

**Review of Issues Raised By "New Comparability" Plans**

Notice 2000-14

I. PURPOSE

The Internal Revenue Service and the Treasury Department are undertaking a review of issues posed by "new comparability" plans and invite public comments. The Service and Treasury believe it is appropriate at this time to review the effect of these rapidly evolving plan designs with the benefit of comments from plan sponsors, plan participants, and other interested parties.

New comparability plans (and similar plan designs such as "super-integrated" plans) are defined contribution plans that generally restrict higher rates of employer contributions to highly compensated employees. The focus of this review is the nondiscrimination requirements applicable to these plans.

Section 401(a)(4) of the Internal Revenue Code provides that a plan is a qualified plan only if the contributions or the benefits provided under the plan do not discriminate in favor of highly compensated employees. For purposes of determining whether nonelective employer contributions under a defined contribution plan discriminate in favor of highly compensated employees, the regulations under § 401(a)(4) permit such contributions either to be tested on a present value basis or to be "cross-tested" on a future value basis. Under this cross-testing method, contributions are converted to and tested as equivalent benefits payable at normal retirement age; the conversion is done by making an actuarial projection of the benefits payable at normal retirement age that are attributable to such contributions. Thus, this cross-testing method effectively permits nonelective employer contributions under a defined contribution plan to be tested as the equivalent of employer-provided benefits under a defined benefit plan.

Notwithstanding the analytical underpinnings of cross-testing, the Service and Treasury are concerned whether cross-tested plan designs that provide for built-in disparities in contribution rates between highly compensated and nonhighly compensated employees can be reconciled with the basic purpose of the nondiscrimination rules as applied to defined contribution plans. In this regard, the Service and Treasury are reviewing whether it is appropriate in all cases, without regard to the particular structure of a cross-tested defined contribution plan, to allow the projected future value of employer contributions to be tested as the equivalent of employer-provided benefits under a defined benefit plan.

For example, in a typical new comparability plan, highly compensated employees (who tend to be older than a majority of

nonhighly compensated employees) receive high allocation rates (often 18% to 20% of compensation), while nonhighly compensated employees, regardless of their age or years of service, receive comparatively low allocation rates (e.g., 3% of compensation). In the typical case, there is a sufficient number of young nonhighly compensated employees to enable the employer to demonstrate compliance with the nondiscrimination standards by comparing the actuarially projected value of the small allocations for those young nonhighly compensated employees with the actuarially projected value of the substantially larger allocations for older highly compensated employees. The Service and Treasury are concerned that, by plan design, nonhighly compensated employees never have an opportunity to earn the higher allocation rates as they work additional years for the employer and grow older. Further, when a sponsor replaces its existing defined contribution plan with a new comparability plan, rank-and-file employees may suffer significant reductions in their allocation rates, while owners and executives may benefit from a significant increase in their allocation rates.

## II. POSSIBLE APPROACHES

In their review of new comparability plans, the Service and Treasury are considering what modifications to the existing rules applicable to these plans might be appropriate. It is anticipated that any such modifications would be applied to plans, including existing plans, on a prospective basis only.

One possible approach to address the issues raised by new comparability plans would be to provide that, for purposes of determining whether a defined contribution plan satisfies § 1.401(a)(4)-8(b)(1) of the Income Tax Regulations (i.e., the rules governing the cross-testing of defined contribution plans), the right to receive each rate of nonelective employer contributions must be currently and effectively available on a nondiscriminatory basis, determined in a manner generally patterned after the approach under § 1.401(a)(4)-4 of the regulations. These regulations already contain a requirement that rates of the other three basic types of contributions -- elective contributions, after-tax employee contributions, and employer matching contributions -- be made currently and effectively available in a nondiscriminatory manner.

If such an approach were adopted, however, it is anticipated that, subject to certain conditions, a plan would be permitted to disregard differences in rates of nonelective contributions that result from differences in attained age or service for purposes of determining whether contribution rates are currently available in a nondiscriminatory manner. Accordingly, under such an approach, the Service and Treasury anticipate that cross-testing would continue to be a permissible testing alternative for generic age-weighted or service-based defined contribution plans (plans under which younger and shorter-service participants become entitled to higher allocation rates as they age and accumulate more service) and certain other

appropriate plan designs.

Comments are invited on this and other possible approaches (including appropriate exceptions) to address the issues raised by new comparability plans. It is requested that comments be submitted by May 15, 2000, and that they refer to Notice 2000-14. Comments can be addressed to CC:DOM:CORP:R (Notice 2000-14), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 2000-14), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may transmit comments electronically via the IRS Internet site at:  
[http://www.irs.gov/tax\\_regs/regslst.html](http://www.irs.gov/tax_regs/regslst.html).

#### DRAFTING INFORMATION

The principal author of this notice is James Flannery of the Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers) between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.