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RETIREMENT PLANS

NEW MINIMUM PARTICIPATION RULES

By: Matt W. Zeigler, Esq.

Simplified Minimum Participation Regulations.

In a significant about-face, the IRS has withdrawn the proposed regulations under Internal Revenue Code Section 401(a)(26) published February 14, 1989 and repropounded them. The old regulations were 93 pages in length and, in their reissued form, have been cut by over half to 40 pages.

Thomas D. Terry, the Treasury Benefits Tax Counsel, said that this section "has become the symbol of complexity".

The basic concept behind minimum participation rules is to limit, by plan design, (1) the maximization of benefits in favor of the prohibit group of highly compensated employees, and (2) the operation of a defined benefit plan as an individual account or for a single highly compensated employee or a small group of highly compensated employees.

As repropounded, the Service decided not to exercise the statutory authority granted it to identify and require separate testing of separate benefit structures, according to Nancy J. Marks, a technical assistant in the Office of Assistant Chief Counsel. The six tests provided under last year's regulations have been replaced with a single facts and circumstances test. "This should significantly simplify testing under the minimum participation rules," she said.

The Rule. These regulations address the minimum numbers of employees that actually participate in qualified plans. The basic rule set out in the Internal Revenue Code is that each qualified plan must "on each day of the plan year" benefit the lesser of:

- (i) 50 employees of the employer, or
- (ii) 40% or more of all employees of the employer.

This is a new annual requirement that must become a part of the yearly administration. However, if a plan meets certain exemptions, then it will be deemed automatically to pass this requirement.

Profit Sharing or Money Purchase Plans; Testing Eliminated. For existing defined contribution plans, such as profit sharing or money purchase plans, the benefits provided in earlier years (a "prior benefit structure") and those plans currently providing benefits to plan

participants, any testing of the prior or the present benefit structure has been eliminated. Instead, the present benefit structure is to be tested under the new non-discrimination regulations under section 401(a)(4) which was addressed in this column in the June, 1990 issue.

Profit sharing and other defined contribution plans must still meet the 50 employee/40% rule, but the prior benefits do not have to be tested under the following rule.

For Defined Benefit Plans. The testing of all prior benefit structures has been reduced to a single test.

The Test. The test of the prior benefit structure of a defined benefit plan is whether the plan

...provides (or currently accrue) meaningful benefits to a group of employees that includes the lesser of 50 employees or 40% of the employer's employees.

Meaningful benefits under a plan is made on a facts and circumstances basis. The relevant factors include the level of current benefits, the length of time the current benefit formula has been in effect and the number of employees with accrued benefits under the plan.

Who are the employees who benefit? An employee, who benefits under a plan for a plan year means only one who "actually accrues a benefit for the plan year". In certain limited circumstances, an employee may not accrue a benefit during the plan year and will still be treated as benefiting. These exceptions to the general rule are: participants who do not accrue a benefit under a §401(k) plan, or participants who do not make an elective contribution under a §401(k) plan.

Exclusions; New 500 Hour Rule. Certain employees may still be excluded from the testing sample. Those exclusions are employees who do not meet the minimum age and years of service requirements of the plan. Also, employees terminating during the plan year may be excluded only if the terminating participant has 500 or less hours of service and is not employed on the last day of the plan year. A transition rule for plan years beginning in 1989, permit the exclusion of employees, otherwise eligible, but who fail to accrue a benefit solely because of the 1,000 hours of service or employment on "last-day" of the plan year requirements, are treated a benefiting under the plan.

Testing Day. Section 401(a)(26) requires that the minimum participation rules be met on each day of the plan year. The new proposed regulations require meeting the 50 employee/40% rule only on one day in the plan year, provided that day is "reasonably representative" of the plan's coverage and the employee population.

Employers with two plans. Plan aggregation is not permitted to meet the requirements of §401(a)(26). Thus, each plan, even if identical in contribution, benefits, and availability of benefits, rights, and features, must be tested separately, except for certain plans (multiemployer plans, multiple employer plans, plans with ESOP features). Thus, employers with more than one plan must insure that each plan continues to meet the 50/40% rule.

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Plan exempted from §401(a)(26). If a plan does not fall into certain exemptions, then it must pass the minimum participation testing requirements. Exempted plans are treated as meeting the requirements of §401(a)(26) without further participation testing. Such plans are: (1) plans with no highly compensated employees; (2) a multiemployer plan whose only participants are bargaining unit employees (i.e. there are no non-union participants); (3) underfunded defined benefit plans; and (4) plans acquired in a merger or consolidation.

Failed the Test? Retroactive Plan Amendments. If a plan fails to satisfy these requirements as of the last day of the plan year, that plan can be amended as of that day to alter eligibility conditions to expand coverage or improve benefits or contributions to enable the plan to pass the test. This is a so-called "fail-safe" amendment."

Effective Date And Transition Rules.

The effective date for these rules is for plan years beginning on and after January 1, 1989.

Conclusion.

All qualified retirement plans must pass the new minimum participation rules. The only plans which are required to pass the prior benefit structure are defined benefit plans. Whether or not benefits provided to participants are "meaningful" will be measured under the new nondiscrimination rules discussed in this column in the June, 1990 issue. For all plans it is important to have a "fail-safe" amendment that would permit a plan sponsor to amend its plan at the end of a plan year in the event that a plan were to inadvertently fail to pass the 50 employee/40% rule because of a closing or sale of a store or line of business, or a reduction in force.