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I. RETIREMENT PLANS FOR AFFILIATED SERVICE ORGANIZATIONS.

A. Introduction.

On December 28, 1980, President Carter signed into law Section 414(m) of the Code, which requires that, for affiliated service organizations, all employees of the organizations will be treated as employed by one employer. Under this new legislation, affiliated service organizations will no longer be entitled to discriminate in favor of professionals in providing qualified retirement plans. There follows below an examination of the state of the law prior to the new legislation, an analysis of the new legislation, and a recommendation with regard to what actions should be taken while Regulations are pending.

B. History.

1. Revenue Ruling 68-370 — The IRS States its Position.

Through Rev. Rul. 68-370, 1968-2 C.B. 174, the Service ruled that a corporation that participated in a joint venture would be required to take employees of the joint venture with another corporation into account in determining whether the corporation’s profit sharing plan met the requirements of Code section 401(a). The Service viewed the joint venture of the two corporations as a partnership, a partnership that was not itself a taxable entity, but merely the aggregate of the constituent partners. Therefore, the establishment of the requisite employment relationship between the partnership and the common-law employees of the partnership also established such relationship between each corporate partner and such employees for purposes of Code section 401.

The important effect of this conclusion was to attribute to each corporate partner the common-law employment relationship that existed between the partnership and the individual employees. Thus, since the employees of the joint venture were considered employees of the corporate partners, the Service held that such employees, and a pro rata share of the compensation paid to them, must be taken into account by each corporate partner in determining whether the qualified plan of each corporate partner met the coverage and nondiscrimination requirements set forth in Code section 401(a).

2. Packard/Burnetta Cases and Sections 414(b) and (c).

   a. Packard. In Ronald C. Packard, 63 T.C. 621 (1975), three dentists, practicing in a partnership, formed a service corporation to which all nonprofessional employees were transferred. The service corporation owned the office building in which the partnership was located and
provided bookkeeping and general staff services and facilities to the partnership and to other dentists not in the partnership.

The Tax Court held that the profit sharing plan adopted by the partnership (which covered only the dentist/partners) was qualified. The court reached this decision after determining that: (1) the service corporation was formed for a bona fide business purpose and was not a subterfuge, and (2) the service personnel were directed and controlled by, and therefore, under the familiar common-law test, were employees of the service corporation as opposed to the partnership. The court emphasized the following factors:

1. The service corporation marketed a complete package of services incidental to the practice of dentistry and sold this complete service not only to the partnership but also to three independent dentists;
2. The fees paid to the service corporation were not limited to a percentage of wages and expenses, but rather were a percentage of gross billings with respect to subscribers;
3. The relationship between the service corporation and the subscribers was formalized in a written lease and management contract; and
4. The partnership and the other subscribers were entitled to specify only the results to be accomplished by the service personnel while the service corporation maintained the right to control, hire and fire service personnel.

b. Code Sections 414(b) and (c). Code sections 414(b) and (c), which were added by ERISA, was the first attempt of Congress to prevent avoidance of the anti-discrimination rules through the use of multiple corporations. Code sections 414(b) and (c) basically incorporate the rules provided in Code section 1563 for determining a “controlled group” of corporations (for corporate surtax exemption purposes). Under Code sections 414(b) and (c) all controlled organizations must be aggregated for purposes of testing the minimum participation and other rules. However, because the tests of Code section 1563 are very restrictive, Code sections 414(b) and (c) were not entirely successful in eliminating abuse. It can be stated in retrospect that Sections 414(b) and (c) were truly a disaster for employee benefit practitioners, since they destroyed the flexible solution of Rev. Rul. 68-370.

b. Burnetta. The Tax Court again used the common-law employee attribution test in Edward L. Burnetta, O.D., P.A., 68 T.C. 387 (1977). In that case, an ophthalmologist and an optometrist formed separate professional corporations and adopted qualified retirement plans. Subsequently, they contracted with a service corporation, owned by the accountant for the professional corporations, to provide service personnel. As originally conceived, the service corporation was to be responsible for the selection, hiring, training and supervision of all service personnel for a number of
unrelated professional corporations. In practice, however, the selection, hiring, training and supervision of the service personnel were maintained by the respective professional corporations. Thus, the Tax Court held that the service personnel were employees of the professional corporations for whom they worked, and, consequently, the qualified retirement plans did not meet the coverage requirements of Code section 401(a)(3)(A) (pre-ERISA).

The Tax Court distinguished the Packard decision on the basis that in Packard the taxpayers were able to establish under the common-law employee test that control over the service personnel in fact rested in the service corporation, not in the partnership. If Code sections 414(b) and (c) had been in existence, their strict application to Burnetta, without consideration of the common-law employee test espoused under Rev. Rul. 68-370, would have resulted in the opposite conclusion.

3. The Kiddie Case — Pre-ERISA.

In the pre-ERISA case of Thomas Kiddie, M.D., Inc., 69 T.C. 1055 (1978), the Tax Court, discussing partnership law instead of the common-law employee/employer rules, thoroughly confused the area of employee participation in qualified plans of professional partnerships. Dr. Kiddie’s professional corporation provided pathological services to a hospital. In 1972, the corporation created a partnership with another professional service corporation to provide pathological services, with each corporation owning 50% of the partnership. The staff employees of Dr. Kiddie’s corporation then became employees of the partnership and Dr. Kiddie’s corporation adopted a qualified pension plan.

The court held that the staff employees were employees of the partnership and were properly excluded from Dr. Kiddie’s pension plan. The court, holding that the Code section 707(b) "greater than 50% test" should apply for purposes of Code section 401(a)(3), refused to attribute the partnership’s employees to Dr. Kiddie’s corporation because it owned only 50% of the partnership and, therefore, did not control the partnership. Whether Dr. Kiddie’s corporation controlled the partnership’s employees and, thus, was their employer, was not examined by the Tax Court.

4. The IRS Position After Kiddie.

The Service refused to follow Kiddie and continued to follow Rev. Rul. 68-370. For instance, in Letter Ruling 7834059, three professional corporations each held a one-third interest in the capital and profits of a law partnership with six full-time employees. One of the professional corporations proposed the adoption of a profit sharing plan. The Service ruled that this corporation could adopt a profit sharing plan, complying with the coverage and nondiscrimination requirements of Code section 401(a), even if the other two corporations and the partnership did not adopt such a plan. Further, the employees of the partnership would be considered the full-time employees of the professional corporation and would participate in the profit sharing plan to the extent of one-third of their compensation received from the partnership. If the professional corporations included the six employees of the partnership as participants in their qualified retirement plans, if any, to the extent of one-third of their compensation received from the partnership,
then the participation and nondiscrimination requirements of Section 401(a) of the Code would be satisfied.

5. **The Garland Case — Post-ERISA.**

An approach similar to that taken by the Service in Letter Ruling 7834059 was rejected by the Tax Court in its unfortunate opinion in *Lloyd M. Garland, M.D., F.A.C.S., P.A.*, 73 T.C. 5 (1979). Petitioner, a professional medical corporation, formed a partnership with a physician, and each partner owned a 50% interest in the partnership. The professional corporation adopted a pension plan which did not cover the common-law employees of the partnership. Dr. Garland felt that his professional corporation was not required by either Code section 414(b) or Code section 414(c) to cover the partnership's employees under the plan. Nevertheless, the Service determined that the plan did not qualify under Code section 401(a) because it did not comply with the antidiscrimination provisions of Code sections 401(a)(4) and 410(b)(1).

The Tax Court held, directly contrary to the position stated in Letter Ruling 7834059, that Code sections 414(b) and 414(c) are the exclusive means for determining whether the employees of affiliated entities should be aggregated for purposes of applying the anti-discrimination provisions. Further, the Tax Court held that, since the professional corporation did not control the partnership's employees, they were properly excluded from participation in the plan. The reasoning in *Kiddie* was followed, totally ignoring the logic and desirability of using the common-law employee test as used in Rev. Rul. 68-370 as an alternative means of compliance with the anti-discrimination provisions.

5. **Fujinon Optical — A Code Section 414(b) Aberration.**

Just as *Garland* demonstrated that Code Section 414(b), when mechanically applied, permitted wholesale evasion of the nondiscrimination requirement through creation of separate entities, the case of *Fujinon Optical, Inc.*, 76 T.C. No. 44 (1981) demonstrated that a mechanical application of Code Section 414(b) could result in aggregation of entities that properly should be viewed as separate employers.

*Fujinon Optical* involved the aggregation of three United States corporations (hereafter referred to as Corporations A, B and C) which had as a common parent a Japanese corporation. This common parent caused Corporations A, B, and C to be members of a controlled group of corporations within the meaning of Code sections 1563(a) and 414(b). Corporation A was involved in the development and marketing of highly sophisticated optical equipment for professional and commercial use. Corporations B and C were simply engaged in the distribution of general purpose film, tape and cameras. Corporation A was completely independent of Corporations B and C. Corporation A never had any business relationship, common employees, or common officers and directors with Corporations B and C. The Tax Court stipulated that Corporation A's business was "in no way integral with or even helpful to the business of either of the other companies."

.c. Corporation A maintained a profit sharing plan covering only employees at Corporation A. At issue was whether the profit sharing
plan satisfied the minimum coverage requirement of Code section 410(b)(1).
The Tax Court noted that Corporation A would satisfy the percentage re-
requirement of Code section 410(b)(1)(A) if considered only by itself, but held
that by reason of the common foreign parent, Corporations A, B, and C were
required to be aggregated, and therefore the percentage test of Code section
410(b)(1)(A) was not satisfied.

d. The Tax Court then examined the application of the
nondiscriminatory coverage test of Code section 410(b)(1)(B). In applying
the coverage test to the employees of Corporations A, B and C, taken as a
whole, the Tax Court found that 7 out of 8 employees covered by the plan
within the highly compensated group. The Tax Court noted that the reason
for this disparity was that Corporation A, by reason of the highly technical
nature of its endeavors, required employment of skilled specialists whose
compensation greatly exceeded the compensation paid to the great majority
of persons employed by Corporations B and C. The Tax Court held that since
virtually all of the covered employees were highly compensated, the nondis-
criminatory classification test of Code section 410(b)(1)(B) was not satisfied,
and the plan, therefore, was disqualified.

e. The Court noted that there was “an appealing argument
to be made that [Corporation A’s] plan simply does not discriminate [since]
for all intents and purposes [Corporation A] operates completely independent
of [Corporations B and C].” The Court stated, however, that Code section
414(b) did not permit any exemption from the aggregation requirements even
in cases for which no manipulative purpose was served by the structure of
related entities. The Court observed that “a legislature seeking to catch a
particular abuse may find it necessary to cast a wider net.” Unfortunately,
in the case of Code sections 414(b), (c) and (m), it appears that the net cast
by Congress will, in many cases, ensnare fish that should rightfully be left
alone and let pass through others that were intended to be the real target of
the remedial legislation.

C. Did the “Loophole” Become a Noose?

Code section 414(m) is effective for plan years ending after
November 30, 1980 for new plans and plan years beginning after that date
for existing plans. Code section 414(m) provides rules for the aggregation of
employees of certain separate organizations for purposes of applying tests to
various benefit plans. It is an emphatic response to the absurd results which
have received judicial approval in Kiddie and Garland, but applies only to
“service organizations.”

For purposes of defining qualified pension plans under Code
section 414(m), all employees of members of an “affiliated service group”
will be treated as employed by a single employer. An “affiliated service
group” consists of a service organization and one or more other organizations,
service or not, which are related. The broad definition of organization includes
a corporation, partnership or “other organization.” Code section 414(m) (2)
defines an affiliated service group as follows:

A first organization (FSO) and one or more of the following:

1. any service organization (A-ORG) which —
   a. is a shareholder or partner in the FSO, and
b. regularly performs services for the FSO or is regularly associated with the FSO in performing services for third persons, and

2. any other organization (B-ORG) if —
   a. a significant portion of the business of such organization is the performance of services for the FSO or A-ORG of a type historically performed in the service fielded by the FSO or A-ORG employees, and
   b. 10% or more of the interests of the B-ORG is held by persons who are officers, highly compensated employees, or owners of the FSO or A-ORG.

The only Service pronouncement to date concerning the interpretation of Section 414(m) appears in Rev. Rul. 81-105, 1981-12 I.R.B. 27. Rev. Rul. 81-105 illustrates that most abusive situations have been eliminated by the ‘‘A-ORG’’ and ‘‘B-ORG’’ tests established under Code section 414(m). (See Appendix 1).

The ‘‘A-ORG’’ test eliminates the use of a typical partnership or professional corporation to discriminate against staff employee participation in qualified retirement plans. That is, the partnership is the FSO because it provides services and the corporate partners are A-ORGs since they are regularly associated with the FSO in performing services (or regularly performs services for the FSO). Example 1 of Rev. Rul. 81-105 illustrates this result.

The ‘‘B-ORG’’ test also eliminates the ability of professionals to ‘‘loan out’’ staff employees to related service organizations. Example 2 of Rev. Rul. 81-105 illustrates the B-ORG rule as follows:

Corporation S provides secretarial services. Corporations A and B, both of which are professional corporations formed by doctors, each own a portion of S. A owns 11 percent of the stock of S and B owns eight percent of the stock. Approximately one-third of S’s services are performed for A and one-third for B, while the other one-third are performed for other firms. A and B each maintain a retirement plan (Plan A and Plan B) and each plan covers the corporation’s only employee. None of the statutory exclusions of section 410(b) of the Code applies.

Under Code section 414(m) (2), Corporations A and B may each be designated as separate FSO’s. Corporation S is a B-ORG for A because a significant portion of S’s business is the performance of services for A, the services are of a type historically performed in the FSO’s service field by its employees, and 11 percent of the interest in S is held by owners of the FSO. S is not a B-ORG for B because the owners of B do not hold 10 percent or more of the interest in S.

It is interesting to note that Rev. Rul. 81-105 does not discuss the possible application of the A-ORG rule to Example 2, presumably on the grounds that S is not a ‘‘service organization” or that neither A nor B is “regularly associated” with S in performing services. Obviously, there are a number of terms such as “regularly performs,” “service organization,” and “other organization” which must be defined in future regulations.

Neither Code section 414(m) nor Rev. Rul. 81-105 define the type of qualified plan which must be provided for the employees of an affiliated service group. Code section 414(m) (1) simply states that “all
employees of the members of an affiliated service group shall be treated as employed by a single employer.' That is, the same discrimination standards apply to the entire group, which means that rank-and-file employees must have benefits that are comparable to those of the officers, shareholders, and highly-paid employees. This has sometimes been called the "best plan" approach (the rank-and-file employees must have benefits provided under the best of the various retirement plans of the affiliated group members).

D. Alternatives for Dealing with Code Section 414(m).

1. Regulations Under Code Section 414(m).

A number of practitioners feel that the Regulations under Code section 414(m) should be drafted to reestablish the pro rata test established under Rev. Rul. 68-370. Section 414(m) was enacted to eliminate the abuses of Kiddie and Garland with regard to basic participation criteria. Requiring a "best plan" approach goes much farther than simply requiring participation; it drastically changes the level of benefits for staff employees and mandates an unduly complicated "comparability" of benefits. Further, some practitioners argue that there is little rationale in requiring that, where only one professional corporation (in a partnership of 10 professional corporations) adopts a qualified retirement plan, the staff employees of the partnership must be provided an identical plan for 100% of their incomes, irrespective of the fact that the activities of the professional corporation only account for one-tenth of the income of the staff employees.

In any event, there is sufficient authority for the Treasury to promulgate regulations adopting the "best plan" and not the pro rata approach. Code section 414(m) (1) requires that "all employees of the members of an affiliated service group shall be treated as employed by a single employer." There is little question concerning the discrimination rules which apply to a single employer — plans for highly compensated employees will not be qualified unless plans for staff employees are comparable. Consequently, practitioners should expect that the Regulations to be issued will adopt the best plan approach since the Service has so indicated in Rev. Rul. 81-105.

Obviously, the enactment of Code section 414(m) places a premium on sophisticated planning, which will probably entail the use of defined benefit plans for affiliated service organizations (with the objective of reducing the required contributions for rank and file employees). Pending the issuance of regulations under Code section 414(m), steps should be taken to either (1) avoid the application of the best plan approach (under the technical ownership rules of Code section 414(m) or (2) meet the requirements of the best plan approach. In either event, a ruling under Rev. Proc. 81-12, 1981-14 I.R.B. 42 should be obtained from the National Office and/or appropriate District Office of the Service to assure qualification. (See Appendix 2).

2. Avoiding Application of Code Section 414(m) Rules.

If an "affiliated service group" exists under Code section 414(m), it must be assumed that the "best plan" rules will apply. Consequently, there exists an incentive for avoiding the technical ownership rules
of Code section 414(m). Groups of professionals and professional corporations should be able to avoid Code section 414(m) by the use of the following forms of group practice.

a. Space Sharing Arrangements. Where professional corporations simply share space and where each corporation employs its own employees, Code section 414(m) will not be applicable. There is no common ownership and no partnership and, consequently, the A-ORG and B-ORG tests are avoided.

b. Of Counsel Arrangements. Where only one professional desires to establish qualified retirement plans, he can separate himself from the professional partnership and then incorporate his practice. The crucial factor under Code section 414(m) is control. If neither the newly-separated professional corporation nor the professional is a partner in the partnership but is only an independent contractor, no "affiliated service group" should exist. However, in order to establish such an independent (contractor) relationship, the separating professional must give up all voting control and ownership in the professional partnership and this might not be palatable to most "senior partners" (i.e., the likely candidates for establishing such "of counsel" professional corporations).

c. Service Bureau and Third Party Arrangements. As long as there is no (or less than 10%) ownership by a professional corporation in an organization providing staff personnel, there should be no need to cover the staff personnel under the qualified retirement plans of the professional corporation. The Garland case held that Section 414 is the exclusive test for determining affiliated service groups, apparently to the exclusion of the common-law employee/employer test. The enactment of Code section 414(m) following Garland has apparently codified this holding and the Service has also agreed. See Example 2 of Rev. Rul. 81-105 indicating that employees of a service bureau need not be considered employees of a professional corporation under Code section 414(m) where the owners of the professional corporation own less than 10% of the service bureau.

The common-law employee-employer test should still retain some vitality and service bureau arrangements should be reviewed very closely, especially where under local law the staff employees must be supervised by professionals (e.g., nurses). In addition, Code section 414(m) (6) gives the Secretary of the Treasury broad discretion to "prescribe such regulations as may be necessary to prevent avoidance with respect to service organizations, through use of separate organizations," of the coverage and discrimination requirements applicable to qualified plans. It is quite possible that an organization that is structured for the purpose of avoiding the technical requirements for aggregation under the specific tests of Code section 414(m) (2) (A) and (B) will be required to be treated as a single organization under regulations prescribed to prevent avoidance.

Although Code section 414(m) applies the stock attribution rules of Code section 267, it would also be technically possible to permit the staff employees to be employed by related parties whose stock would not be attributable to the professional corporations or the owners of the professional corporations (e.g., mothers-in-law or the associates of the professional practice).
E. Structuring Plans to Satisfy the Code Section 414(m) Requirements.

In many situations it will not be feasible to structure ownership of related entities in such a manner that creation of an affiliated service group within the meaning of Code section 414(m) will be avoided. In such situations the coverage and nondiscrimination requirements of Code sections 401(a)(4) and 410(b)(1) must be satisfied for the entire affiliated service group. For purposes of discussion it will be assumed that the affiliated service group consists of: (1) a partnership which employs all or a majority of the rank-and-file employees and may also employ one or more professionals, and (2) one or more corporate partners that employ an incorporated former partner. In this setting, each of the professional corporations will adopt a defined benefit plan.

There are two basic approaches under which the affiliated service group could satisfy the coverage and discrimination tests. These approaches are summarized immediately below and are developed in greater detail in the discussion that follows:

The "Fair Cross Section" Approach. Each professional corporation could employ a sufficient cross section of the employees of the affiliated service group so that a plan covering solely the employees of the adopting professional corporation would be deemed to cover a nondiscriminatory classification of employees, and therefore will satisfy the coverage and nondiscrimination requirements.

"Comparable Plan/Best Plan." If a professional corporation that adopts a plan does not employ a nondiscriminatory cross section of the employees of the affiliated service group, then the partnership that employs the bulk of the rank-and-file employees must establish a qualified plan, often referred to as the "core plan," which provides contributions or benefits at least as favorable as the "best plan" maintained by any professional corporation that is part of the affiliated service group.

1. The "Fair Cross Section" Approach.

a. A Hypothetical Case.

(1) Approach One — A Professional Corporation Employing Only Its Sole Shareholder. Suppose a professional service partnership contains 10 partners, 20 associates, and 30 staff personnel. Assume the senior partner transferred his partnership interest to his solely owned professional corporation, and the professional corporation adopted a defined benefit plan that will provide a benefit equal to 100% of final five year average pay subject to the dollar ceiling of Code section 415(b)(1)(A). If the senior partner were the sole employee of his professional corporation, the plan clearly would not satisfy the minimum coverage requirements of Code section 410(b)(1), and the partnership would be required to adopt a "comparable" plan. Funding the partnership’s comparable plan might constitute a prohibitive financial burden for the partnership to undertake, and the senior partner may be required to settle for a plan providing a benefit of substantially less than 100% of compensation, or may be discouraged from adopting any qualified retirement plan at all.
(2) Approach Two — A Professional Corporation Employing A Nondiscriminatory Classification. Suppose that in lieu of the partnership's adoption of a comparable plan, an attempt is made to have the senior partner's professional corporation employ a nondiscriminatory classification of the affiliated service group's employees, so that coverage of solely the professional corporation's employees would constitute a nondiscriminatory classification within the meaning of Code section 410(b) (1) (B).

The basic issue presented by Approach Two is, how many rank-and-file employees must the professional corporation employ to accomplish the objective of covering a nondiscriminatory classification. Although definitive authority does not exist on this issue, it is possible that if as few as one or two rank-and-file employees are transferred to the professional corporation (for example the senior partner's secretary and an assistant), the professional corporation's plan may pass the classification and nondiscrimination test.

This approach should not be taken absent a favorable IRS determination based on a full disclosure of all the facts. In addition, it might be best to provide full and immediate vesting under this approach to prevent a discrimination in operation problem under Code section 411(d) (1). Obtaining a determination for this approach might require administrative appeals and even declaratory judgment proceedings in the Tax Court; but in many circumstances the potential cost savings might justify the effort involved.

2. The "Comparable Plan/Best Plan" Approach.

If the plan of a single member of an affiliated service group does not cover a nondiscriminatory classification of the employees of the affiliated service group, an alternative approach to satisfying the minimum coverage requirement is to take into account more than one plan maintained by the affiliated service group to satisfy the coverage requirement. Code section 410(b) (1) and Treas. Reg. §1.401-3(f) provide that two or more plans designated by the employer as constituting parts of a single plan will be treated as a single plan for purposes of determining whether the coverage test is satisfied. An affiliated service group consisting of a partnership of professional corporations may therefore designate the plan(s) of corporate partner(s) and a plan maintained by the partnership as a single plan for purposes of satisfying the minimum coverage requirements. Any plans so aggregated will be qualified only if they do not discriminate in favor of the prohibited group. Hence such plans must be "comparable plans" with respect to the contributions or benefits provided under the plans.

a. Rev. Rul. 70-183, 1970-1 C.B. 104 states the basic framework for evaluating comparability of qualified retirement plans. The key to comparability is that in order to satisfy the nondiscrimination requirement of Code section 401(a) (4) plans may provide either nondiscriminatory contributions or nondiscriminatory benefits, see Rev. Rul. 69-253, 1969-1 C.B. 129. Accordingly, Rev. Rul. 70-183 holds that two (or more) deferred compensation plans will, when considered as a single plan, not be discriminatory if:

(1) The plans are both defined benefit plans and provide comparable benefits.
The plans are both defined contribution plans (profit-sharing, stock bonus or money purchase pension plans) and provide comparable contributions.

One plan is a defined benefit plan and the other plan is a defined contribution plan and the plans provide either, comparable contributions or comparable benefits.

Rev. Rul. 81-202, 1981-34 I.R.B. 5 sets forth new standards that may be applied in comparing contributions or benefits under different plans. (See Appendix 3).

Basic requirement that either plan contributions or plan benefits must be shown not to discriminate in favor of the prohibited group (I.R.C. secs. 401(a) (4), (5), and 415(b) (6).

The issue of comparability arises where a single plan, standing alone, fails the coverage requirements of I.R.C. sec. 410(b).

In such a case, two or more plans may be designated as a single plan for purposes of satisfying the coverage requirements (Treas. Reg. Sec. 1.410(b)-l(d) (3) (i).

Where such a designation is made, the plans considered as a unit must be shown not to discriminate in favor of the prohibited group.

No such designation may be made with respect to a TRASOP or a plan maintained by a Subchapter S Corporation (Treas. Reg. Sec. 1.410(b)-l(d) (3) (ii).

Historically benefits have been compared in the case of defined benefit plans and contributions have been compared in the case of defined contribution plans.

Where both types of plans were involved, either contributions or benefits were compared.

The ruling sets forth standards that may be applied in comparing contributions or benefits under different plans.

The ruling allows either contributions or benefits to be compared regardless of the types of plans involved (Sec. 3.01).

The tests in the ruling are not exclusive (Sec. 1).

Because different defined benefit plans have differing forms of benefits, rules are necessary to adjust all types of benefits to a standard form for purposes of comparison. Such rules are provided under Rev. Rul. 81-202.

Where a defined contribution plan is involved, rules are necessary to determine benefits under the plan for purposes of comparison. Such rules are provided under Rev. Rul. 81-202.

Under I.R.C. Sec. 401(a) (5), Social Security benefits may be taken into account for comparability purposes. Rules for imputing Social Security benefits are provided under Rev. Rul. 81-202.

Basic test for comparability of benefits is that "Normalized Employer-Provided Benefits" may not constitute a greater percentage of non-
deferred compensation for prohibited group employees than for rank-and-file employees. (Sec. 3.01 and 3.02).

F. Conclusion

1. A final suggestion of critical importance is to seek advance administrative approval of comparability from the Key District Director of Internal Revenue Service by following the procedure set out in Rev. Proc. 81-12 wherever an affiliated service group exists or may exist. The courts have repeatedly held that the Commissioner's determination of whether a plan's coverage is nondiscriminatory is entitled to "a shade more than its usual substantial weight," Commissioner v. Pepsi-Cola Niagara Bottling Corp., 399 F.2d 390 (2nd Cir. 1968), and will be overturned only if it is "found to be arbitrary or an abuse of discretion," Ed & Jim Fleitz, Inc., 50 T.C. 384 (1968). Therefore, absent on advance ruling regarding comparability, an employer will be faced with a heavy burden of proof should the Service challenge coverage as discriminatory.

2. Rev. Proc. 81-12, Section 5.03, states that failure to properly indicate in a determination letter request that there is or may be an affiliated service group and to provide the information specified in Rev. Proc. 81-12 will constitute an omission of a material fact and will result in the applicant being unable to rely on the determination letter concerning the effect of Code section 414(m).

3. Section 5.04 of Rev. Proc. 81-12 states that determination letters issued for determinations that have considered questions arising under Code section 414(m) will specifically state that the implications of Code section 414(m) were considered and that the plan satisfied the qualification requirements of such section. Rev. Proc. 81-12, Section 5.04 further states, "Absent such a statement pertaining to section 414(m), a determination letter does not apply to any qualification issue arising by reason of section 414(m)." Accordingly, in addition to requesting that a determination letter address any existing or potential Code section 414(m) issue, practitioners should take care to review the favorable determination letter to assure that the letter specifically purports to address Code section 414(m).

4. The availability under Rev. Proc. 81-12 of an advance administrative determination regarding satisfaction of Code section 414(m) offers the only available solution to the numerous as yet unanswered questions raised in the preceding discussion concerning the comparability of plans. Pending issuance of Code section 414(m) regulations and other administrative guidelines regarding comparability, the best advice we feel for the practitioner is to structure plans of affiliated service groups to attempt to provide actuarially comparable benefits and leave resolution of the unanswered issues to the determination letter procedure provided in Rev. Proc. 81-12.
APPENDIX 1

SECTION 414. — Definitions and Special Rules [Pension, Profit-Sharing, Stock Bonus Plans, etc.]

Affiliated service group. Information is provided with respect to when various businesses will be considered an affiliated service group and how this aggregation affects the retirement plans maintained by members of the group. Rev. Ruls. 68-370 and 75-35 obsoleted.

Rev. Rul. 81-105

SECTION 1. PURPOSE

This revenue ruling provides guidance with respect to the application of section 414(m) of the Internal Revenue Code, as added by the Miscellaneous Revenue Act of 1980, Pub. L. 96-605, 1981-6 I.R.B. 21, 24. The guidance emphasizes the interaction of section 414(m) of the Code with the nondiscrimination requirements of sections 410(b) and 401(a) (4) in response to questions that have arisen as to how those sections interact. This revenue ruling also obsoletes Rev. Rul. 68-370, 1968-2 C.B. 174, and Rev. Rul. 75-35, 1975-1 C.B. 131.

SECTION 2. APPLICABLE LAW

.01 Section 414(m) (1) of the Code provides that, for purposes of certain employee benefit requirements designated in section 414(m) (4), except to the extent otherwise provided in regulations, all employees of the members of an affiliated service group shall be created as employed by a single employer.

.02 Section 414(m) (2) defines an affiliated service group as a first service organization (FSO) and one or more of:

1. any service organization (A-ORG) which is a shareholder or partner in the FSO and which regularly performs services for the FSO or is regularly associated with the FSO in performing services for third persons, and

2. any other organization (B-ORG) if

(a) a significant portion of the business of that organization is the performance of services for the FSO or A-ORG of a type historically performed in the service field of the FSO or A-ORG by employees, and

(b) 10 percent or more of the interest of the B-ORG is held by persons who are officers, highly compensated employees, or owners of the FSO or A-ORG.

.03 The list of employee benefit requirements in section 414(m) (4) of the Code includes the following:

1. Section 410(b) which requires that, to satisfy the requirements of section 410(a), a retirement plan must cover either a certain percentage of employees or a classification of employees that does not discriminate in favor of employees who are officers, shareholders, or highly compensated (the prohibited group).

2. Section 401(a) (4), which requires that, to satisfy the requirements of section 401(a), either the contributions or the benefits under a retirement plan must not discriminate in favor of the prohibited group.
SECTION 3. EXAMPLES

.01 Example 1 —

(1) Facts — P, a law partnership consists of corporate partners A, B, C and 10 individual partners. Each of the partners owns less than 10% of the partnership. The partnership employs some lawyers, paralegals, and clerical employees. The partnership has a qualified plan, Plan P, covering some but not all of the common law employees. Corporation A and B each have only one employee, the sole shareholder. Corporation A maintains a retirement plan, Plan A. Corporation B maintains no plan. Corporation C employs the sole shareholder, a lawyer employee, and three clerical employees. Corporation C maintains a retirement plan, Plan C, for all its employees. Corporations A, B, and C regularly perform services for P. No individual is a participant in more than one plan and none of the statutory exclusions of section 410(b) applies.

(2) Determination of who are employees of a single employer under section 414(m) of the Code — In order to determine whether the employees covered by Plans A and C satisfy the coverage requirements of section 410(b), it must first be determined what employees are considered as employed by a single employer. Under section 414(m) (2), the partnership, P, may be designated as a FSO. Corporations A, B, and C are partners in the FSO, and regularly perform services for the FSO. Accordingly Corporations A, B, and C are A-ORGS. Because Corporations A, B, and C are A-ORGS for the same FSO, Corporations A, B, C, and the FSO constitute an affiliated service group. Consequently all the employees of Corporations A, B, C, the common law employees of P, and the partners of P are considered as employed by a single employer, and must be taken into account when testing whether the coverage requirements of section 410(b) are satisfied. This group is hereafter called the total aggregated employees.

(3) Determination of whether Plan A satisfies the coverage and nondiscrimination requirements — Plan A covers only one employee, the sole shareholder of Corporation A. Because none of the statutory exclusions of section 410(b) of the Code applies, 1 participant does not satisfy the percentage tests in section 410(b) (1) (A) when compared to the total aggregated employees. Because Plan A covers only prohibited group employees and the total aggregated employees contain several rank and file employees, the non-discriminatory classification test of section 410(b) (1) (B) is not satisfied, either. When a plan does not, considered alone, satisfy the requirements of section 410(b), the employer may designate other plans of the employer to be considered as a unit with the first plan. Such plans, considered as a unit must, among other things, satisfy the coverage and nondiscrimination requirements.

Assuming Plan P were so designated, the first question to consider is whether a plan covering only Employee A and the participants of Plan P satisfies the requirements of either section 410(b) (1) (A) or (B) of the Code when compared to the total aggregated employees. (Alternatively, the employer may designate Plans A, C, and P as a unit or simply Plans A and C as a unit.) If neither coverage test is satisfied Plan A is not a qualified plan. If either coverage test is satisfied, in order for Plan A to be qualified, Plans A and P, considered as a unit must also satisfy the non-discrimination
requirements of section 401(a) (4). In making this determination the rules for testing discrimination, including rules which permit imputing social security benefits, apply. In testing for discrimination, all the compensation paid by the affiliated service group to the participants of Plan P is considered, without regard to the percentage ownership of Corporation A in the partnership.

(4) Determination of whether Plan C satisfies the coverage and nondiscrimination requirements — Plan C covers one shareholder, one lawyer employee, and three clerical employees. Coverage of five participants is not adequate to satisfy the percentage tests of section 410(b) (1) (A) of the Code when compared to the total aggregated employees. Whether the nondiscriminatory classification test of section 410(b) (1) (B) would be satisfied by Plan C if its participants are compared to the total aggregated employees depends on additional facts and circumstances not herein provided. See section 1.410(b)-1(d) (2) of the Income Tax Regulations. If section 410(b) (1) (B) were satisfied, the nondiscrimination requirements of section 401(a) (4) would be applied considering the participants of Plan C only (without considering the participants of Plans A or P). However, if the requirements of section 410(b) (1) (B) were not satisfied by Plan C alone, then the plan could be considered in combination with other plans, as described in (3).

.02 Example 2 —

(1) Facts — Corporation S provides secretarial services. Corporations A and B, both of which are professional corporations formed by doctors, each own a portion of S. A owns 11 percent of the stock of S and B owns eight percent of the stock. Approximately one-third of S’s services are performed for A and one-third for B, while the other one-third are performed for other firms. A and B each maintain a retirement plan (Plan A and Plan B) and each plan covers the corporation’s only employee. None of the statutory exclusions of section 410(b) of the Code applies.

(2) Determination of who are employees of a single employer under section 414(m) of the Code — In order to determine whether the employees covered by Plans A and B satisfy the coverage requirements of section 410(b), it first must be determined which employees are considered as employed by a single employer. Under section 414(m) (2), Corporations A and B may each be designated as separate FSOs. Corporation S is a B-ORG for A because a significant portion of S’s business is the performance of services for A, the services are of a type historically performed in the FSO’s service field by employees, and 11 percent of the interest in S is held by owners of the FSO. S is not a B-ORG for B because the owners of B do not hold 10 percent or more of the interest in S.

Because Corporation S is a B-ORG for Corporation A, a FSO, the two constitute an affiliated service group. Consequently, all the employees of A and S are considered as employed by a single employer and must be taken into account when testing whether the coverage requirements of section 410(b) are satisfied. Corporation B is not part of an affiliated service group with either Corporation A or S. Thus, the employee of B is not aggregated with any other employees for purposes of testing coverage.

(3) Determination of whether Plan A satisfies the coverage and nondiscrimination requirements — Plan A covers only one employee, the sole shareholder of Corporation A. Because none of the statutory
exclusions of section 410(b) of the Code applies, one participant does not satisfy the percentage tests of section 410(b) (1) (A) when compared to the total employees of the A and S affiliated service group. Because Plan A covers only prohibited group employees and the total aggregated employees of the affiliated service group includes rank and file employees, the nondiscriminatory classification test of section 410(b) (1) (B) is not satisfied, either. Accordingly, unless a sufficient number of the employees of S were covered by Plan A or by another plan so that at least one of the tests of section 410(b) were satisfied, Plan A is not a qualified plan. If, however, section 410(b) were satisfied, the single plan or combination of plans which satisfied that section must also satisfy the nondiscrimination requirements of section 401(a) (4). As in Example 1, the normal rules apply in testing for discrimination under section 401(a) (4) and all the compensation paid to the employees of Corporation S is considered, without regard to the percentage ownership of Corporation A in Corporation S.

(4) Determination of whether Plan B satisfies the coverage and nondiscrimination requirements — Because Plan B covers the only employee of Corporation B, and the corporation is not a part of any affiliated service group, Plan B satisfies both sections 410(b) and 401(a) (4) of the Code.

.03 Example 3 —

(1) Corporations A and B are professional corporations formed by doctors (A and B). Corporation A and Corporation B each own one-half of P, a lock repair shop. Corporations A and B utilize the services of P, however, these corporations are an insignificant portion of P’s customers.

(2) Under the rules of section 414(m) (2) of the Code there is no affiliated service group based on these facts. Considering A or B Corporations as a FSO, P is not a B-ORG for either FSO because the services performed by P are not of a type historically performed by employees in the service field of the FSO. Furthermore, the service performed for A and B Corporations is not a significant portion of P’s business.

(3) Considering P as a FSO, A and B Corporations are not A-ORGS for P because they are not regularly associated with P in performing service for third persons.

SECTION 4. AREAS OF LAW AFFECTED BY SECTION 414(m) OF THE CODE

This section provides a list of some, but not all, other requirements for retirement plans which are affected by section 414(m) (2) of the Code.

<table>
<thead>
<tr>
<th>Code Section</th>
<th>Effect</th>
</tr>
</thead>
</table>
| 410(a)       | (a) All service in the affiliated service group must be counted.  
               | (b) Year that employment begins is based on the entire affiliated service group. |
| 411          | (a) All service in the affiliated service group must be counted. |
| 415          | (a) All benefits and annual additions from the affiliated service group are aggregated.  
               | (b) All compensation from the affiliated service group is aggregated. |

(a) Multiple integration rules of section 17 apply to the entire affiliated service group.
(b) All service in the affiliated service group must be counted.
(a) All service in the affiliated service group must be counted.
(b) Discrimination is tested considering all contributions by and compensation from the affiliated service group.

SECTION 5. EFFECTIVE DATE

This revenue ruling shall apply to plan years ending after November 30, 1980. However, in the case of a plan in existence on November 30, 1980, the amendments made by this section shall apply to plan years beginning after that date.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Ruls. 68-370 and 75-35 are obsoleted.


Affiliated service groups — Qualification for exempt status — Rulings and determination letters. — Procedures are provided for the issuance of rulings on whether particular entities are members of an affiliated service group within the meaning of Code Sec. 414(m) and for obtaining determination letters on the qualification of an employees' pension, profit-sharing, stock bonus, annuity, or bond purchase plan under Code Sec. 401(a) or 403(a). Rev. Procs. 80-24 and 80-30 amplified.

SECTION 1. PURPOSE

This revenue procedure prescribes the procedures (1) for obtaining a ruling on whether particular entities are members of an affiliated service group within the meaning of section 414(m) of the Internal Revenue Code, and (2) for obtaining determination letters on the qualification, under sections 401(a) or 403(a), of an employees' pension, profit-sharing, stock bonus, annuity, or bond purchase plan established by a member of an affiliated service group.

SECTION 2. BACKGROUND

.01 Statutory Requirements. Section 414(m) of the Code was added by Pub. L. 96-605, 1981-6 I.R.B. 21, 24 (February 9, 1981). In general, section 414(m) provides that for purposes of certain employee benefit requirements under sections 105(h), 125, 401(a), 408(k), 410, 411, and 415 of the Code, employees of an affiliated service group as defined in section 414(m), shall be treated as employed by a single employer. Thus, for example, if an employer that is a member of an affiliated service group establishes or maintains an employees' qualified pension, annuity, profit-sharing, stock bonus, or bond purchase plan, employees of other members of the affiliated service group must be considered employees of that member in determining whether its plan meets applicable requirements of section 401(a).
.02 Impact of Statutory Requirements. Section 414(m) of the Code does not impact on any qualified plan unless the employer maintaining the plan is part of an affiliated service group. In the case of an employer that is part of an affiliated service group, section 414(m) affects several important areas of plan qualification. For example, being part of an affiliated service group expands the group of employees who must be considered in applying the coverage requirements of section 410(b). Also, certain form requirements are changed. This includes plan language for crediting years of service with respect to members of the affiliated service group for purposes of the minimum participation standards in section 410(a) and the minimum vesting standards in section 411. For a discussion of these requirements, see Rev. Rul. 81-105, 1981-12 I.R.B. 27.

.03 Applicable Procedures.
(1) Rev. Proc. 80-24, 1980-1 C.B. 658, sets forth the general procedures of the Internal Revenue Service for issuing National Office rulings and opinion letters, and for issuance of determination letters by an Employee Plans Key District Director.
(2) Rev. Proc. 80-30, 1980-1 C.B. 685, sets forth the general procedures pertaining to issuance of determination letters by Employee Plans Key District Directors on the qualification of pension annuity, profit-sharing, stock bonus, and bond purchase plans involving sections 401, 403(a), 405(a), 409A, and 4975(e) of the Code.

.04 Effective Dates of Section 414(m). Section 414(m) is effective immediately for plans established after November 30, 1980. However, for plans in existence on November 30, 1980, section 414(m) is effective for plan years beginning after November 30, 1980.

SECTION 3. RESPONSIBILITIES OF EMPLOYERS AND PLAN ADMINISTRATORS

.01 In General. An employer is responsible for determining at any particular time whether it is a member of an affiliated service group, and if so, whether its plan(s) continues to meet the requirements of section 401(a) of the Code after the effective date of section 414(m). An employer or plan administrator also is responsible for taking appropriate action relative to their qualified plan if the employer is, becomes, or ceases to be a member of an affiliated service group.

.02 Employers Not Affected by Section 414(m). Any employer that is not a member of an affiliated service group is not required to change its qualified plan or plans to satisfy section 414(m) of the Code.

.03 Rulings Program. Employers may wish to receive rulings from the Service with respect to several issues that may arise under section 414(m) of the Code. One issue is whether the employer is part of an affiliated service group. Section 4 of this revenue procedure describes how the National Office will issue rulings on whether or not an employer is part of an affiliated service group. This issue impacts on other areas of the Code as well as qualified retirement plans. (See section 2.01 of this procedure.) Furthermore, the issue of whether an employer is part of an affiliated service group depends on the relationship of this employer to other employers and is independent
of whether or not that employer or any other employer maintains a plan. Such rulings will not consider the qualified status of any plan.

.04 Determination Letter Program. An employer that is informed it is a member of an affiliated service group under section 414(m) of the Code may want a determination as to the effect of such membership on the employer’s plan. For example, questions may arise whether certain form requirements are satisfied or coverage is adequate. Section 5 of this revenue procedure provides that Service district offices will issue determination letters which consider (1) whether an employer is a member of an affiliated service group; and (2) the impact of section 414(m) on the plan. This determination letter procedure will be available (a) in the case of an initial request for a determination letter, (b) for a determination letter request on a plan amendment, and (c) in certain circumstances, even though the plan has not been amended.

SECTION 4. RULINGS

.01 Rulings Requests Considered. An employer may request a ruling from the National Office of the Internal Revenue Service on whether that employer is a member of an affiliated service group within the meaning of section 414(m) of the Code. All such ruling requests shall include a statement from the employer which sets forth all the information specified in section 6 of this revenue procedure, and any further information the employer believes relevant to the issue of whether or not it is part of an affiliated service group under section 414(m). Employers are not required to have a plan, or to amend any existing plan or plans to obtain such a ruling.

.02 Compliance with Other Service Procedures. Employers seeking a ruling under this section shall comply with provisions of Rev. Proc. 80-24, pertaining to the issuance of rulings by the National Office.

.03 Scope of Rulings. Rulings issued by the National Office under this section shall be limited to the question of whether the employer is a member of an affiliated service group, and if so, which other entities also are part of that group. Such rulings do not consider the qualified status of any plan under section 401(a) of the Code.

SECTION 5. DETERMINATION LETTERS

.01 Procedures for Obtaining Determination Letters. An employer that has adopted a new employee plan, or an employer that has amended an employee plan to satisfy section 414(m) of the Code, may request a determination, under Rev. Proc. 80-30 and this revenue procedure, on whether the plan is qualified, taking into consideration employees of any other organization that must be treated as employees of that employer under section 414(m). Generally, a determination letter issued with respect to the plan will cover section 414(m) only if the employer submits, with the determination letter application, the information specified under section 6.

.02 Special Coverage Determinations. Generally, in the case of a plan amendment, the Service will only consider the impact of the plan
amendment upon the qualified status of the plan. However, when the information submitted indicates that the employer's affiliated service group status under section 414(m) of the Code has changed, the Service also will consider the acceptability of coverage under section 410(b) (1), and whether the limitations on contributions and benefits under section 415 are satisfied. Also, if the employer believes that the current plan, without amendment, will satisfy the requirements of section 410(a), but the employer's affiliated service group status has changed, the plan may be submitted for a determination letter which will consider the change in status and its effect on the plan.

.03 Omission of Material Facts. Failure to properly indicate that there is or may be an affiliated service group and to provide the information specified in section 6.01 and 6.02 of this procedure (or a National Office ruling and other documents in lieu of such information as specified in section 6.01), is an omission of a material fact that will result in the applicant being unable to rely on any favorable determination concerning the effect of section 414(m) of the Code on the qualified status of the plan.

.04 Statement in Determination Letters. If the Service considers whether the plan of an employer or group of employers satisfies the requirements of section 414(m) of the Code, the determination letter issued to the employer(s) will state that questions arising under section 414(m) have been considered, and that the plan satisfies qualification requirements relating to that section. Absent such a statement pertaining to section 414(m), a determination letter does not apply to any qualification issue arising by reason of section 414(m).

SECTION 6. REQUIRED INFORMATION

.01 Information to Be Submitted for Rulings. The issue of whether an employer is a member of an affiliated service group shall be considered during the processing of a ruling request only if that employer provides the following information.

(1) A description of the business of the employer, specifically discussing whether it is a service organization including the reasons therefor;

(2) The identification of other members (or possible members) of the affiliated service group;

(3) A description of the nature of the business of each member (or possible member) of the affiliated service group, specifically discussing whether such member is a “service” organization;

(4) The ownership interests between the employer and the members (or possible members) of the affiliated service group (include ownership interests as described in section 414(m) (2) (B) (ii) or 414(m) (5) (B) of the Code);

(5) A description of services performed for the employer by the members (or possible members) of the affiliated service group, or vice versa (including an opinion whether the services are a significant portion of the member’s business, and are of a type historically performed in the employer’s service field by employees);
(6) A description of how the employer and the members (or possible members) of the affiliated service group associate in performing services for other parties.

.02 Information to Be Submitted with Applications for Determination Letters. Determination letters issued with respect to a plan’s qualification under section 401(a) or 403(a) of the Code will be a determination as to the effect of section 414(m) upon that plan’s qualified status, only if the application includes:

(1) The information specified in section 6.01 of this procedure, except where a ruling is issued to the employer under section 4 of this procedure and the facts on which that ruling was based have not changed;

(2) A brief description of any other plans maintained by the members (or possible members) of the affiliated service group, if such other plan(s) is designated as a unit for qualification purposes;

(3) A description of how the plan(s) satisfies the coverage requirements of section 410(b) if the members (or possible members) of the affiliated service group are considered part of an affiliated service group with the employer;

(4) A copy of any ruling issued by the National Office to the employer under section 4 and, if known, a copy of any such ruling issued to any other member or possible member of the same affiliated service group, accompanied by a statement as to whether the facts upon which the ruling was based have changed.

SECTION 7. TIMES FOR COMPLIANCE WITH SECTION 414(m)

.01 Date for Plan Amendments. A plan shall satisfy the requirements of section 414(m) of the Code for a particular plan year if it is amended to comply with that section by the latest of:

(1) December 31, 1981;

(2) The last day of such plan year; or

(3) The last day of this sixth month after the month in which the employer obtains a National Office ruling on whether it is a member of an affiliated service group, provided such ruling is requested by the later of the dates specified in paragraphs (1) and (2). Thus a calendar year plan that must be amended to comply with section 414(m) in order to retain its qualified status for 1981, must be amended by December 31, 1981, unless a ruling or determination letter is requested by that date.

.02 Effective Date of Plan Amendments. All plan amendments under this section to conform any employees’ qualified plan to section 414(m) of the Code shall be effective on the effective date of section 414(m) applicable to that plan.

.03 Extension of Time for Conforming Plans. If a plan or proposed plan amendment is submitted for a determination letter in accordance with the procedures prescribed in this revenue procedure by the dates specified in section 7.01 above, the time for correcting any deficiency in the plan provisions designed to satisfy section 414(m) of the Code shall be extended to 91 days after the issuance of any determination letter with respect to such plan provisions.
SECTION 8. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 80-24, 1980-1 C.B. 658, is amplified to prescribe the procedure for obtaining a letter ruling on the issue of whether or not an employer is a member of an affiliated service group. .02 Rev. Proc. 80-30, 1980-1 C.B. 685, is amplified to prescribe the procedures for obtaining determination letters on the plan of an applicant that is a member of an affiliated service group.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective as of April 6, 1981.

Rev. Rul. 81-202

SECTION 1. PURPOSE

This revenue ruling provides guidelines for determining whether several different retirement plans, considered as a unit, provide contributions or benefits that discriminate in favor of employees who are officers, shareholders, or highly compensated (the prohibited group). These guidelines do not constitute an exclusive list of the methods that may be used to demonstrate that two plans, taken as a unit, do not discriminate in favor of the prohibited group. This revenue ruling also supersedes Rev. Rul. 70-580, 1970-2 C.B. 90.

SECTION 2. BACKGROUND

.01 Section 410(b) of the Internal Revenue Code requires that, in order to satisfy the requirements of section 401(a) of the Code, a retirement plan must cover either a certain percentage of employees or a classification of employees that does not discriminate in favor of the prohibited group.

.02 Section 1.410(b)-1(d)(3)(i) of the Income Tax Regulations allows an employer to designate two or more plans as a single plan for purposes of satisfying the requirements of section 410(b) of the Code. (Section 1.410(b)-1(d)(3)(ii) of the regulations prohibits this designation in certain cases involving TRASOPs and plans subject to section 401(a)(17)). However, if several plans are so designated as a unit, the plans considered as a unit must also satisfy the nondiscrimination requirements of section 401(a)(4).

.03 Section 401(a)(4) of the Code requires that, in order to satisfy the requirements of section 401(a), either the contributions or the benefits under a retirement plan must not discriminate in favor of the prohibited group.

.04 Section 401(a)(5) of the Code provides that a retirement plan shall not be considered discriminatory, within the meaning of sections 401(a)(4) and 410(b), merely because the contributions or benefits of employees under the plan differ because of any retirement benefits created under State or Federal law. An example of such retirement benefits is the old age, survivors, and disability insurance benefits under the Social Security Act (social security benefits). Section 1.401-3(e) of the regulations and Rev. Rul. 71-446, 1971-2 C.B. 187 provide rules for measuring the value of employer-provided social security benefits.
.05 Section 401(a)(5) of the Code also provides that several plans of an employer shall not be considered discriminatory, within the meaning of section 401(a)(4), merely because employees’ rights to benefits under the separate plans do not become nonforfeitable at the same rate. Rev. Ruls. 74-165, 1974-1 C.B. 96 and 74-166, 1974-1 C.B. 97 provide rules for measuring the value of different vesting schedules.

SECTION 3. GENERAL RULE

.01 General Rule — Several plans, considered as a unit, will satisfy the nondiscrimination test of section 401(a)(4) of the Code as to the amount of benefits or contributions, if either the Normalized Employer-Provided Benefits or both the Actual Employer Contributions and the Adjusted Employer Contributions do not constitute a greater percentage of non-deferred compensation for prohibited group employees than for rank and file employees. The choice of either testing Normalized Employer-Provided Benefits or both Actual and Adjusted Employer Contributions may be made by the taxpayer independent of whether the plans being considered are defined benefit plans or defined contribution plans. In testing for discrimination, the normalized employer-provided social security benefits or actual and adjusted employer contributions to social security may be taken into account. (See section 6.) In testing for discrimination, reasonable grouping of participants by compensation ranges may be made. However, pursuant to section 401(a)(10) of the Code, a plan providing benefits for an owner-employee may not provide contributions or benefits for employees that are less favorable than contributions or benefits for owner-employees.

.02 Normalized Employer-Provided Benefits defined — For purposes of the revenue ruling, Normalized Employer Provided Benefits are the flat benefit or unit benefits computed under section 4, normalized in accordance with section 5 to reflect the value of an annuity for the life of the participant commencing at age 65 with no death benefits and no other ancillary benefits and to reflect a difference in vesting provisions among the plans being considered.

.03 Actual and Adjusted Employer Contributions defined —

(1) Defined contribution plans — In the case of a defined contribution plan, the Actual Employer Contributions are the employer contributions allocated to the account of a participant (not including forfeitures, even if used to reduce employer contributions) and the Adjusted Employer Contributions are the sum of the employer contributions and forfeitures allocated to the account of the participant.

(2) Defined benefit plans — In the case of a defined benefit plan the Actual and Adjusted Employer Contributions are identical. Such contributions are the annual level dollar contributions from the date of initial participation in the plan to the latest of 65, current age, or the normal retirement age to fund the normalized flat benefit described in section 3.02. These contributions must be determined using solely reasonable interest and mortality assumptions.
SECTION 4. LEVEL OF EMPLOYER BENEFITS

.01 Flat benefit basis —

(1) Defined benefit plans — In the case of a defined benefit plan the flat benefit used for testing discrimination is the employer-provided portion of the participant’s most valuable projected benefit. The participant’s most valuable projected benefit is determined by projecting the accrued benefit to which the participant would be entitled at each possible retirement age based on the assumption that he or she continued to earn annually until such age the same rate of compensation as in the current year. This computation is made without regard to any benefit attributable to voluntary employee contributions. See section 411(d)(5) of the Code. These projected benefits are expressed as the actuarial equivalent amount of plan benefit commencing at age 65, and the most valuable projected benefit is selected. The employer-provided portion of the participant’s most valuable projected benefit is the total benefit reduced by the projected benefit at age 65 attributable to mandatory employee contributions that would be made to the date of the most valuable projected benefit.

(2) Defined contribution plans — In the case of a defined contribution plan that provides a pre-retirement death benefit not less than the account balance, the participant’s normalized flat benefit is determined as the amount purchasable as a life annuity commencing at age 65, by the accumulation, using a reasonable mortality and interest rate, of both (a) the participant’s account balance in the year that discrimination is being tested, and (b) all reasonably estimated future Adjusted Employer Contributions for the participant. In the case of a defined contribution plan that provides no pre-retirement death benefit at any time other than the minimum required benefit under section 401(a)(11)(C) (relating to joint and survivor annuities), the participant’s normalized flat benefit is determined as the amount purchasable as a life annuity commencing at age 65 by the accumulation, using a reasonable interest rate only, of both (a) the participant’s account balance in the year that discrimination is being tested, and (b) all reasonably estimated future Adjusted Employer Contributions for the participant. In the case of a money purchase plan, future Adjusted Employer Contributions shall be determined as the amount specified in the plan. Thus, for example, in a plan that provides for contributions of X% of compensation reduced by forfeitures, future Adjusted Employer Contributions are X% per year.

.02 Unit benefit basis — For either a defined benefit or defined contribution plan, the unit benefit may be determined by dividing the flat benefit computed as described in subsection .01 by the years of service the participant would have at the age at which the flat benefit was determined. Service must be determined on a reasonable and consistent basis.

SECTION 5. NORMALIZING BENEFITS

.01 General Rule — In the case of a defined benefit plan providing ancillary benefits, the flat benefit described in section 4.01(1) must be normalized by multiplying such flat benefit by the factors described in subsections .02, .03, .04, and .05 in succession.

.02 Form of annuity — If the plan provides benefits in a form other than as a single life annuity, the adjustment factor is the ratio of the
present value of benefits under such form to the present value of benefits under a life annuity. The reciprocals of the factors found in section 9 of Rev. Rul. 71-44 may be used for this purpose.

.03 Pre-retirement death benefit — If the plan provides for pre-retirement death benefits, the adjustment factor is the ratio of the present value of death benefits and retirement benefits to the present value of retirement benefits. The reciprocals of the factors used in section 8 of Rev. Rul. 71-446 may be used for this purpose.

.04 Disability benefit —

(1) If the plan provides a qualified disability benefit (as defined in section 411(a)(9) of the Code), commencing at disability and payable for life, or until recovery from disability before normal retirement age, and such benefit is payable only for the period of time when the participant is eligible for and receives disability benefits under the Social Security Act, the disability adjustment factor is 1.11.

(2) If the plan provides any other form of disability benefit, such benefit shall be considered under section 4.01 as a retirement benefit.

.05 Vesting — If the plans being compared provide for different rates of vesting, the level of benefits may require adjustment by a vesting adjustment factor. Section 401(a)(5) of the Code provides for adjustments in such a situation. However, until regulations are adopted under this section, see Rev. Rul. 74-166.

SECTION 6. IMPUTING SOCIAL SECURITY BENEFITS OR CONTRIBUTIONS

.01 In general — Except as provided in subsections .04 and .05, if the plans of an employer, when considered as a unit, discriminate in favor of the prohibited group, this discrimination may be eliminated by considering employer-provided social security benefits as Normalized Employer-Provided Benefits or as both Actual and Adjusted Employer Contributions. This section provides rules for measuring the value of the employer-provided social security benefits or contributions. Subsections .02 and .03 provide rules for measuring the value of social security in testing whether plans discriminate in favor of a participant who is not an owner-employee. Subsection .04 provides rules for measuring the value of social security in testing whether plans discriminate in favor of an owner-employee. If social security benefits or contributions are imputed, they must be imputed for all individuals in the same manner.

.02 Imputing social security benefits —

(1) Flat benefits — In the case of a plan testing for discrimination on a flat benefit basis, employer-provided social security benefits may be determined under either (A) or (B) below.

(a) The imputed social security benefits equal 37\(\frac{1}{2}\) percent of a participant’s highest five-year average compensation, to the extent such compensation does not exceed the participant’s covered compensation. For a participant with less than 15 years of service at expected retirement age, this amount should be reduced to 2\(\frac{1}{2}\) percent per year of service. Covered compensation in any plan year will be determined in accordance
with the rules set forth in section 3.02 of Rev. Rul. 71-446, as clarified by

(b) The imputed social security benefits equal
83\(\frac{1}{3}\) percent of the participant's primary insurance amount, determined using
the same assumptions that are used to compute the flat benefit under section
4.01.

(2) Unit benefits — In the case of a plan testing for discrimination on a unit benefit basis, employer-provided social se-
curity benefits may be determined under either (A) or (B) below.

(a) The imputed social security benefits equal
1.4 percent of compensation in any year to the extent such compensation does
not exceed the taxable wage base for the calendar year within which the plan
year ends.

(b) The imputed social security benefits equal
the amount determined under paragraph (1) divided by the participant's pro-
jected years of service as used in section 4.02.

.03 Imputing social security contributions — Both actual and
adjusted employer contributions to social security for a plan year are deemed
to be 7% of the participant's compensation in that year to the extent that such
compensation does not exceed the taxable wage base for the calendar year
within which the plan year ends.

.04 Discrimination in favor of an owner-employee —
For purposes of testing whether several plans discriminate in favor of
an owner-employee,

(1) if such owner-employee participates in a defined
benefit plan, social security benefits may not be taken into account, and

(2) if such owner-employee participates in a defined
contribution plan, social security benefits may only be taken into account if
the requirements of section 401(d)(6) are satisfied.

.05 Multiple integration — This subsection only applies in the
case where there is some participant covered in one or more of the combination
of plans being tested for discrimination who is covered under another plan
(not in the combination) maintained by the employer in which social security
must be imputed for that plan to be nondiscriminatory (i.e., an integrated
plan). In this case, the amount of social security benefits or contributions
imputed under subsections .02 and .03 is multiplied for each participant by
the multiple integration factor that is lowest for any participant. The multiple
integration factor is equal to the excess, if any, of the number 1 over the sum
of the integration utilization factors for all other plans in which this individual
participates. The integration utilization factor is the ratio of (a) the lowest
amount of social security benefits or contributions needed to be imputed for
that plan to be nondiscriminatory, to (b) the maximum amount that may be
imputed under this section.

SECTION 7. REASONABLE INTEREST RATES

.01 For purposes of this revenue ruling, all computations must
be based on reasonable actuarial assumptions. Although the assumptions used
for every purpose need not be identical, they must not be applied in an
inconsistent manner so as to distort the results.
The reasonableness of the interest rate is determined under the facts and circumstances. For purposes of this revenue ruling, an interest rate not less than 5 percent nor more than 6 percent will automatically be considered reasonable.

SECTION 8. SCOPE OF REVENUE RULING

This revenue ruling considers only whether the amount of benefits or contributions are discriminatory in ongoing plans. However, other aspects of discrimination could nonetheless exist. For example, in the case of two plans each providing full vesting after 10 years service, more rapid vesting may be needed to satisfy the requirements of section 411(d)(1) of the Code. See Rev. Proc. 76-11, 1976-1 C.B. 550. The adjustment described in section 5.05 adjusts for a difference in vesting schedules but does not consider the minimum vesting necessary to preclude discrimination.

SECTION 9. EXAMPLE

Facts — Employer M maintains a defined benefit and a defined contribution pension plan in 1981. Neither plan permits employee contributions.

(1) The defined benefit plan covers all the rank and file employees of M, and provides for a benefit accrual each year of 2 percent of that year’s compensation. This benefit is provided in the form of a life annuity paid monthly starting at age 65. The plan also provides an insured death benefit prior to retirement of 100 times the anticipated monthly annuity. The plan provides full and immediate vesting but does not provide an early retirement benefit.

(2) The defined contribution plan covers the two shareholders of M and provides for contributions each year of 20 percent of that year’s compensation. The plan provides for full and immediate vesting and a preretirement death benefit of the participant’s account balance. Considered alone, the defined contribution plan does not satisfy the coverage requirements of section 410(b) of the Code and must be considered in combination with the defined benefit plan to satisfy the coverage and nondiscriminatory requirements.

(3) The participants in the plans and other information is shown below:

**Defined Contribution Plan**

<table>
<thead>
<tr>
<th>Participant</th>
<th>Current Age</th>
<th>Prior Service</th>
<th>Current Compensation</th>
<th>Account Balance Beginning of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>55</td>
<td>10</td>
<td>$100,000</td>
<td>$280,000</td>
</tr>
<tr>
<td>B</td>
<td>50</td>
<td>6</td>
<td>90,000</td>
<td>120,000</td>
</tr>
</tbody>
</table>

**Defined Benefit Plan**

<table>
<thead>
<tr>
<th>Participant</th>
<th>Current Age</th>
<th>Prior Service</th>
<th>Current Compensation</th>
<th>Accrued Benefit Beginning of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>45</td>
<td>10</td>
<td>$12,000</td>
<td>$2,300</td>
</tr>
<tr>
<td>D</td>
<td>35</td>
<td>0</td>
<td>10,000</td>
<td>0</td>
</tr>
</tbody>
</table>
.02 Analysis of comparability — In accordance with section 3.01, the plans may be tested for discrimination by comparing either the Normalized Employer-Provided Benefits or both the Actual and Adjusted Employer Contributions. The analysis below first considers whether the Normalized Employer-Provided Benefits are nondiscriminatory. In accordance with section 3.02, the Normalized Employer-Provided Benefits may be compared as either flat benefits or unit benefits.

.03 Flat benefit basis —

(1) Defined contribution plan — in order to compare the Normalized Employer-Provided Benefits on a flat benefit basis, one must determine the normalized benefit for the two employees in the defined contribution plan. Because the defined contribution plan provides a pre-retirement death benefit of not less than the account balance, in accordance with section 4.01(2) the normalized benefit determined by projecting both the account balance and future assumed Adjusted Employer Contributions to age 65 and determining the single life annuity which is actuarially equivalent to this projected account balance. In the example, the UP 1984 Mortality Table and 5 percent interest are used for this purpose.

The Normalized Employer-Provided Benefit on a flat benefit basis is computed as follows:

<table>
<thead>
<tr>
<th>Table 1</th>
<th>A</th>
<th>B</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) 1981 Age (x)</td>
<td>55</td>
<td>50</td>
</tr>
<tr>
<td>(2) Account Balance Beginning of 1981</td>
<td>$280,000</td>
<td>$120,000</td>
</tr>
<tr>
<td>(3) Account Projection Factor*</td>
<td>.1869</td>
<td>.2470</td>
</tr>
<tr>
<td>(4) (2) x (3)</td>
<td>52,332</td>
<td>29,640</td>
</tr>
<tr>
<td>(5) 1981 Compensation</td>
<td>100,000</td>
<td>90,00</td>
</tr>
<tr>
<td>(6) Assumed Adjusted Employer Contributions [20% of (5)]</td>
<td>20,000</td>
<td>18,000</td>
</tr>
<tr>
<td>(7) Contribution Projection Factor**</td>
<td>1.4461</td>
<td>2.5559</td>
</tr>
<tr>
<td>(8) (6) x (7)</td>
<td>28,922</td>
<td>46,006</td>
</tr>
<tr>
<td>(9) Normalized Employer-Provided Benefit [(4) + (8)]</td>
<td>81,254</td>
<td>75,646</td>
</tr>
</tbody>
</table>

* Actuarial factor to determine amount of life annuity payments each year commencing at age 65 for each $1 of account balance at age x. Expressed in standard actuarial notation, this factor is computed as:

\[ D_x + N_{x\rightarrow 65}^{(12)} \]

** Actuarial factor to determine amount of life annuity payments to be paid each year commencing at age 65 for each $1 of annual contribution from age x to age 65. Expressed in standard actuarial notation, this factor is computed as:

\[ (N_x - N_{65}) + N_{x\rightarrow 65}^{(12)} \]

(2) Defined benefit plan — Because the defined benefit plan provides for no early retirement benefits, the flat benefit determined under section 4.01(1) is the sum of 2% of current compensation times the number of years from the attained age to age 65 plus the current accrued benefit. This benefit must then be normalized in accordance with section 5. The plan provides for a pre-retirement death benefit requiring normalization. Although any reasonable actuarial factors may be used for this adjustment, section 5.03 states that the reciprocal \((9/6)\) of the factor shown in section 8
of Rev. Rul. 71-446(8/9) may be used. For this example, this 9/8 factor is used. The Normalized Employer-Provided Flat Benefit may be computed as follows:

\[ \text{Normalization Factor} = \frac{2\% \times (2) \times (4)}{37'/2\%} \]

\[ \text{Most Valuable Projected Benefit} = (3) + (5) \]

\[ \text{Normalized Flat Benefit} = (6) \times (7) \]

(3) Comparison — The flat benefits are compared by expressing the normalized flat benefits as a percentage of 1981 compensation.

The percentages are higher for the prohibited group. Therefore, in order to demonstrate that the plan is nondiscriminatory on a flat benefit basis, social security benefits must be imputed using the rules of section 6. Although there are several ways to impute social security benefits, in this example the method described in section 6.02(1)(A) is used. Covered compensation was computed pursuant to section 3 of Rev. Rul. 71-446.

\[ \text{Social Security} = \frac{6,098}{12,000} \times 100 = 51.67\% \]

\[ \text{Total Benefit} = (2) + (6) \]

\[ (7) \times (1) = 87.35\% \]

Line (8) shows the Normalized Employer-Provided Benefits are non-discriminatory, and no further computation need be made. However, for illustrative purposes, comparability is also tested on a unit benefit basis and on a contributions basis.

.04 Unit benefit basis — In accordance with section 4.02 the unit benefit amount is obtained by dividing the flat benefit amount (on Line (2) of Table 3) by the years of service the participant would have at age 65.

\[ (3) \div (1) = 4.06\% \]

\[ (4) \div (5) = 4.00\% \]

Table 2

<table>
<thead>
<tr>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td></td>
</tr>
<tr>
<td>Compensation</td>
<td></td>
</tr>
<tr>
<td>Accrued Benefit</td>
<td></td>
</tr>
<tr>
<td>No. of Years Until age 65 (65 - (1))</td>
<td></td>
</tr>
<tr>
<td>Future Accruals [2% \times (2) \times (4)]</td>
<td></td>
</tr>
<tr>
<td>Most Valuable Projected Benefit [(3) + (5)]</td>
<td></td>
</tr>
<tr>
<td>Normalization Factor</td>
<td></td>
</tr>
<tr>
<td>Normalized Flat Benefit [(6) \times (7)]</td>
<td></td>
</tr>
</tbody>
</table>

Table 3

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981 Compensation</td>
<td>$100,000</td>
<td>$90,000</td>
<td>$12,000</td>
</tr>
<tr>
<td>Adjusted Normalized Flat Benefit from Tables 1 &amp; 2</td>
<td>81,254</td>
<td>75,646</td>
<td>7,988</td>
</tr>
<tr>
<td>(2) \div (1)</td>
<td>81.25%</td>
<td>84.05%</td>
<td>66.57%</td>
</tr>
</tbody>
</table>

Table 4

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flat Benefit Amount</td>
<td>$81,254</td>
<td>$75,646</td>
<td>$7,988</td>
</tr>
<tr>
<td>Service at age 65</td>
<td>20</td>
<td>21</td>
<td>30</td>
</tr>
<tr>
<td>(2) \div (1)</td>
<td>4,063</td>
<td>3,602</td>
<td>266</td>
</tr>
<tr>
<td>Compensation</td>
<td>100,000</td>
<td>90,000</td>
<td>12,000</td>
</tr>
<tr>
<td>(3) \div (4)</td>
<td>4.06%</td>
<td>4.00%</td>
<td>2.21%</td>
</tr>
</tbody>
</table>
The percentages are higher for the prohibited group. Therefore, in order to demonstrate that the plan is nondiscriminatory on a unit benefit basis, social security benefits may be imputed, as allowed by section 6. Although there are several ways of imputing social security benefits, in this example social security benefits are imputed using the rule described in section 6.02(2)(A). The taxable wage base for 1981 is $29,700.

\[
\begin{array}{cccccc}
(6) & \text{Lesser of (4) or $29,700} & 29,700 & 29,700 & 12,000 & 10,000 \\
(7) & \text{Social Security (1.4\% of (6))} & 416 & 416 & 168 & 140 \\
(8) & \text{Total Unit Benefits ((3) + (7))} & 4479 & 4018 & 434 & 365 \\
(9) & (8) \div (4) & 4.48\% & 4.46\% & 3.62\% & 3.65\% \\
\end{array}
\]

Even after imputing social security benefits, the benefits under the plans are discriminatory on a unit benefit basis. Nevertheless, because the plan is not discriminatory on the flat benefit basis, the Normalized Employer-Provided Benefits are nondiscriminatory.

.05 Contributions —

(1) Defined contribution plan — Section 3.01 provides that contributions will be nondiscriminatory if both the Actual Employer Contributions and the Adjusted Employer Contributions do not constitute a greater percentage of non-deferred compensation for the prohibited group than for the rank and file employees.

Section 3.03(1) defines Actual and Adjusted Employer Contributions. Because there are no forfeitures in the defined contribution plan, the Actual and Adjusted Employer Contributions both equal 20\% of compensation, or $20,000 for A and $18,000 for B.

(2) Defined benefit plan — Section 3.03(2) defines the Actual and Adjusted Employer Contributions in the case of a defined benefit plan as the level dollar contribution, required from the date of initial participation to the later of 65, or the normal retirement age, to fund the amount described in section 3.02. The amount described in section 3.02 is the amount contained on line (8) of Table 2. Although any reasonable actuarial assumptions may be used for this computation, the UP 1984 Mortality Table and 5 percent interest are used in this example.

The contributions may be computed as follows:

\text{Table 5}

\[
\begin{array}{ccc}
C & D \\
(1) & \text{Flat Benefit (Line (8) of Table 2)} & \$7,988 & \$6,700 \\
(2) & \text{Age at initial participation (y)} & 35 \\
(3) & \text{Level Cost Factor*} & .1202 & .1200 \\
(4) & \text{Adjusted Employer Contribution [((1) \times (3))]} & 960 & 800 \\
(5) & \text{1981 Compensation} & 12,000 & 10,000 \\
(6) & (5) \div (6) & 8\% & 8\% \\
\end{array}
\]

*Annual contribution necessary to provide life annuity of $1 per year at age 65 by level dollar contributions from age in (2) to 65. Expressed in standard actuarial notation, this factor is computed as:

\[
N_{65}'(l) + (N_l - N_{65})
\]

(3) Comparison — Expressed as a percentage of 1981 compensation, the contributions are discriminatory. However, allowed by section 6, social security contributions may be imputed to eliminate this
discrimination. Section 6.03 states that social security contributions are deemed to be 7% of compensation up to the taxable wage base. The taxable wage base for 1981 is $29,700.

Table 6

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>1981 Compensation</td>
<td>$100,000</td>
<td>$90,000</td>
<td>$12,000</td>
</tr>
<tr>
<td>(2)</td>
<td>Actual and Adjusted Contributions</td>
<td>20,000</td>
<td>18,000</td>
<td>960</td>
</tr>
<tr>
<td>(3)</td>
<td>Lesser of (1) or $29,700</td>
<td>29,700</td>
<td>29,700</td>
<td>12,000</td>
</tr>
<tr>
<td>(4)</td>
<td>Social Security Contributions</td>
<td>2,079</td>
<td>2,079</td>
<td>840</td>
</tr>
<tr>
<td>(7% of (3))</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(5)</td>
<td>Total Contributions [(2) + (4)]</td>
<td>22,079</td>
<td>20,079</td>
<td>1,800</td>
</tr>
<tr>
<td>(6)</td>
<td>(5) ÷ (1)</td>
<td>22.08%</td>
<td>22.31%</td>
<td>15.00%</td>
</tr>
</tbody>
</table>

Thus, the total contributions are discriminatory. Nevertheless, because the plan is not discriminatory on the basis of benefits, the requirements of section 401(a)(4) of the Code are satisfied.

SECTION 10. EFFECT ON OTHER DOCUMENTS

This revenue ruling supersedes Rev. Rul. 70-580 because the positions stated therein are restated in this ruling.