

Answers to the Self Assessment Problems of Chapter 8

Questions

1. True

2. a. (1) Uniformity requirements for DC Plans have been met:
 - use of the last day for allocation purposes is permitted
 - plan definition of compensation meets 414(s)
 - points formula satisfies the calculation-based safe harbor but a year-end test required to compare NHCE average % to HCE average %. Here NHCE average = 11.2% compared to HCE average = 12.25%, so test would not be met in this plan year Uniformity requirements met. However, use of a points formula still requires annual calculations comparing the average NHCE allocation rate to the average HCE allocation rate. For the PY, the average NHCE allocation rate is 11.2%, compared to the average HCE allocation rate of 12.25%.

(2) TG = 4 partners + 15 associates + 5 staff employees = 24 - 6 HCEs, 18 NHCEs

NHCE concentration ratio = $18/24 = 75\%$

Benefiting under the plan: 9 - 4 HCEs, 5 NHCEs

RP for the Plan = $5/18$ vs. $4/6 = 42\%$

Under the general test, since the highest % for any HCE is 15% which exceeds the lowest % for any NHCE (which is 5%), the general test fails. Thus we restructure.

TG = 9 + 15 = 24 - 6 HCE, 18 NHCE; NHCE concentration ratio = $18/24 = 75\%$
 RP for plan: $5/18$ vs. $4/6$ which is 42% ✓

Prong #1 of ABT deemed automatically satisfied; Prong #2 = lesser of 42% or midpoint of the safe/unsafe harbor which is $(38.75 - 28.75) = 33.75\%$
 None of the rate groups satisfies the second prong of the ABT test.

We have three rate groups as there are three different HCE allocation rates:

	Z	20%
Rate Group #3	Partner D	15%
	X, Y	13%
Rate Group #2	Partners B, C	13%
Rate Group #1	Partner A	8%

RP for Rate Group #1: $3/18$ vs. $4/6 = 17\%$ vs. $66\% = 25\%$

RP for Rate Group #2: $3/18$ vs. $3/6 = 17\%$ vs. $50\% = 34\%$

RP for Rate Group #3: $1/18$ vs. $1/6 = 6\%$ vs. $17\% = 35\%$

All Rate Groups fail the 70% RP test. However, under the ABT test:

-- 1st prong deemed satisfied

- the 2nd prong, reduces the 70% RP downwards. Based on a NHCE concentration 75%, there is a new safe harbor equal to the midpoint between the safe and unsafe harbors of 38.75 and 28.75, which is

33.75%. Hence the RP % for Groups #2 and 3 would meet the midpoint, but the RP% for Groups #1 would fail. There are no facts and circumstances under the restructuring; hence the plan fails the nondiscrimination testing for the current PY.

- b. (1) BRF to be tested include: *no space*
- Uses of optional form since there may be a subsidy. Conditioning the availability of the lump sum upon a non-compete covenant is permissible under the regulations (Q&A 6(a)(2)). Tests include the effective and actual utilization tests to see who took advantage of which forms. Need to know who has taken advantage of these optional forms.
 - The fact that NRA is 65 + 5 years is not a BRF for a DC plan, thus no testing.
 - The difference in application of the vesting schedule should pose no problem, as it is consistent with the effective date of the plan. Immediate vesting upon disability/death is not a problem.
 - Availability of a rollover feature subject to the PA's discretion could be discriminatory. Again ask who has taken advantage of such feature.
 - Individual direction of account balances should not be a problem unless only HCEs are using it and none of the NHCEs
 - The availability of purchasing whole life insurance by the partners and only term insurance by the staff will be ruled to be discriminatory.
- (2) Daily valuation is recommended if the computer system can handle such valuations at modest costs. However, since the valuation is presently at year-end, changing to a daily valuation will alter participant's account values. Query if the valuation date is considered part of the accrued benefit such that the last year-end value must be preserved.
3. a. Since the annual accrual rate would be available to a separate group of participants under the plan, it would have to be tested under the general test of IRC §401(a)(4). Also there is a most valuable accrual rate in the early retirement benefit as it is subsidized. That test requires that the highest accrual rate and the most valuable accrual rate of any HCE not exceed the lowest accrual rate and most valuable accrual rate of any NHCE. If the select group of participants consists of any HCEs, this test will not be satisfied. Hence, there will be rate groups developed for each HCE with a different accrual rate. Coverage tests must then be applied to each rate group and satisfied either under the ratio percentage or average benefits percentage tests.
- b. Several options: the plan could be aggregated for coverage purposes with another plan and then tested under IRC §401(a)(4) as an aggregate plan; the plan language could state that the select group does not accrual a rate in excess of the applicable rate that satisfies the requirements of IRC §401(a)(4); the accrual rates of the NHCEs could be increased so as to satisfy the nondiscrimination tests; the accrual rates could be converted to defined contribution allocations and then compared

- for nondiscrimination purposes.
- c. Under the Treas. Reg. §1.401(a)(4), a plan that does not otherwise satisfy the general nondiscrimination tests may take into consideration the disparity that would have been allowed if the plan's formula took into consideration permitted disparity, and then test under the nondiscrimination test. With a base percentage of 1% on all compensation, the permitted disparity rules permit up to an additional 1% of compensation in excess of the Social Security maximum taxable wage base. Here the accrual rate requested is only an additional .5% rate for the highly paid.