667$). The

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plan's ratio percentage is below the unsafe harbor percentage and thus the classification is considered discriminatory.

Example 6. The facts are the same as in *Example 4*, except that the plan benefits 500 nonhighly compensated employees. The plan's ratio percentage is thus 20.83 percent $([500/9,600]/[100/400] = 5.21\%/25\% = 0.2083)$, above the unsafe harbor percentage (20 percent) and below the safe harbor percentage (23 percent). The Commissioner may determine that the classification is nondiscriminatory after considering all the facts and circumstances.

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§ 1.410(b)-5 Average benefit percentage test.

(a) *General rule.* A plan satisfies the average benefit percentage test of this section for a plan year if and only if the average benefit percentage of the plan for the plan year is at least 70 percent. A plan is deemed to satisfy this requirement if it satisfies paragraph (f) of this section for the plan year.

(b) *Determination of average benefit percentage.* The average benefit percentage of a plan for a plan year is the percentage determined by dividing the actual benefit percentage of the nonhighly compensated employees in plans in the testing group for the testing period that includes the plan year by the actual benefit percentage of the highly compensated employees in plans in the testing group for that testing period. See paragraph (d)(3)(ii) of this section for the definition of testing period.

(c) *Determination of actual benefit percentage.* The actual benefit percentage of a group of employees for a testing period is the average of the employee benefit percentages, calculated separately with respect to each of the employees in the group for the testing period. All nonexcludable employees of the employer are taken into account for this purpose, even if they are not benefitting under any plan that is taken into account.

(d) *Determination of employee benefit percentages—(1) Overview.* This paragraph (d) provides rules for determining employee benefit percentages. See paragraph (e) of this section for alternative methods for determining employee benefit percentages.

(2) *Employee contributions and employer-provided benefits disregarded.*

Only employer-provided contributions and benefits are taken into account in determining employee benefit percentages. Therefore, employee contributions (including both employee contributions allocated to separate accounts and employee contributions not allocated to separate accounts), and benefits derived from such contributions, are not taken into account in determining employee benefit percentages.

(3) *Plans and plan years taken into account—(i) Testing group.* All plans included in the testing group under § 1.410(b)-7(e)(1), and only those plans, are taken into account in determining an employee's employee benefit percentage.

(ii) *Testing period.* An employee's employee benefit percentage is determined on the basis of plan years ending with or within the same calendar year. These plan years are referred to in this section as the relevant plan years or, in the aggregate, as the testing period.

(4) *Contributions or benefits basis.* Employee benefit percentages may be determined on either a contributions or a benefits basis. Employee benefit percentages for any testing period must be determined on the same basis (contributions or benefits) for all plans in the testing group.

(5) *Determination of employee benefit percentage—(i) General rule.* The employee benefit percentage for an employee for a testing period is the rate that would be determined for that employee for purposes of applying the general test for nondiscrimination in §§ 1.401(a)(4)-2, 1.401(a)(4)-3, 1.401(a)(4)-8 or 1.401(a)(4)-9, if all the plans in the testing group were aggregated for purposes of section 410(b). Thus, if employee benefit percentages are determined on a contributions basis, each employee's employee benefit percentage is the aggregate normal allocation rate that would be determined for the employee under § 1.401(a)(4)-9(b)(2)(ii)(A) (if the plans in the testing group include both defined benefit and defined contribution plans), the allocation rate that would be determined for the employee under § 1.401(a)(4)-2(c)(2) (if the plans in the testing group include only defined contribution plans), or the equivalent normal allocation