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NUTS AND BOLTS OF THE TRA 1986 RESTATEMENT PROCESS

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Nuts and Bolts of the TRA 1986 Restatement Process

By *Matt W. Zeigler*

It is now time to amend retirement plans and trusts to conform with the Tax Reform Act of 1986 ("TRA '86"), the Omnibus Budget Reconciliation Act of 1986 ("OBRA '86"), the Omnibus Budget Reconciliation Act of 1987 ("OBRA '87"), the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA"), and the Omnibus Budget Reconciliation Act of 1989 ("OBRA '89") (collectively referred to as "TRA '86").

OPENING OF THE DETERMINATION LETTER PROCESS

For Defined Contribution Plans, the determination letter was opened effective May 1, 1990. Filing now will enable a plan sponsor to take advantage of not only the special reliance procedure, but also for those sponsors with less than 100 participants, a substantially lower user fee.

For Defined Benefit Plans, the determination letter process was opened in September, 1990, slightly before the scheduled user fee increase set for October 1, 1990.

Revenue Procedure 90-20[1] sets out the special procedures pertaining to the issuance of determination letters on the qualified status of certain ongoing retirement plans.

NEW FORMS

The IRS now requires the use of a new set of forms which have a special pink first page that will be "optically scanned" by a computer, and of course, must be manually typed and signed on the pink original and a *carbon* copy.

Revenue Procedure 90-20 announced that on or after April 30, 1990, certain ongoing defined contribution plans may file for determination letters that include consideration of the changes made by TRA '86...

The new required forms to use are the Form 5300 (Rev. 2-90), for individually designed plans, Form 5307 (Rev. 2-90), for Master, Prototype, Regional Prototype or Volume Submitter Plans, or Form 6406 (Rev. 2-90), for short form amendments. The IRS has software available to create the new Form 5307 for IBM and compatible equipment (not including Apple MacIntosh equipment). Interested practitioners may obtain that software package free of charge.[2]

An applicant will also need the new Employee Census Form 5302 (Rev. 2-90) for the supporting employee data. The Schedule T, which was required in the last restatement process for the 1982 and 1984 tax acts, will not be required. The remainder of the forms and documents required for the plan application will be the Form 8717 User Fee, the corporate resolutions adopting the plan, the plan, the latest determination letter (if the plan was previously approved), and Form 2848, the power of attorney.

FILING REQUIREMENTS

Revenue Procedure 90-20 announced that on or after April 30, 1990, certain ongoing defined contribution plans may file for determination letters that include consideration of the changes made by TRA '86, including those changes made by OBRA '89. To be eligible for this all inclusive determination letter, a plan must meet all of the following requirements:

- The plan is an ordinary defined contribution plan (target benefit, ESOP, stock bonus plans are *NOT* included);
- The employer must *NOT* be relying on the Section 410(b)(2) average

benefit percentage test to meet coverage requirements;

- The employer must *NOT* be relying on the "line of business" exception under Section 410(b)(5) to meet coverage requirements;
- Any disparity (social security integration) in contributions under the plan must satisfy the requirements of Section 401(l) and IRS Notice 89-70; and
- The plan may *NOT* rely on any other plan to meet coverage requirements of Section 410(b) or nondiscrimination requirements of Section 401(a)(4).

The applicant also *must include a certification* (separate from any cover letter submitted with the application) that the requirements indicated above are met by the plan or the employer maintaining the plan. The application must also include a copy of the latest determination letter, f available. If the letter is not available, an explanation must be included in a cover letter.[3]

A determination letter under this Revenue Procedure will not consider whether the plan meets the Section 401(a)(26) minimum participation requirement that a qualified plan must benefit the lesser of 50 employees or 40% of the employer's active employees unless special information is submitted with the application. That information must demonstrate that 50 active employees or 40% of the active employees benefit under the plan for the current year.

This is easy for defined contribution plans because the requirement of testing the prior benefit structures has been eliminated for these plans[4] and current benefit structures are tested only on the basis of the nondiscrimination regulations of Section 401(a)(4)[5] (discussed below). However, for defined benefit plans, a single "meaningful benefits" test to determine compliance with these minimum participation rules for prior benefit structures has been adopted.[6]

INCREASE IN IRS USER FEES SET FOR OCTOBER 1, 1990

The IRS has imposed "user fees" on those persons that utilize its services. Sponsors of qualified retirement plans will be required to amend their plans over the next year-and-one-half. The user fee is determined by how many participants are in the plan. For example, a defined contribution plan with less than 100 participants requires a user fee payment of $450; for those plans with 100 or more participants, the user fee will be $750.

Effective October 1, 1990, the user fee for qualified defined contribution plans with less than 100 participants, $700; for those plans with 100 or more participants, the user fee will be $825.

For those plan sponsors who adopt a so-called "Regional Prototype Plan" used by law firms, banks, insurance companies with a large volume of similar plan applications, the present user fee is $100 with the increase to $125 set for October 1st.

DEADLINE FOR RESTATEMENTS

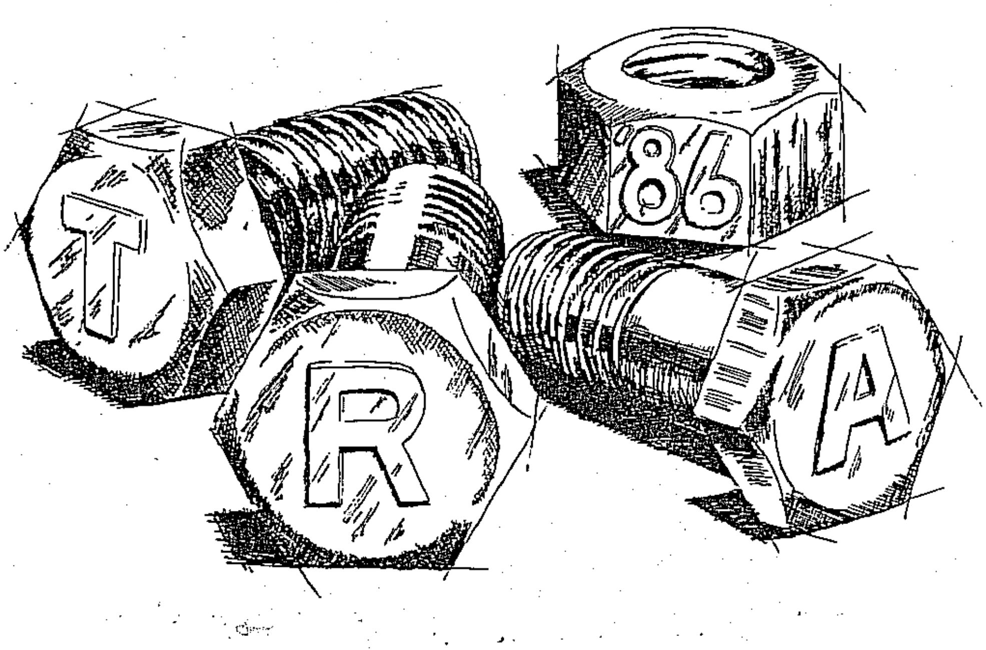
The deadline for the restatement of the retirement plans to comply with TRA 1986 under Section 401(b) of the Code is before the end of the 1991 plan year.[7]

EXTENDED RELIANCE PERIOD

Largely due to all of these changes, the IRS has announced an extended reliance period. A special reliance procedure permits an employer who files earlier than the last day of the 1991 plan year to receive a determination letter which will be valid for a longer period of time.[8]

Sponsors of qualified retirement plans will be required to amend their plans over the next year-and-one-half.

Under this procedure, an employer who files its application for a favorable determination letter on or before *June 30, 1991,* (and that also satisfied certain yet to be announced standards) will be able to rely on their favorable determination letter until the end of the *1994* plan year.



New vesting schedules are required effective with the beginning of the first day of the first plan year beginning on or after **January 1, 1989.**

This longer extended reliance period would keep a plan qualified except if Congress makes changes in the law. But the special procedure will apply to all regulatory changes made either by the Department of Labor, which governs the employee aspects of ERISA, or by the IRS which rules on the tax effects of ERISA plans.

For plans that file for a favorable determination letter after June 30, 1991, but before the last day of the 1991 plan year, employers can rely on their favorable letter until only the end of the *1993* plan year.

SUMMARY PLAN DESCRIPTIONS

All of these changes will require a complete reworking of the summary plan description which must not only be provided to all plan participants but also filed with the Department of Labor in Washington, D.C.

MISCELLANEOUS CHANGES

New Vesting Schedule

New vesting schedules are required effective with the beginning of the first day of the first plan year beginning on or after *January 1, 1989*. The choices are the "5-year cliff" schedule (after 4 years, 0%; after 5 years, 100%) or the "7-year graded" schedule (after 2 years, 0%; 3 years, 20%; 20% each year; after 7 years, 100%). The choices for the top heavy vesting schedules remain the same: Either the "3-year cliff" schedule (after 2 years, 0%; after 3 years, 100%) or the "6-year graded" schedule (after 1 year, 0%; 2 years, 20%; 20% each year; after 6 years, 100%).

Compensation Limit

The Internal Revenue Service has limited the amount of compensation that any plan can take into account when allocating a participant's share of employer contributions in a defined contribution plan, or the amount of benefit to be received in a defined benefit plan. The amount of compensation that can be taken into account for such purposes each year is $200,000. Any compensation received by a participant in excess of that amount is disregarded in applying the nondiscrimination rules. This annual compensation limit will be adjusted upward annually by the Commissioner of the IRS. The base year is 1989 and the first limit is $200,000. For 1990, the limit is $209,200.[9] The effective date for the use of this limit on compensation is for plan years beginning on or after January 1, 1991.

THE NEWEST NONDISCRIMINATION RULES

Proposed Regulations Under §401(a)(4)[10]

On May 10, 1990 the Internal Revenue Service published its long-awaited regulations dealing with discrimination in qualified employee retirement plans. These regulations were supposed to have been published in the summer of 1989, but they have been revised and simplified. Because of the move toward simplification, other previous proposed regulations have been modified.

These regulations are designed to test in a general way whether the amount of contributions or benefits discriminate in favor of the highly compensated employees ("HCEs"). The rule tests the contribution amount as a percentage of compensation, so the actual dollar amount can be greater for HCEs, as long as these employees don't receive a larger percentage of pay.

Overview. In news releases accompanying the regulations, the IRS representatives stated that they had made a "deliberate attempt" to provide safe harbors for each of the most common types of plans. Some of the major types of changes to the format of the proposed regulations are the first use of lengthy preambles designed to set out the new rules and the underlying philosophy in plain English. Of the 48-page preamble, over 40 pages are dedicated to these new proposed nondiscrimination regulations. IRS representatives have asked practitioners to utilize the preamble as a tool for interpreting the regulations. Moreover, the text of these regulations is designed to be more readable, but nevertheless require 116 pages. Also, they are in the treatise form and not the question and answer format. The IRS also provided a very helpful outline/guide of the regulations which, itself, is 9 pages long.

Seven safe harbors provide the groundwork for the basic rule that benefits must not unfairly favor the HCEs. A plan can meet some of the safe harbors by plan design alone, some require detailed individual employee data testing. Those safe harbors that require some employee data are designed to utilize readily available data whenever possible. There are two safe harbors for defined contribution plans, three safe harbors for defined benefit plans, one safe harbor for target benefit plans, and one safe harbor for a defined benefit plan with a floor offset arrangement.

Where a plan does not fit into a safe harbor, the regulations supply a general rule whereby each plan, by data testing and not plan design, must demonstrate that the amount of employer-derived contributions or benefits do not discriminate in favor of the prohibited group of employees, i.e., the HCEs. As promulgated in the regulations, the general rule is that no HCE can have a contribution allocation rate or a benefit accrual rate that exceeds that of the nonhighly compensated employees ("NHCEs").[11]

For example, if a plan document provides employees with an allocation rate or benefit accrual rate calculated with the same percentage of compensation or the same dollar amount for every employee under the plan, then that plan will meet the safe harbor.

After the general rule is satisfied, the plan must meet the second requirement which is that both the current and effective availability of the benefits, rights, and features provided under a plan must be nondiscriminatory. For example, optional forms of benefits, like annuities and lump sum distributions and ancillary benefits, like disability benefits and plan loan and investment options, must all be equally available to all employees under the plan.[12]

The third requirement of the new regulations is that the effect of the plan in certain special circumstances (e.g., plan amendments, past service credit, plan terminations) must not be discriminatory in favor of the HCEs.[13]

A basic consideration underlying all of these rules is that they must be interpreted in a "... reasonable manner consistent with the purpose of preventing discrimination in favor of HCEs."[14]

An overriding consideration governing the basis for these rules is the mandate that a qualified plan must satisfy both the proposed nondiscrimination regulations under §401(a)(4) *and* the minimum coverage requirements of §410(b).

> *...Section 410(b) requires that a plan cover a nondiscriminatory group of employees, and Section 401(a)(4) requires that the contributions or benefits provided to employees covered under the plan not discriminate in favor of those employees who are highly compensated. Because the requirements of (these sections) form a single, coordinated nondiscrimination rule, the same plan year, employer, and group of employees must be used to satisfy both sections, unless otherwise provided.*[15]

In order to meet these requirements, the plans can be aggregated and disaggregated (now called "restructured") into a single plan or into many plans, provided each plan meets the minimum coverage rules of §410(b) and all of the items used to test the plans are determined consistently with respect to the same plan year.[16]

The proposed regulations are the exclusive rules for determining compliance with §401(a)(4). A plan must comply with these rules both in form and in operation.[17] There are numerous special rules for some kinds of benefits or various groups of employees or benefits provided through qualified plans.

Because of the move toward simplification, other previous proposed regulations have been modified.

For Defined Contribution Plans. Of the seven new safe harbor tests, two will probably encompass the usual form of a majority of the plans adopted by employers. The first safe harbor test for defined contribution plans will permit automatic passage of the §401 (a)(4) tests. For example, in a profit sharing plan, if all participants receive the same share of the employer's contribution as a percentage of compensation, that plan will pass the test. Plans can "sail into" this new safe harbor on a plan design basis. So, all that a plan sponsor needs to do is review the language of the plan document in order to determine whether or not it meets the safe harbor criteria, rather than doing complex employee testing based upon the actual data used for the year.

SAFE HARBOR #1: Defined Contribution Plan with Uniform Allocation Formulas

This is a designed based safe harbor which can be met without extensive data testing which would calculate the allocation rates for individual employees. A plan satisfies this safe harbor if:

> *...the plan allocates all amounts taken into account under paragraph (c)(2) of this section [contributions and forfeitures] for the plan year under a single uniform formula that allocates the same percentage of compensation or the same dollar amount to every employee under the plan.*[18]

Any differences in the allocation formula that are caused by the maximum contribution limitations under §415, and differences caused by integration with social security under §401(l), also will not cause a plan to fail if every employee has the same integration level, the same base contribution percentage, and the same excess contribution percentage.

Does a formula for distributing an employer-provided contribution based upon a ratio of an individual participant's compensation to the total of all participant's compensation satisfy this safe harbor? This type of a formula yields neither a uniform dollar amount nor a uniform percentage of compensation.

In response to this question, the answer is "Yes," according to the representatives of the IRS at the IRS Central Region Employee Benefits Conference for Practitioners in Cincinnati, Ohio held June 7-8, 1990. The ratio method identified a uniform formula which applied to all of the participants in the plan.

What about a formula whereby each employee is awarded one point for each $100 of compensation? If participants receive an allocation of the employer contribution based upon the ratio of their individual number of points to the total number of points for all participants in the plan, then that formula will also satisfy the "single uniform formula" test of Safe Harbor #1, even though there will be slight variations in the actual percentage of compensation allocated. This comment was made by IRS representatives at the

American Law Institute and the ABA semi-annual Employee Benefits Conference in Washington, D.C. October 4-6, 1990.

SAFE HARBOR #2: Defined Contribution Plan with Age or Service Differences in Allocation Formulas

Employers who wish to take their employees' years of service or age into account have a separate safe harbor test. Although awards of prior service credit was frowned upon by the IRS in the past, these new proposed regulations permit a "single uniform formula weighted for age or service."[19]

Also, it is even possible for some HCEs to receive a larger share of the contribution if the percentage of variance meets certain requirements called the "Permitted Disparity Rules." These rules keep the idea of "social security integration" in place so long as every employee under the plan has the same integration level, the same base contribution percentage, and the same excess contribution percentage.

This is also a designed based safe harbor, but if selected, compliance will have to be demonstrated based upon the collection and testing of individual employee data. A plan satisfies this safe harbor if the following criteria are met:

> *...A plan must allocate all amounts taken into account under paragraph (c)(2) of this section [contributions and forfeitures] under a single uniform formula weighted for age or years of service. A single uniform formula weighted for age or service is one that would allocate to each employee in the plan the same percentage of compensation or the same dollar amount, if every employee had the same age and the same number of years of service or plan participation. Thus, the dollar amount of allocations may vary solely on account of compensation, age, years of service, or years of plan participation.*[20]

The "weighing" is permitted so long as the average rate of allocations for the HCEs does not exceed the average rate of allocations for the NHCEs.[21] However, social security integration cannot be considered in determining the average of the rates. The rate of allocations can be expressed as either a percentage or a dollar amount. This averaging feature is what needs to be tested each year to determine qualification.

Plans (other than 401(k) and (m) plans) failing both of these safe harbors may still pass only if all HCEs have allocation rates equal to or less than the allocation rates of the NHCEs.

For Defined Benefit Plans. The three safe harbors for defined benefit pension plans enable these plans to satisfy the nondiscrimination requirements on the basis of plan design as well, and not on complicated after-the-fact testing.

The first safe harbor is for a "unit credit plan." This is a plan that contains a formula under which all employees accrue a benefit, for each year of service, either as a percentage of compensation or as a dollar amount, and all employees with the same number of years of service accrue the same benefit. Again, some discrimination in favor of the HCEs is permissible as long as those employees do not receive a benefit in excess of 133% of the amount of benefit for the non-highly paid employees.

The remaining two safe harbors are for flat benefit plans which permit the accrual of benefits for more than or less than 25 years.[22]

However, these new sets of regulations have retained the other general nondiscrimination requirements and look to a facts and circumstances test. These rules still prohibit any favored treatment by plans of the owners or other HCEs of the plan sponsors either on a plan design basis or whether there is any discrimination in the actual operation of the plan. Such favoritism may be demonstrated by giving a lump sum payment to an HCE when he or she leaves employment while the NHCE must wait until age 65 or allowing the highly paid employees to have self-directed accounts when that option is not available to the lower paid employees.

EFFECTIVE DATE FOR NONDISCRIMINATION REGULATIONS

The effective date for these nondiscrimination regulations is the first day of the plan year beginning after December 31, 1990. This gives the plan sponsors time to review their design to determine whether any change is necessary.

NEW 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 reproposed them also on May 10, 1990. 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 prohibited group of HCEs, and (2) the operation of a defined benefit plan as an individual account or for a single HCE or a small group of HCEs.

As reproposed, 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.*[23]

This is a new annual requirement that must become a part of the yearly administration. However, if a plan meets certain exemptions, 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 nondiscrimination regulations under Section 401(a)(4) discussed above.[24]

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.*[25]

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.[26]

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."[27] 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.[28]

The new minimum coverage test measures the percentage of NHCEs benefiting under a plan against the percentage of HCEs benefiting under the 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.[29] 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.[30] A transition rule for plan years beginning in 1989 permits 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, to be treated as benefiting under the plan.[31]

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.[32]

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, and plans with ESOP features). Thus, employers with more than one plan must insure that each continues to meet the 50/40% rule.[33]

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 HCEs; (2) a multiemployer plan whose only participants are bargaining unit employees (i.e., there are no nonunion participants); (3) underfunded defined benefit plans; and (4) plans acquired in a merger or consolidation.[34]

Failed the Test? Retroactive Plan Amendments. If a plan fails to satisfy these requirements as of the last day of the plan year, the regulations permit that plan to 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.

Such a so-called "fail-safe" amendment, while normally included in plans, can cause some headaches if a former participant were to sue the plan sponsor on the theory that this amendment should have been extended to cover him/her. In other words, while the "fail-safe" amendment lends flexibility to an employer to insure the plan remains qualified, that flexibility provides an argument for an employee or former employee who did not benefit under the plan for that year alleging that the plan permits retroactive amendments to add benefits for them.

Effective Date

The effective date for these rules is for plan years beginning on and after January 1, 1989.[35]

Thus, 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 above. For all plans it is important to have a "fail-safe" amendment that would permit a sponsor to amend its plan at the end of a plan year in the event that it inadvertently failed to pass the 50 employee/40% rule because of a closing or sale of a store, a separate line of business, or a reduction in work force.

NEW MINIMUM COVERAGE REQUIREMENTS

There are new minimum coverage tests under Section 410(b) of the Code and proposed regulations, published May 18, 1989, to measure the percentage of employees that are covered by a qualified retirement plan.[36]

The new minimum coverage test measures the percentage of NHCEs benefiting under a plan against the percentage of HCEs benefiting under the plan. The test is met if the percentage of NHCEs benefiting is equal to or greater than 70% of the percentage of HCEs benefiting under the plan.

For example: Assume that, for a plan year, Plan A benefits 100% of an employer's active HCEs and 70% of employer's active NHCEs. The plan's ratio percentage for such year is 70% (i.e., 70% divided by 100%), and thus the plan satisfied the ratio percentage test. A plan would fail if, for example, Plan B benefits 60% of the employer's HCEs and 40% of the employer's NHCEs. This plan fails because the ratio is 40% divided by 60% or 66⅔%. The percentage in order to pass must be 70%.

Who are the employees who benefit under a plan? In a profit sharing or money purchase plan, an employee benefits if they receive an allocation of the employer's contribution or forfeitures for that year. An income allocation alone does not make an employee active for the purposes of the testing.[37]

New Rule for Terminating Employees. There is a special rule for terminating employees who have between 501 and 1,000 hours of service during a plan year. If a plan has a requirement that an employee be employed on the last day of the plan year in order to receive an allocation of the employer contribution for that year, and the employee terminates employment during the plan year with 500 or more hours but less than 1,000 hours, that terminated employee must be treated as an active employee. However, if an employee terminates during the year with less than five hundred hours of service, that employee can be excluded from the testing.[38]

This new special rule for terminating employees will affect those employers who have a smaller participant population in their plan for the year and those employers who have significant termination of participants during a plan year.

Nondiscriminatory Classification Test. These new minimum coverage rules also contain a new "nondiscriminatory classification test."[39] There are two parts to this test. Part one is that the plan provides that the class of employees that benefit under the plan is a reasonable class of employees.[40] This is a facts and circumstances test which reviews whether the classification is reasonable under objective business criteria that identify the benefiting employees under the plan by, for example, job classification or compensation, salaried or hourly, but not by name or other specific criteria.

Part two of the test requires either (A) a review of the facts and circumstances of the plan or (B) a safe harbor percentage of employees benefiting under the plan is attained. The facts and circumstances portion reviews (1) the underlying business reason for the classification, (2) the percentage of employees benefiting under the plan, (3) that the employees benefiting under the plan are in a salary range which is representative of the total number of employees in the work force and (4) that the difference between the percentage of the NHCEs benefiting under the plan is not very different from the percentage of participating HCEs. (In other words, the smaller the differences the more likely the classification is to be nondiscriminatory.)[41]

The second (B) portion of part two of the nondiscriminatory classification test compares the percentage of NHCEs benefiting with the percentage of HCEs benefiting under the plan. In short, this is a complicated testing procedure that compares the number of NHCEs actually benefiting as opposed to the total of all NHCEs eligible under the plan and as against the percent of all HCEs actually benefiting as compared to the percent of all HCEs eligible under the plan.[42]

What this test measures is the difference between the percent of those NHCEs and HCEs who actually benefit under the plan as opposed to the total number of employees who are only eligible but do not receive a benefit. So, if there are a large number of NHCEs who do not participate and do not receive a benefit and more or all of the HCEs receive a

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benefit under the plan, then the plan will fail this test and would face a serious qualification problem. However, if all of the NHCEs are eligible NHCEs and are benefiting, and all of the HCEs are benefiting under the plan, then the percentage is going to be 100% and there will be no difficulty in passing this test.

In short, this is a very complicated testing procedure requiring employee data to be performed every year and there is an extensive table of safe harbor and unsafe harbor percentages that are specified in the proposed regulations under Section 410(b) of the Code.[43]

EFFECTIVE DATE

The effective date for these new minimum coverage regulations is for the first plan year beginning on or after January 1, 1989.[44] There is a transition rule for the 1989 plan year which permits the inclusion of employees who fail to accrue a benefit solely because of the failure to satisfy the 1,000 hour per year requirement or the last day requirement for purposes of the 70% coverage test. For purposes of the 1989 plan year only, those employees who fail to meet any of those requirements may still be treated as benefiting for that plan year only.[45]

FAILED THE TEST?

In the event that the plan does not pass the test, the plan document may provide for a retroactive plan amendment to permit more liberal eligibility conditions to cover more employees that may work less than 1,000 hours of service. This would be another use for a "fail-safe" plan amendment.

CONCLUSION

There are many new areas of rather complicated data evaluation that are required in order that a qualified plan remain qualified. The nondiscrimination, minimum participation and minimum coverage proposed regulations together comprise almost 200 pages of "fine print" that, if not followed, will disqualify a plan. Remember, that the same people who brought us 200 pages of regulations interpreting the written documentation requirements of Section 89 in March of 1989 are still employed by the IRS and drafted the regulations addressed in this monograph.

The effect of the IRS draftors has been significantly reduced following the repeal of Section 89 and is demonstrated by the withdrawal this year of the proposed regulations of February, 1989 which outlined six separate tests for prior benefit structures under §401(a)(26) for defined contribution plans. Unfortunately, at present, the area of employee benefits has not yet been significantly simplified. ■

Footnotes

1. I.R.B. 1990-15, April 9, 1990. CCH at ¶17,299L-74.
2. Practitioners interested in the free software may send the IRS a blank formatted 5¼" floppy disk and the IRS will copy the program and return it to you. For information, contact Vickie Surguy at (513) 684-3241.
3. Rev. Proc. 90-20, I.R.B. 1990-15, April 9, 1990, Sections 4 and 5; and EP/EO Newsletter, EP/EO Cincinnati Key District, June, 1990.
4. §1.401(a)(26)-3(a).
5. Preamble to 401(a)(26) proposed regulations of May 10, 1990 at page 8-9.
6. §1.401(a)(26)-3.
7. Rev. Proc. 89-65, I.R.B. 1989-50, December 11, 1989. This extension applies to all of the TRA 1986 Acts, referenced above, except OBRA '89.
8. Rev. Proc. 89-65, SEC. 6.02.
9. Internal Revenue News Release IR-90-15, 1-30-90; Proposed Reg §1.401(a)(17)-1(a)(2).
10. Section 1.401(a)(4).
11. §1.401(a)(4)-2(c)(1) and §1.401(a)(4)-3(c)(1).
12. §§1.401(a)(4)-4, 1.401(a)(4)-9, and 1.401 (a)-4.
13. §1.401(a)(4)-5.
14. §1.401(a)(4)-1(c)(2).
15. *Id.* at -1(c)(8).
16. *Id.* at -1(c)(8) and (9).
17. *Id.* at -1(a).
18. §1.401(a)(4)-2(b)(2).
19. §1.401(a)(4)-2(b)(2).
20. §1.401(a)(4)-2(b)(3)(i).
21. §1.401(a)(4) Preamble at page 11.
22. §1.401(a)(4)-3(b)(3) and (4).
23. Internal Revenue Code Section 401(a)(26).
24. Preamble to 401(a)(26) proposed regulations of May 10, 1990 at page 8-9.
25. §1.401(a)(26)-3(c).
26. *Id.* at -3(c)(2).
27. §1.401(a)(26)-5(a).
28. §1.401(a)(26)-5(b).
29. §1.401(a)(26)-6(b)(1).
30. §1.401(a)(26)-6(b)(7).
31. §1.401(a)(26)-9(b)(3).
32. §1.401(a)(26)-7(a) and (b).
33. §1.401(a)(26) Proposed Regulations, Preamble at page 11.
34. §1.401(a)(26)-1(b).
35. §1.401(a)(26)-9(a).
36. §1.410(b)-1.
37. §1.410(b)-3(b)(1).
38. §1.410(b)-3(c)(1).
39. §1.410(b)-4.
40. §1.410(b)-4(b).
41. §1.410(b)-4(c)(3).
42. §1.410(b)-4(c)(2).
43. §1.410(b)-4(c)(4)(vi).
44. §1.410(b)-10.
45. §1.410(b)-10(b)(2).