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Appendix: Additional Information for a 25-Year 401(k) Retrospective

Introduction

The November 2006 *Perspective* summarized the 25-year history of 401(k) plans.[1] This Appendix provides additional detail on (1) the history of participation rates in pension plans and (2) the evolution of nondiscrimination rules.

Participation Rates

On net over the past two decades, both the portion of the private-sector workforce that works for an employer that offers a pension plan, and the portion that participates in such plans have changed little (Figure A1). In 1987, 50 percent of private-sector wage

Figure A1

Pension Plan Participation Little Changed Since 1987

Sponsorship of and participation in retirement plans, percent of workers, 1987–2005

	Sponsorship			Participation		
	Private-Sector Wage and Salary Workers, Ages 21–64			Private-Sector Wage and Salary Workers, Ages 21–64		
Year	All	Full Time, Full Year	Part Time/ Part Year	All	Full Time, Full Year	Part Time/ Part Year
1987	50.0	59.1	32.6	39.4	50.6	18.0
1988	50.4	59.2	32.8	39.5	50.3	17.9
1989	51.9	60.4	34.6	41.3	52.0	19.5
1990	53.0	61.5	36.2	41.5	52.4	19.9
1991	53.0	62.1	35.8	41.6	19.6	53.2
1992	53.4	62.4	36.0	41.4	53.2	18.7
1993	51.9	60.7	34.4	40.7	51.9	18.3
1994	55.4	63.7	38.1	42.7	54.0	19.4
1995	54.7	62.0	38.1	43.0	52.9	20.6
1996	56.5	64.0	39.4	43.8	54.3	19.8
1997	57.3	64.4	40.5	44.6	54.7	20.6
1998	59.4	65.9	42.4	46.6	55.9	22.4
1999	58.7	65.7	40.3	46.8	56.1	22.3
2000	59.6	65.1	43.9	47.3	55.5	28.8
2001	58.1	63.9	42.8	45.6	53.9	24.2
2002	55.2	60.9	40.9	43.4	51.7	22.5
2003	55.2	61.3	39.8	43.5	52.0	22.0
2004	54.9	60.6	39.9	45.1	51.5	21.8
2005	52.9	58.4	38.2	42.0	49.6	21.6

Source: Patrick Purcell, CRS Report for Congress RL30122, *Various Years*

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and salary workers were employed at firms that offered a retirement plan and 40 percent participated in a plan. In 2005, the percentages had increased to 53 percent and 42 percent, respectively. Although there was little change on net between 1987 and 2005, there were discernable trends in offer and participation rates in the intervening years. During the mid- to late-1990s, a period with tight labor markets and robust stock market returns, both offer and participation rates increased sharply, with offer rates increasing from 52 percent in 1993 to 60 percent in 2000, and participation rates increasing from 41 percent to 47 percent over the same time span. Since 2000, however, both offer and participation rates have edged back down. As can also be seen in the data, full-time workers are more likely to work for a firm that offers a pension plan, and more likely to participate in a plan if one is offered.

Despite the fact that a relatively stable proportion of the workforce has been offered a pension plan over the past two decades, the type of pension plan offered has changed as the number of firms offering a 401(k) has grown dramatically. In 2003, about half of wage and salary workers were offered 401(k)-type plans, compared to only 8 percent in 1983 (Figure A2).

In addition, there has been a remarkable upward trend in participation rates among workers whose employers sponsor a plan. For many traditional defined benefit (DB) and defined contribution (DC) plans, there is little distinction between eligibility and participation—once eligible, the employee is included in the plan. However, given the importance of elective employee contributions, the decision of whether or not to participate is key for 401(k) plans. Among workers at firms sponsoring 401(k)-type plans, only 38 percent participated in 1983 compared with 70 percent in 2003 (Figure A2). This upsurge in participation likely is due in part to employees becoming more comfortable with 401(k) plans over time, and in part to the fact that 401(k) plans are more likely to be the primary, rather than supplementary, retirement plan.

Nondiscrimination Rules

Concerned that pension rules were being used to set up plans that served primarily to shelter income for well-compensated executives, Congress enacted the 1942 Revenue Act, which limited firms' ability to favor shareholders, officers, supervisors, and highly compensated workers with respect to coverage, benefits, or finances.[2] From this general provision, nondiscrimination rules and their associated regulations have become some of the lengthiest and most complicated in the tax code.

Figure A2

Employer Sponsorship and Employee Participation by Type of Plan

Civilian nonagricultural wage and salary workers, age 16 and older, selected years

Year	Percentage of Employees		Participation Rate of Employees Conditional on Employer Offering a Plan
	Employer Sponsors a Plan	Employee Participates in a Plan	
	Any Type of Plan		
1983	52.5	42.9	81.7
1988	63.1	47.7	75.6
1993	64.4	49.3	76.6
1998	65.0	47.2	72.6
2003	67.9	51.5	75.8
	401(k)-Type Salary Reduction Plan (Either Primary or Secondary)		
1983	8.1	3.1	38.3
1988	26.9	15.3	56.9
1993	36.8	23.8	64.7
1998	45.9	29.1	63.4
2003	49.9	34.9	69.9

Sources: Investment Company Institute Tabulations from the May 1983 Current Population Survey (CPS) and Copeland (September 2005)

By linking the amount of pension benefits that high-paid workers receive to the amount of benefits rank-and-file workers receive, the intent of nondiscrimination rules is often interpreted as being to increase the amount of pension benefits received by rank-and-file workers. However, the effect of nondiscrimination rules likely varies from firm to firm. Some firms may respond to nondiscrimination rules primarily by providing more compensation to rank-and-file workers in the form of pension benefits; at other firms, the form of compensation that they choose to provide may be little changed by the rules; other firms may respond to the rules primarily by restricting benefits paid to high paid workers; and the rules may cause still other firms to decide not to offer pension benefits to any employees.[3]

Rules in Effect Prior to 1996

From the birth of 401(k) plans in the early 1980s until the mid-1990s, the nondiscrimination rules that applied to pension plans in general and 401(k) plans in particular increased in complexity and restrictiveness and, although there has been a trend to simplify the rules, they continue to be very involved. This section summarizes the major provisions of the nondiscrimination rules and describes how they have changed over time.

Defining "Highly Compensated Employees." The first step in applying nondiscrimination rules is to define the group of employees that are subject to benefit restrictions. Before the Tax Reform Act of 1986 (TRA '86), a firm could not discriminate in favor of officers, shareholders, or highly compensated workers. However, the term "highly compensated" was not defined in the Internal Revenue Code (IRC) and was applied based on the facts and circumstances of each case.

TRA '86 introduced a uniform definition of a "highly compensated employee" (HCE).[4] HCEs were determined on company-wide basis even if the plan in question covered only a portion of employees, such as a specific line of business within the firm. An HCE was defined as an employee that, in the current or preceding year: (1) was a 5-percent owner of the employer; (2) earned more than $75,000; (3) earned more than $50,000 and was among the top 20 percent of workers when ranked by compensation; or (4) was a highly paid officer.

If an employee was an HCE due to either the $75,000 or $50,000 rule, but did not otherwise meet the definition of HCE in the previous year, the employee would not be considered an HCE unless the employee was among the top 100 highest paid employees for the current year or became a 5-percent owner during the current year. That is, most employees had to meet the $75,000 or $50,000 rules for two consecutive years before being designated an HCE.

For purposes of the highly paid officer provision, a highly paid officer was defined as an officer of the firm that received compensation in excess of 150 percent of the DC plan dollar limit. The limit in 1987 was $30,000, making the compensation cut-off $45,000. For purposes of this provision, no more than 50 employees (or if less, the greater of three employees or 10 percent of the employees) were to be designated as officers.[5] If no officer had compensation greater than 150 percent of the DC plan dollar limit, the highest paid officer was designated an HCE for purposes of this provision.

TRA '86 also included a family aggregation rule that many felt was particularly burdensome to small businesses.[6] Under this rule, if an employee of the firm was a 5-percent owner or one of the top 10 HCEs ranked by compensation, then any family members that also worked for company (spouse, lineal ascendant or descendent, or spouse of lineal ascendant or descendent) would be aggregated for nondiscrimination purposes. That is, for purposes of determining compensation or allowable contributions or benefits, the compensation and contributions or benefits of all family members would be aggregated.

Minimum Coverage Test. In general, the minimum coverage test aims to ensure that the employer offers participation in the retirement plan to a wide slice of the firm's workforce. Prior to TRA '86, the minimum coverage test could be met if the plan benefited either a significant percentage of employees or a classification of employees determined by the Department of Treasury not to be discriminatory. The "significant percentage test" could be met if either 70 percent of employees participated or if at least 80 percent of employees were eligible to participate and 70 percent of those eligible participated. The "classification test" could be met if, for example, a business limited a pension plan to a specific line of business within a company or limited the plan to certain professions within the firm, and this classification was determined not to be discriminatory.

TRA '86 tightened the coverage tests by specifying that a plan must meet one of three numerical tests.[7] Under the "percentage test" a plan must benefit at least 70 percent of non-highly compensated employees (NHCEs). The "ratio test" required that the proportion of NHCEs benefiting under a plan was at least 70 percent of the proportion of HCEs. Although similar to existing rules, the percentages are applied to NHCEs—not to all employees—effectively tightening the restrictions placed on plans. The third test requires (like prior law) that an employer cover a classification of workers determined not to be discriminatory, but also requires that the plan show that the average benefit percentage (that is, the average benefit as a percentage of compensation) of NHCEs is at least 70 percent of the average benefit percentage of HCEs ("average benefit test").

Benefits and Contributions Tests. In general, plans may not discriminate in favor of HCEs in terms of benefits or contributions. DB plans typically apply the standard to the level of future retirement benefits earned in the plan during the year, while DC plans typically are evaluated on the basis of current contributions to the plan. Because the IRC contains only a very general provision prohibiting discrimination, the details of these rules are largely governed over the years by IRS regulations and rulings. The Internal Revenue Service (IRS) issued comprehensive regulations in 1991.[8]

As described below, 401(k) plans are generally no longer tested under these rules because pre-tax and after-tax employee contributions and employer matching contributions are tested under the ADP and ACP tests. An employer's non-elective (i.e., profit-sharing) contribution to a 401(k) plan would be tested under these rules.[9]

However, some discrimination in favor of HCEs is allowed, under the so-called "permitted disparity" rule. That is, it is allowable for plans to be "integrated" with Social Security and thus provide proportionately less in benefits to individuals earning under the Social Security earnings cap ($94,200 in 2006).[10] In addition, if they so choose, DC plan sponsors can be tested in terms of future retirement benefits and DB plan sponsors can choose to be tested in terms of current contributions, under so-called "cross-testing."[11] All else equal, $1 of future retirement benefits costs more in terms of current contributions for older employees than for younger employees. Conversely, $1 in current contributions buys more future benefits for a 20 year-old than it would for a 60 year-old.

Top-Heavy Plans. Prior to 1982, plans for owner-employees (called H.R. 10 or Keogh plans) were subject to a number of special rules. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA '82) included a provision applying a number of these special rules to all qualified plans that are classified as "top heavy." Generally, a plan was top heavy if a significant portion of a plan's benefits—60 percent or more—had accrued to "key" employees. For DB plans, benefits are calculated as the present value of accrued plan benefits. For DC plans, accrued benefits are defined as current account balances. Also included in the accrued benefit total were any lump-sum

payouts made from the plan in the previous five years. A key employee was an employee that met one or more of four conditions: (1) was an officer; (2) was a 5-percent owner of the employer; (3) was a 1-percent owner earning more than $150,000 from the employer; or (4) was one of top 10 employees with the largest ownership interests in the employer (with ownership aggregated over family members). Congress amended the four categories somewhat in 1984, 1986, and 1988.[12]

If a plan is determined to be top heavy, it is subject to certain sanctions. Among the sanctions, the amount of compensation that can be taken into account under a plan was limited to $200,000. That is, when designing plan features, such as the formula for benefits under a DB plan or the rate of employer contributions under a DC plan, only the first $200,000 of compensation could be used in determining the benefit or contribution. Also, benefits accrued under the plan must vest—that is, give participants a non-forfeitable right to the benefits—on an accelerated basis. Specifically, the benefits must vest at least as quickly as one of two vesting schedules: three-year cliff vesting or six-year graded vesting.[13] In addition, each non-key employee must accrue a minimum level of benefits (in the case of a DB plan) or receive a minimum level of contributions (in the case of a DC plan). The minimum level of contributions for a DC plan is equal to 3 percent of compensation or, if less, the rate of contributions to the key employee with the highest rate of contribution.

Includable Compensation. Originally a sanction for top-heavy plans, the provision that limited the amount of compensation that can be taken into account under a plan to $200,000 was applied to all plans under TRA '86. This limit applied to all plans starting in 1989 and was indexed to inflation thereafter. The Omnibus Reconciliation Act of 1993 (OBRA '93) reduced the limit, which had risen to $235,840 in 1993, to $150,000 in 1994.[14]

Special Rules for Cash or Deferred Arrangements. Precursors to today's 401(k) plans were profit-sharing plans with cash or deferred arrangements (CODAs). Some employers with these profit-sharing plans distributed end-of-year bonuses to employees. The CODA allowed employees to defer receipt of some or all of their bonus by having their employer make a contribution on their behalf to the profit-sharing plan. In 1956, the IRS issued a revenue ruling that addressed the nondiscrimination implications of CODAs.[15] In the ruling, the IRS considered two profit-sharing plans in which the bonuses were calculated as a percentage of compensation. Although the percentage changed from year to year based on the company's profits, the bonus as a percentage of compensation was the same for all employees in a given year. Employees could choose to defer the entire bonus, one-half of the bonus, or none of the bonus. The IRS ruled that these CODAs could generally meet the nondiscrimination requirements by passing a numerical test. Under this test, a plan was deemed to have met the coverage and contributions tests described above if at least one-half of participants were among the lowest two-thirds of eligible employees ranked by compensation. Because the test weighted employees based on the percentage of the bonus that the employee chose to defer, this test allowed the top-paid one-third of employees, on average, to defer up to twice as much as a percentage of compensation as the bottom-paid two-thirds and still meet the nondiscrimination requirements.[16]

The 1956 ruling was made obsolete by the Revenue Act of 1978 when Congress added section 401(k) to the IRC.[17] In the place of the old requirement, 401(k) plans were subject to a new test—the actual deferral percentage (ADP) test. Under this test, the ADP for each employee was defined as the ratio of employee pre-tax contributions to employee compensation. To satisfy the nondiscrimination requirements, the average ADP for the top one-third of employees ranked by compensation

could not exceed the average ADP for all other eligible employees by a certain percentage (Figure A3). Specifically, the maximum allowable ADP for the high-paid group was the greater of the results from two tests, the 1.5 test or the 2.5 test. The 1.5 test set the maximum average ADP of the high-paid group at 150 percent of the average ADP of the low-paid group. The 2.5-test set the maximum average ADP of the high-paid group as the lesser of: 250 percent of the average ADP of the low-paid group; or the average ADP of the low paid plus 3 percentage points. Mathematically, the formula for the test is (with *HP* referring to high-paid group and *LP* referring to the low-paid group):

Maximum ADP of HP = MAX (1.5(LP ADP); MIN (2.5*(LP ADP), (LP ADP)+3%))*

Proposed regulations in 1981 made two clarifications to the ADP test. First, the regulations stipulated that, for purposes of the ADP test, employers may take into account mandatory employer contributions as well as CODA deferrals, as long as these contributions vested immediately. Second, the regulations allowed 401(k) plans to satisfy nondiscrimination rules by either passing the ADP instituted in 1978 or by meeting the general benefits and contributions test. However, Congress overrode this latter option when it passed the Deficit Reduction Act of 1984 (DEFRA '84), which required that CODAs meet the new ADP test.

TRA '86 modified these requirements further. First, as described above, a new uniform definition of an HCE was implemented and the test now compared the ADP of HCEs to the ADP of NHCEs (rather than comparing the top one-third of employees to the bottom two-thirds). Second, the formula that related the maximum allowable ADP for HCEs to the ADP of NHCEs was modified again. The "1.5 test" was modified to become the "125 test": the maximum average ADP of HCEs could now be 125 percent, rather than 150 percent, of the average ADP of NHCEs. The "2.5 test" was modified to become the "2-times test": the maximum average ADP of HCEs could now be the lesser of 200 percent, rather than 250 percent, of the average ADP of the low paid or the average ADP of the low paid plus 2 percentage points, rather than plus 3 percentage points. Mathematically, the formula for the new test is:

Maximum ADP of HCE = MAX (1.25(NHCE ADP); MIN (2*(NHCE ADP), (NHCE ADP)+2%))*

Figure A3

Law Changes and the ADP Test

Percent of compensation

	Maximum Allowable Average ADP of High Paid Based on a Given Average ADP of Low Paid	
	Revenue Act of 1978	Tax Reform Act of 1986
ADP of Low Paid	Highest Paid 1/3 Compared to Lowest Paid 2/3	HCE Compared to NHCE
1.0	2.5	2.0
2.0	5.0	4.0
3.0	6.0	5.0
4.0	7.0	6.0
5.0	8.0	7.0
6.0	9.0	8.0
7.0	10.5	9.0
8.0	12.0	10.0
9.0	13.5	11.25
10.0	15.0	12.5

Source: Investment Company Institute Calculations

Relative to previous law, the maximum allowable ADP for HCEs was reduced at all levels of NHCE ADP (Figure A3). However, because the new uniform definition of HCEs was generally less restrictive than the old standard—in the sense that typically fewer employees were designated as HCEs than were in the top one-third of employees by compensation—it is not clear if the overall impact of rule changes with respect to the ADP test was to restrict contributions made by HCEs.

TRA '86 also instituted a new test—the actual contribution percentage (ACP) test. In general, this test applied the same test to the sum of matching employer contributions and employee after-tax contributions that the ADP test applied to employee pre-tax contributions.[18] However, a complication is that TRA '86 also included a third test referred to as the "multiple-use" test. As noted above, there are two tests imbedded in the ADP test—the 125 test and the 2-times test—with the ADP test taking the maximum value from the two tests. The multiple-use test stipulated that if the 2-times test was used to satisfy the ADP test, the 125 test must be used to satisfy the ACP test.

In addition, the includable compensation provision (explained above) impacts the restrictions placed on high earners by the nondiscrimination rules. For example, suppose an executive that earns more than the includable compensation limit contributes $15,000 to a 401(k). If the includable compensation limit is set at $150,000, the executive's ADP is 10 percent. If the includable compensation limit is set at $200,000, the executive's ADP is 7½ percent.

Simplification of Nondiscrimination Rules Began in 1996

The trend toward ever more complicated nondiscrimination rules was not reversed until the Small Business Job Protection Act of 1996 (SBJPA), which simplified the definition of an HCE and made 401(k) nondiscrimination testing less administratively burdensome.

Prior to SBJPA, there were four criteria to determine if an employee was an HCE; after SBJPA there were only two criteria for determining HCE status.[19] As under prior law, a 5-percent owner was considered a key employee. However, the rule pertaining to highly paid officers was repealed and the two separate rules relating to the level of compensation—which by 1996 had increased with inflation so that any employee earning over $100,000 or over $66,000 and in the top 20 percent of workers ranked by compensation—were replaced by a single rule: any worker earning over $80,000 (indexed to inflation) was considered an HCE. At the discretion of the plan sponsor, a plan can limit HCEs determined under the $80,000 rule to employees in the top 20 percent of employees ranked by compensation; this is known as the "top paid group" election.

The new definition of an HCE effectively loosened the restrictions put on plans, to the extent firms generally have the same number of employees or fewer designated HCEs than under the previous rules.[20] Also, SBJPA repealed the family aggregation rule and the rule that made the highest paid officer an HCE regardless of compensation.

SBJPA made changes to the ADP and ACP tests to make them less administratively burdensome.[21] First, firms were allowed to calculate the maximum permitted ADP and ACP of HCEs based on the ADP and ACP of NHCEs for the preceding year rather than the current year.[22] Second, SBJPA instituted a new design-based safe harbor for the ADP test. That is, if an employer provides sufficient non-elective employer contributions or matching employer contributions, gives all participants written notice of eligibility, rights, and obligations under the plan, and all employer contributions vest immediately, the plan would be deemed to pass the ADP test without actually having to apply the test. Non-elective employer contributions must be at least 3 percent of compensation to all NHCEs. If matching employer contributions are used to meet the safe harbor, the match formula must be at least as generous at all levels of employee contributions as a 100 percent match on the first 3 percent of compensation and a 50 percent match on the next 2 percent of compensation.

Under certain conditions, an employer meeting the requirements of the ADP safe harbor can use the design-based safe harbor to satisfy the ACP test as well. The ACP test with respect to employer matching contributions is met provided that there are no matching contributions on after-tax contributions or on elective deferrals above 6 percent of compensation; that the rate of employer match does not increase as the rate of after-tax contributions or elective deferrals increases; and that the match rate with respect to HCEs is less than or equal to the match rate with respect to NHCEs. Any after-tax contribution would continue to be tested under the ACP test.[23]

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) simplified the rules of top-heavy plans.[24] For example, EGTRRA provided that a CODA that satisfies both the ADP and ACP tests by using the design-based safe harbor was no longer considered a top-heavy plan. The definition of key employee was also changed. Prior to EGTRRA, an employee was considered a key employee if he or she was (1) an officer earning over one-half of the DB plan dollar limitation of section 415 ($70,000 for 2001); (2) a 5-percent owner of the employer; (3) a 1-percent owner of the employer earning over $150,000; or (4) one of the 10 employees earning more than the DC plan dollar limit ($35,000 for 2001) with the largest ownership interests in the employer. EGTRRA modified the definition by increasing the officer threshold to $130,000 and eliminating the fourth criteria (top-ten owners). The other two criteria—1-percent owners with compensation over $150,000 or 5-percent owners—were unchanged.

EGTRRA loosened the restrictions on employee contributions caused by nondiscrimination testing. For example, the limit on includable compensation, which had risen to $170,000 by 2001, was increased to $200,000 in 2002 and indexed for inflation. Although a substantial increase, the limit in 2006 ($220,000) is still below the level it had reached in 1993 ($235,840).[25] In addition, EGTRRA allowed individuals age 50 or older to make catch-up contributions (up to $5,000 in 2006), and catch-up contributions are not subject to nondiscrimination testing.[26] EGTRRA also loosened restrictions on employer matching contributions by repealing the multiple-use test.

The Pension Protection Act of 2006 (PPA) made a few changes that affect non-discrimination testing. For example, it made permanent EGTRRA's increased contribution limits.[27] In addition, Congress added a new design-based safe harbor that plans can use to satisfy the ADP and ACP tests if the plan includes a "qualified automatic enrollment arrangement."[28] In general terms, the safe harbor is similar to the one described earlier, but allows for lower matching contributions and allows matching or non-elective contributions to have a two-year vesting schedule. This new safe harbor will be available to plans beginning in 2008.

Notes

[1] See the November 2006 *Perspective* (available at www.ici.org/pdf/per12-02.pdf). This Appendix contains an abbreviated references section; for a complete bibliography, see the November 2006 *Perspective*.

[2] See Clark, Mulvey, and Schieber (August 31, 2000) for a discussion of the history of nondiscrimination rules.

[3] See Brady (forthcoming) for a discussion of the incentives firms face under 401(k) nondiscrimination rules.

[4] TRA '86 § 1114.

[5] In other words, no more than 50 employees would be designated officers under this provision at firms with 500 employees or more; for firms with between 30 and 500 employees, no more than 10 percent of employees would be designated officers; for firms with 30 employees or fewer, no more than three employees.

[6] For example, see discussion in Joint Committee on Taxation (December 18, 1996).

[7] TRA '86 § 1112.

[8] Treas. Reg. §§ 1.401(a)(4)-1 through 1.401(a)(4)-13.

[9] Employer non-elective contributions in most 401(k) plans generally pass this test because the IRS rules provide a safe harbor when employees are allocated the same percentage of plan-year compensation or the same dollar amount. Treas. Reg. § 1.401(a)(4)-2(b)(1).

[10] See IRC § 401(l).

[11] Treas. Reg. § 1.401(a)(4)-8.

[12] Deficit Reduction Act of 1984 §§ 524, 713 (P.L. 98-369); TRA '86 § 1852; Technical and Miscellaneous Revenue Act of 1988 § 1011 (P.L. 100-647).

[13] Cliff vesting means that no benefits are vested until the vesting date, at which point the benefits are 100 percent vested. Graded vesting means that benefits vest gradually over time. Under six-year graded vesting, 20 percent of benefits vest after two years, and an additional 20 percent vest each year until benefits are 100 percent vested after six years. Prior to the TRA '86, the rules for non-top-heavy plans required plans to vest at least as fast as 10-year cliff vesting or one of two graded vesting schedules that fully vested after 15 years.

[14] See Figure 9 in the November 2006 *Perspective*.

[15] Rev. Rul. 56-497, 1956-2 CB 284 (July 1956).

[16] See Vine (Spring 1986) for a discussion of this rule and other 401(k) plans changes contemplated during the tax reform debate of 1986.

[17] See Rev. Rul. 80-16, 1980-1 CB 82 (January 1980).

[18] In some circumstances, the employer may include in the ACP calculation other types of contributions not needed to satisfy the ADP test. See IRC § 401(m)(3).

[19] SBJPA § 1431.

[20] For any firm with fewer than 20 percent of eligible employees earning compensation of $80,000 or greater, fewer employees would be deemed HCEs under the new law than under the old law. For firms where 20 percent or more of employees made at least $80,000, but fewer than 20 percent of employees made over $100,000, the new rules would allow the plan to designate the same number of employees as HCEs as they had under the old law. If more than 20 percent of employees earned over $100,000, the firm could choose to designate fewer employees as HCEs under the new law relative to the old law.

[21] SBJPA § 1433.

[22] An employer can elect to use current year ratios for the test. If a plan is in its first year, it can use a default assumption of 3 percent for both the average ADP and the average ACP of NHCEs.

[23] For this reason, many safe-harbor 401(k) plans do not allow after-tax employee contributions.

[24] EGTRRA § 613.

[25] See Figure 9 in the November 2006 *Perspective*.

[26] See Figure 8 in the November 2006 *Perspective*.

[27] PPA § 811.

[28] PPA § 902.

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