

LRM #94 on cross-tested profit-sharing plans – This LRM has been updated since it was posted to the EP website in draft form in June 2005 (as LRM #25B). The final version of LRM #94 follows immediately below:

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94. Document Provision, Nonstandardized plans only

Statement of Requirement: Profit-sharing plan – Cross-tested allocation formula, Regs. 1.401(a)(4)-8(b), 1.410(b)-6(f), Rev. Proc. 2005-16, 2005-10 I.R.B. 674 section 5.04

Sample Plan Language:

As elected by the employer in the adoption agreement, the employer will determine the total amount of contributions for each plan year and either (1) allocate such total amount to participant groups (the “Participant Group Allocation method”), or (2) allocate such total amount using age weighted allocation rates (the “Age Weighted Allocation method”). Employer contributions will be allocated to each eligible employee.

Participant Group Allocation method. If the employer has elected the Participant Group Allocation method in the adoption agreement, each eligible employee of the employer will constitute a “separate allocation group” for purposes of allocating contributions. Only a limited number of allocation rates (defined below) is permitted, and the number of allocation rates cannot be greater than the maximum allowable number of allocation rates. The maximum allowable number of allocation rates is equal to the sum of the allowable number of allocation rates for eligible nonhighly compensated employees (eligible NHCEs) and the allowable number of allocation rates for eligible highly compensated employees (eligible HCEs). The allowable number of allocation rates for eligible HCEs is equal to the number of eligible HCEs, limited to 25. The allowable number of NHCE allocation rates depends on the number of eligible NHCEs, limited to 25.

The allocation will be made as follows: First, the total amount of contributions is allocated among the deemed aggregated allocation groups in portions determined by the employer. A deemed aggregated allocation group consists of all of the separate allocation groups that have the same allocation rate. Second, within each deemed aggregated allocation group, the allocated portion is allocated to each employee in the ratio that such employee’s compensation, as defined in section _____ of the plan, bears to the total compensation of all employees in the group. An allocation rate is the amount of contributions allocated to an employee for a year, expressed as a percentage of compensation, as defined in section _____ of the plan. The number of eligible NHCEs to which a particular allocation rate applies must reflect a reasonable classification of employees, and no employee can be assigned to more than one deemed aggregated allocation group for a plan year.

(Note to reviewer: The blanks should be filled in with the plan section number that corresponds to Option B in the Sample Adoption Agreement language in LRM #31.)

(Note to Reviewer: Check whether the allowable number of allocation rates are distributed among the eligible NHCEs in a reasonable manner and that reasonable classifications are used.

For plans with only one or two eligible NHCEs, the allowable number of NHCE allocation rates is one. For plans with 3 to 8 eligible NHCEs, the allowable number of NHCE allocation rates cannot exceed two. For plans with 9 to 11 eligible NHCEs, the allowable number of NHCE allocation rates cannot exceed three. For plans with 12 to 19 eligible NHCEs, the allowable number of NHCE allocation rates cannot exceed four. For plans with 20 to 29 eligible NHCEs, the allowable number of NHCE allocation rates cannot exceed five. For plans with 30 or more eligible NHCEs, the allowable number of NHCE allocation rates cannot exceed the number of eligible NHCEs divided by five (rounded down to the next whole number if the result of dividing is not a whole number), but shall not exceed 25.

Age Weighted Allocation method. If the Age Weighted Allocation method is elected in the adoption agreement, the total employer contribution will be allocated to each eligible employee such that the equivalent benefit accrual rate for each participant is identical. The equivalent benefit accrual rate is the annual annuity commencing at the participant's testing age, expressed as a percentage of the participant's compensation as defined in section _____ of the plan which is provided from the allocation of employer contributions and forfeitures for the plan year, using standardized actuarial assumptions that satisfy 1.401(a)(4)-12 of the Income Tax Regulations. The employee's testing age is the later of normal retirement age, or the employee's current age.

(Note to reviewer: The blank should be filled in with the plan section number that corresponds to Option B in the Sample Adoption Agreement language in LRM #31.)

Minimum allocation gateway. Any allocation of contributions must satisfy the minimum allocation gateway:

Each eligible NHCE must have an allocation rate (defined above) that is not less than the lesser of 5%, or one-third of the allocation rate of the HCE with the highest allocation rate.

(Note to reviewer: There are other gateways that may be used in order for a defined contribution plan to cross-test using equivalent benefits under 1.401(a)(4)-8(b). The plan may provide for a different gateway other than the minimum allocation gateway (for instance, the broadly available allocation rate

requirement of Regulations section 1.401(a)(4)-8(b)(1)(iii) or the gradual age or service based allocation rate requirement of section 1.401(a)(4)-8(b)(1)(iv)); however, sample language for other gateways is not provided herein. If a sponsor wishes to use other gateways, it is important to ensure that the benefits provided under the plan remain definitely determinable. In order for plan benefits to remain definitely determinable, the plan document should specify which gateway is used. The plan document could allow adopting employers to elect between different gateways, but in order to provide definitely determinable benefits it is not sufficient for the plan document merely to specify that one of the gateway requirements will be satisfied.)

(Note to reviewer: No section 401(a)(4) failsafe language is allowed. The plan must pass nondiscrimination testing based on Income Tax Regulations sections 1.401(a)(4)-1 through 1.401(a)(4)-13.)

Sample Adoption Agreement Language:

() Contributions will be allocated under the following method (select one)

A. () Participant Group Allocation

Plan participants will be divided into the following groups (one or more) with the same allocation ratio:

Specify groups by category of participant, including both HCEs and NCHES: _____

(The specific categories of participants should be such that resulting allocations are provided in a definite predetermined formula that complies with 1.401-1(b)(1)(ii). The number of allocation rates must not exceed the maximum allowable number of allocation rates. HCEs may each be in separate allocation groups. Eligible NHCEs must be grouped using allocation rates specified in plan language. The grouping of eligible NHCEs must be done in a reasonable manner and should reflect a reasonable classification in accordance with 1.410(b)-4(b). Also, standard interest rate and standard mortality table assumptions in accordance with 1.401(a)(4)-12 must be used when testing the plan for satisfaction of nondiscrimination requirements. In the case of self-employed individuals (i.e., sole proprietorships or partnerships), the requirements of 1.401(k)-1(a)(6) continue to apply, and the allocation method should not be such that a cash or deferred election is created for a self-employed individual as a result of application of the allocation method.)

B. () Age Weighted Allocation

The following assumptions will be used to calculate the equivalent benefit accrual rate:

Pre-retirement Mortality _____

Post-retirement Mortality _____

Pre-retirement Interest _____

Post-retirement Interest _____

(Standard interest rate and standard mortality table assumptions in accordance with 1.401(a)(4)-12 must be used when testing the plan for satisfaction of nondiscrimination requirements. A table of age-weighted factors (that comply with the previous sentence) may also be used.)