Section 401.—Pension, Profit-Sharing, Stock Bonus Plans, etc.

26 CFR 1.401(a)(4)–1: Nondiscrimination requirements of section 401(a)(4).

Nondiscrimination; duplicate benefits. This ruling provides that the duplication of benefits for highly compensated employees may result in the failure of plans to satisfy the nondiscrimination requirements of section 401(a)(4) of the Code.

Rev. Rul. 99–51

Employer A maintained one plan, Plan X, a calendar year defined benefit plan, benefiting all of A's highly compensated employees within the meaning of § 414(q) of the Internal Revenue Code of 1986 (HCEs) and all of A's employees who are not highly compensated employees (NHCEs). Under Plan X, each employee's accrued benefit equals an annual benefit commencing at normal retirement age of one percent of average annual compensation per year of service. A "year of service" includes all years of service with Employer A. There are no related or predecessor employers nor is service under any other plan taken into account under Plan X.

In November 1997, Plan X was amended effective as of December 31, 1997 (the spin-off date) to become two plans: Plan X-H covering Employer A's HCEs and Plan X-N covering Employer A's NHCEs. The assets and benefit liabilities under Plan X as of the spin-off date were allocated between Plan X-H and Plan X-N in accordance with § 414(l). Pursuant to the terms of the amendment, NHCEs were excluded from participation in Plan X-H and HCEs were excluded from participation in Plan X-N. In addition, the amendment provided that there would be no benefit accruals under Plan X-H with respect to periods after the spin-off date (i.e., Plan X-H was "frozen" as of the spin-off date). Benefit accruals continued under Plan X's original formula for participants in Plan X-N.

Employer A later amended Plan X-N to include the HCEs and to provide the HCEs with an annual benefit commencing at normal retirement age equal to one percent of average annual compensation per year of service with Employer A. The years of service included in the computation of the HCEs' accrued benefit under Plan X-H were included in the computation of their benefits under Plan X-N as well. Benefits employees accrued under Plan X-N were not offset by their accrued benefits under Plan X-H.

Plan X, Plan X-H and Plan X-N are the only plans that have been maintained by Employer A, and none of these plans have been top-heavy within the meaning of § 416 for any plan year.

Section 401(a)(4) provides that contributions or benefits under a plan qualified under § 401(a) must not discriminate in favor of HCEs.

Section 1.401(a)(4)–1(c)(2) of the Income Tax Regulations provides that the regulations under § 401(a)(4) must be interpreted in a reasonable manner consistent with the purpose of preventing discrimination in favor of HCEs.

Section 1.401(a)(4)–5(a)(1)&(2) provides that, for determining whether the timing of a plan amendment or series of amendments has the effect of discriminating significantly in favor of HCEs, a plan amendment includes the establishment or termination of the plan, and any change in the benefits, rights, features or benefit formulas under the plan. Whether the timing of a plan amendment or series of plan amendments has the effect of discriminating significantly in favor of HCEs is determined at the time the plan amendment first becomes effective based on all relevant facts and circumstances. These include the relative numbers of current HCEs and NHCEs affected by the plan amendment, the relative accrued benefits of current HCEs and NHCEs before and after the plan amendment and any additional benefits provided to current HCEs and NHCEs under other plans.

Section 1.401(a)(4)–11(d)(2) provides that, on the basis of all relevant facts and circumstances, the manner in which employees' service is credited for all purposes under the plan must not discriminate in favor of HCEs.

Section 1.401(a)(4)–11(d)(3) provides that, except as otherwise provided, service for periods in which an employee did not participate in the plan may not be taken into account in determining whether the plan satisfies § 401(a)(4).

Held, under the facts of this case there is a duplication of service and benefits that discriminates in favor of HCEs in violation of § 401(a)(4).

DRAFTING INFORMATION

The principal author of this revenue ruling is Kenneth Conn of the Employee Plans Division. For further information regarding this revenue ruling, call the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers) between 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday, or Mr. Conn at (202) 622-6214 (also not a toll-free number).