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similarly situated residual shared employees to a qualified separate line of business for which they provide minimal services might not be considered reasonable. In addition, the allocation of the professional employees of a department to one qualified separate line of business and the allocation of the support staff of the same department to a different qualified separate line of business would not be reasonable.

[T.D. 8376, 56 FR 63453, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32920, June 27, 1994]

§ 1.414(r)-8 Separate application of section 410(b).

(a) *General rule.* If an employer is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with § 1.414(r)-1(b) for a testing year, the requirements of section 410(b) must be applied in accordance with this section separately with respect to the employees of each qualified separate line of business for purposes of testing all plans of the employer for plan years that begin in the testing year (other than a plan tested under the special rule for employer-wide plans in § 1.414(r)-(c)(2)(ii) for such a plan year). Conversely, if an employer is not treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with § 1.414(r)-1(b) for a testing year, the requirements of section 410(b) must be applied on an employer-wide basis for purposes of testing all plans of the employer for plan years that begin in the testing year. See § 1.414(r)-1(c)(2) and (d)(6). Paragraph (b) of this section explains how the requirements of section 410(b) are applied separately with respect to the employees of a qualified separate line of business for purposes of testing a plan. Paragraph (c) of this section explains the coordination between sections 410(b) and 401(a)(4). Paragraph (d) of this section provides certain supplementary rules necessary for the application of this section.

(b) *Rules of separate application—(1) In general.* If the requirements of section 410(b) are applied separately with respect to the employees of each qualified separate line of business operated by the employer for a testing year, a plan (other than a plan that is tested under the special rule for employer-

wide plans in § 1.414(r)-1(c)(2)(ii) for a plan year) satisfies the requirements of section 410(b) only if—

(i) The plan satisfies section 410(b)(5)(B) of an employer-wide basis; and

(ii) The plan satisfies section 410(b) on a qualified-separate-line-of-business basis.

(2) *Satisfaction of section 410(b)(5)(B) on an employer-wide basis—(i) General rule.* Section 410(b)(5)(B) provides that a plan is not permitted to be tested separately with respect to the employees of a qualified separate line of business unless the plan benefits a classification of employees found by the Secretary to be nondiscriminatory. A plan satisfies this requirement only if the plan satisfies either the ratio percentage test of § 1.410(b)-2(b)(2) or the nondiscriminatory classification test of § 1.410(b)-4 (without regard to the average benefit percentage test of § 1.410(b)-5), taking into account the other applicable provisions of §§ 1.410(b)-1 through 1.410(b)-10. For this purpose, the nonexcludable employees of the employer taken into account in testing the plan under section 410(b) are determined under § 1.410(b)-6, without regard to the exclusion in § 1.410(b)-6(e) for employees of other qualified separate lines of business of the employer. Thus, in testing a plan separately with respect to the employees of one qualified separate line of business under this paragraph (b)(2), the otherwise nonexcludable employees of the employer's other qualified separate lines of business are not treated as excludable employees. However, under the definition of "plan" in paragraph (d)(2) of this section, these employees are not treated as benefiting under the plan for purposes of applying this paragraph (b)(2).

(ii) *Application of facts and circumstances requirements under nondiscriminatory classification test.* The fact that an employer has satisfied the qualified-separate-line-of-business requirements in §§ 1.414(r)-1 through 1.414(r)-7 is taken into account in determining whether a classification of employees benefiting under a plan that falls between the safe and unsafe harbors satisfies § 1.410(b)-4(c)(3) (facts and circumstances requirements). Except

in unusual circumstances, this fact will be determinative.

(iii) *Modification of unsafe harbor percentage for plans satisfying ratio percentage test at 90 percent level*—(A) *General rule.* If a plan benefits a group of employees for a plan year that would satisfy the ratio percentage test of § 1.410(b)-2(b)(2) on a qualified-separate-line-of-business basis under paragraph (b)(3) of this section if the percentage in § 1.410(b)-2(b)(2) were increased to 90 percent, the unsafe harbor percentage in § 1.410(b)-4(c)(4)(ii) for the plan is reduced by five percentage points (not five percent) for the plan year and is applied without regard to the requirement that the unsafe harbor percentage not be less than 20 percent. Thus, if the requirements of this paragraph (b)(2)(iii)(A) are satisfied, the unsafe harbor percentage in § 1.410(b)-4(c)(4)(ii) is treated as 35 percent, reduced by $\frac{3}{4}$ of a percentage point for each whole percentage point by which the non-highly compensated employee concentration percentage exceeds 60 percent.

(B) *Facts and circumstances alternative.* If a plan satisfies the requirements of paragraph (b)(2)(iii)(A) of this section, but has a ratio percentage on an employer-wide basis that falls below the unsafe harbor percentage determined under paragraph (b)(2)(iii)(A) of this section, the plan nonetheless is deemed to satisfy section 410(b)(5)(B) on an employer-wide basis if the Commissioner determines that, on the basis of all of the relevant facts and circumstances, the plan benefits such employees as qualify under a classification of employees that does not discriminate in favor of highly compensated employees.

(3) *Satisfaction of section 410(b) on a qualified-separate-line-of-business basis.* A plan satisfies section 410(b) on a qualified-separate-line-of-business basis only if the plan satisfies either the ratio percentage test of § 1.410(b)-2(b)(2) or the average benefit test of § 1.410(b)-2(b)(3) (including the non-discriminatory classification test of § 1.410(b)-4 and the average benefit percentage test of § 1.410(b)-5), taking into account the other applicable provisions of §§ 1.410(b)-1 through 1.410(b)-10. For this purpose, the non-excludable em-

ployees of the employer taken into account in testing the plan under section 40(b) are determined under § 1.410(b)-6, taking into account the exclusion in § 1.410(b)-6(e) for employees of other qualified separate lines of business of the employer. Thus, in testing a plan separately with respect to the employees of one qualified separate line of business under this paragraph (b)(3), all employees of the employer's other qualified separate lines of business are treated as excludable employees.

(4) *Examples.* The following examples illustrate the application of this paragraph (b).

Example 1. (i) Employer A is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with § 1.414(r)-1(b) for the 1994 testing year with respect to all of its plans. Employer A operates two qualified separate lines of business as determined under § 1.414(r)-1(b)(2), Line 1 and Line 2. Employer A maintains only two plans, Plan X which benefits solely employees of Line 1, and Plan Y which benefits solely employees of Line 2. In testing Plan X under section 410(b) with respect to the first testing day for the plan year of Plan X beginning in the 1994 testing year, it is determined that Employer A has 2,100 non-excludable employees, of whom 100 are highly compensated employees and 2,000 are non-highly compensated employees. After applying § 1.414(r)-7 to these employees, 50 of the highly compensated employees and 100 of the nonhighly compensated employees are treated as employees of Line 2, and the remaining 50 highly compensated employees and the remaining 1,900 nonhighly compensated employees are treated as employees of Line 1.

(ii) All of the highly compensated employees and 1,300 of the nonhighly compensated employees who are treated as employees of Line 1 benefit under Plan X. Thus, on an employer-wide basis, Plan X benefits 50 percent of all Employer A's highly compensated employees (50 out of 100) and 65 percent of all Employer A's nonhighly compensated employees (1,300 out of 2,000). Plan X consequently has a ratio percentage determined on an employer-wide basis of 130 percent (65%+50%), see § 1.410(b)-9, and could satisfy section 410(b) under the ratio percentage test of § 1.410(b)-2(b)(2) if that section were applied on an employer-wide basis without regard to the provisions of this paragraph (b). Under paragraph (a) of this section, however, the requirements of section 410(b) must be applied separately with respect to the employees of each qualified separate line of business operated by Employer A for all plans of Employer A for plan years that begin in the 1994 testing year. This rule does

not apply to plans tested under the special rule for employer-wide plans in § 1.414(r)-1(c)(2)(ii). Plan X benefits only 65 percent of the nonhighly compensated employees of Employer A, however, and therefore cannot satisfy the 70 percent requirement necessary to be tested under that rule. As a result, for the plan year of Plan X beginning in the 1994 testing year, Plan X is not permitted to satisfy section 410(b) on an employer-wide basis and, instead, is only permitted to satisfy section 410(b) separately with respect to the employees of each qualified separate line of business operated by Employer A, in accordance with paragraphs (b)(2) and (b)(3) of this section.

Example 2. The facts are the same as in *Example 1*. All of the 50 highly compensated employees treated as employees of Line 2 benefit under Plan Y, and 80 of the 100 nonhighly compensated employees treated as employees of Line 2 benefit under Plan Y. Thus, Plan Y benefits 50 percent of all Employer A's highly compensated employees (50 out of 100) and only 4 percent of all Employer A's nonhighly compensated employees (80 out of 2,000). Thus, while Plan Y has a ratio percentage of 80 percent ($80\% \div 100\%$) on a qualified-separate-line-of-business basis, it has a ratio percentage of only 8 percent ($4\% \div 50\%$) on an employer-wide basis. See § 1.410(b)-9. Under § 1.410(b)-4(c)(4)(iii), the nonhighly compensated employee concentration percentage is $2,000/2,100$ or 95 percent. Because 8 percent is less than 20 percent (the unsafe harbor percentage applicable to Employer A under § 1.410(b)-4(c)(4)(ii)), Plan Y does not satisfy the nondiscriminatory classification test of § 1.410(b)-4 on an employer-wide basis. Nor does Plan Y satisfy the ratio percentage test of § 1.410(b)-2(b)(2) on an employer-wide basis, since 8 percent is less than 70 percent. Under these facts, Plan Y does not satisfy section 410(b)(5)(B) on an employer-wide basis in accordance with paragraph (b)(2) of this section for the plan year of Plan Y beginning in the 1994 testing year, and therefore fails to satisfy section 410(b) for that year. This is true even though Plan Y satisfies section 410(b) on a qualified-separate-line-of-business basis in accordance with paragraph (b)(3) of this section.

Example 3. The facts are the same as in *Example 2*, except that all of the employees treated as employees of Line 2 benefit under Plan Y. Thus, Plan Y benefits 50 percent of all of Employer A's highly compensated employees (50 out of 100) and 5 percent of all of Employer A's nonhighly compensated employees (100 out of 2,000). Plan Y therefore has a ratio percentage of 100 percent ($100\% \div 100\%$) on a qualified-separate-line-of-business basis and a ratio percentage of 10 percent ($5\% \div 50\%$) on an employer-wide basis. Because Plan Y has a ratio percentage of at least 90 percent on a qualified-separate-line-of-business basis, a reduced unsafe harbor

percentage applies to Plan Y under paragraph (b)(2)(iii)(A) of this section. The reduced unsafe harbor percentage applicable to Plan Y is 8.75 percent because Employer A's nonhighly compensated employee concentration percentage is 95 percent. Plan Y's employer-wide ratio percentage of 10 percent therefore exceeds the unsafe harbor percentage. Plan Y thus satisfies section 410(b)(5)(B) on an employer-wide basis in accordance with paragraph (b)(2) of this section for the plan year of Plan Y beginning in the 1994 testing year. Plan Y also satisfies section 410(b) on a qualified-separate-line-of-business basis in accordance with paragraph (b)(3) of this section.

Example 4. The facts are the same as in *Example 3*, except that Employer A's total nonexcludable nonhighly compensated employees are 2,500 (rather than 2,000), of whom 100 are treated as employees of Line 2 and of whom 90 benefit under Plan Y. Plan Y has a ratio percentage of 90 percent ($90\% \div 100\%$) on a qualified-separate-line-of-business basis, and Employer A's nonhighly compensated employee concentration percentage is $2,500/2,600$ or 96 percent. Thus, the reduced unsafe harbor percentage applicable to Plan Y under paragraph (b)(2)(iii)(A) of this section is 8 percent. Plan Y benefits 50 percent of all of Employer A's highly compensated employees (50 out of 100) and 3.6 percent of all of Employer A's nonhighly compensated employees (90 out of 2,500). Plan Y therefore has a ratio percentage of only 7.2 percent ($3.6\% \div 50\%$) on an employer-wide basis, which falls below the reduced unsafe harbor percentage of 8 percent. Nonetheless, under paragraph (b)(2)(iii)(B) of this section, Plan Y will be deemed to satisfy section 410(b)(5)(B) on an employer-wide basis if the Commissioner determines that, on the basis of all of the relevant facts and circumstances, the plan benefits such employees as qualify under a classification of employees that does not discriminate in favor of highly compensated employees.

Example 5. (i) The facts are the same as in *Example 1*, except that Plan X benefits only 950 of the employees of Line 1. Assume Plan X satisfies the reasonable classification requirement of § 1.410(b)-4(b) on an employer-wide basis. Plan X benefits 50 percent of all Employer A's highly compensated employees (50 out of 100) and 47.5 percent of all Employer A's nonhighly compensated employees (950 out of 2,000). Plan X consequently has a ratio percentage determined on an employer-wide basis of 95 percent ($47.5\% \div 50\%$), see § 1.410(b)-9, and thus satisfies section 410(b)(5)(B) on an employer-wide basis.

(ii) Plan X has a ratio percentage determined on a qualified-separate-line-of-business basis of 50 percent ($50\% \div 100\%$). Because 50 percent is less than 70 percent, Plan X must satisfy the nondiscriminatory classification test of § 1.410(b)-4 and the average

benefit percentage test of § 1.410(b)-5 on a qualified-separate-line-of-business basis in order to satisfy the other requirements of section 410(b). Plan X satisfies the non-discriminatory classification requirement of § 1.410(b)-4(c) on a qualified-separate-line-of-business basis because its ratio percentage determined on a qualified-separate-line-of-business basis is more than 22.25 percent, the safe harbor percentage applicable to Line 1 under § 1.410(b)-4(c)(4)(i). Because Plan X satisfies the reasonable classification requirement of § 1.410(b)-4(b) on an employer-wide basis, it is also deemed to satisfy this requirement on a qualified-separate-line-of-business basis. See § 1.410(b)-7(c)(5). In determining whether Plan X satisfies the average benefit percentage test of § 1.410(b)-5, only Plan X and only employees of Line 1 are taken into account. See §§ 1.410(b)-6(e) and 1.410(b)-7(e).

Example 6. The facts are the same as in *Example 2*, except that, prior to the 1994 testing year, Employer A merges Plan X and Plan Y so that they form a single plan within the meaning of section 414(l). Under the definition of “plan” in paragraph (d)(2) of this section, however, the portion of the newly merged plan that benefits employees of Line 2 (former Plan Y) is still treated as a separate plan from the portion of the newly merged plan that benefits employees of Line 1 (former Plan X). The portion of the newly merged plan that benefits employees of Line 2 (former Plan Y) fails to satisfy section 410(b) for the reasons stated in *Example 2*. Under these facts, because the portion of the newly merged plan that benefits employees of Line 2 fails to satisfy section 410(b), the entire newly merged plan fails to satisfy section 410(b) for the plan year of the newly merged plan that begins in the 1994 testing year. See paragraph (d)(5) of this section.

(c) *Coordination of section 401(a)(4) with section 410(b)—(1) General rule.* For purposes of these regulations, the requirements of section 410(b) encompass the requirements of section 401(a)(4) (including, but not limited to, the permitted disparity rules of section 401(l), the actual deferral percentage test of section 401(k)(3), and the actual contribution percentage test of section 401(m)(2)). Therefore, if the requirements of section 410(b) are applied separately with respect to the employees of each qualified separate line of business of an employer for purposes of testing one or more plans of the employer for plan years that begin in a testing year, the requirements of section 401(a)(4) must also be applied separately with respect to the employees of the same qualified separate lines of

business for purposes of testing the same plans for the same plan years. Furthermore, if section 401(a)(4) requires that a group of employees under the plan satisfy section 410(b) for purposes of satisfying section 401(a)(4), section 410(b) must be applied for this purpose in the same manner provided in paragraph (b) of this section. See, for example, §§ 1.401(a)(4)-2(c)(1) and 1.401(a)(4)-3(c)(1) (requiring each rate group of employees under a plan to satisfy section 410(b)), § 1.401(a)(4)-4(b) (requiring the group of employees to whom each benefit, right, or feature is currently available under a plan to satisfy section 410(b)), and § 1.401(a)(4)-9(c)(1) (requiring the group of employees included in each component plan into which a plan is restructured to satisfy section 410(b)). Thus, the group of employees must satisfy section 410(b)(5)(B) on an employer-wide basis in accordance with paragraph (b)(2) of this section and also must satisfy section 410(b) on a qualified-separate-line-of-business basis in accordance with paragraph (b)(3) of this section, in both cases as if the group of employees were the only employees benefiting under the plan.

(2) *Examples.* The following examples illustrate the application of the rule in this paragraph (c).

Example 1. Employer B is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with § 1.414(r)-1(b) for the 1993 testing year. Employer B operates two qualified separate lines of business as determined under § 1.414(r)-1(b)(2), Line 1 and Line 2. Employer B maintains Plan Z, which benefits employees in both Line 1 and Line 2. Under the definition of “plan” in paragraph (d)(2) of this section, the portion of Plan Z that benefits employees of Line 1 is treated as a separate plan from the portion of Plan Z that benefits employees of Line 2. Under this paragraph (c), this result applies for purposes of both section 410(b) and section 401(a)(4).

Example 2. The facts are the same as in *Example 1*, except that Plan Z benefits solely employees of Line 1. In testing Plan Z under section 401(a)(4) for the plan year of Plan Z beginning in the 1993 testing year, Employer B restructures Plan Z into several component plans (within the meaning of § 1.401(a)(4)-9(c)). Under § 1.401(a)(4)-9(c)(1), each of these component plans is required to satisfy section 410(b). This paragraph (c) requires that each of the component plans be

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tested separately with respect to the employees of each qualified separate line of business operated by Employer B. This testing must be done in accordance with paragraph (b) of this section. Consequently, each component plan must satisfy section 410(b)(5)(B) on an employer-wide basis in accordance with paragraph (b)(2) of this section and must also satisfy section 410(b) on a qualified-separate-line-of-business basis in accordance with paragraph (b)(3) of this section.

Example 3. The facts are the same as in *Example 1*, except that Plan Z is a profit-sharing plan, and contributions to Plan Z are made pursuant to cash or deferred arrangement in which all employees of Employer B are eligible to participate. Assume that, as a result, Plan Z satisfies the requirements to be tested under the special rule for employer-wide plans in § 1.414(r)-1(c)(2)(ii). Under these facts, the requirements of sections 410(b), 401(a)(4) and 401(k), including the actual deferral percentage test of section 401(k)(3) and § 1.401(k)-1(b), would generally be required to be applied separately to the portions of Plan Z that benefit the employees of Line 1 and Line 2, respectively. However, if Plan Z is tested under the special rule in § 1.414(r)-1(c)(2)(ii), these requirements must be applied on an employer-wide basis.

(d) *Supplementary rules—(1) In general.* This paragraph (d) provides certain supplementary rules necessary for the application of this section.

(2) *Definition of plan.* For purposes of this section, the term *plan* means a plan within the meaning of § 1.410(b)-7(a) and (b), after application of the mandatory disaggregation rules of § 1.410(b)-7(c) (including the mandatory disaggregation rule for portions of a plan that benefit employees of different qualified separate lines of business) and the permissive aggregation rules of § 1.410(b)-7(d). Thus, for purposes of this section, the portion of a plan that benefits employees of one qualified separate line of business is treated as a separate plan from the other portions of the same plan that benefit employees of other qualified separate lines of business of the employer, unless the plan is tested under the special rule for employer-wide plans in § 1.414(r)-1(c)(2)(ii) for the plan year.

(3) *Employees of a qualified separate line of business.* For purposes of applying paragraph (b) of this section with respect to a testing day, the employees

of each qualified separate line of business of the employer are determined by applying § 1.414(r)-7 to the employees of the employer otherwise taken into account under section 410(b) for the testing day. For purposes of applying paragraph (c) of this section with respect to a testing day, the employees of each qualified separate line of business of the employer are determined by applying § 1.414(r)-7 to the employees of the employer otherwise taken into account under section 410(a)(4) for the testing day. For the definition of *testing day*, see § 1.414(r)-11(b)(6).

(4) *Consequences of failure.* If a plan fails to satisfy either paragraph (b)(2), (b)(3), or (c)(1) of this section, the plan (and any plan of which it constitutes a portion) fails to satisfy section 401(a). However, this failure alone does not cause the employer to fail to be treated as operating qualified separate lines of business in accordance with § 1.414(r)-1(b), unless the employer is relying on benefits provided under the plan to satisfy the minimum benefit portion of the safe harbor in § 1.414(r)-5(g)(2) with respect to at least one of its qualified separate lines of business.

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§ 1.414(r)-9 Separate application of section 401(a)(26).

(a) *General rule.* If an employer is treated as operating qualified separate lines of business for purposes of section 401(a)(26) in accordance with § 1.414(r)-1(b) for a testing year, the requirements of section 401(a)(26) must be applied separately with respect to the employees of each qualified separate line of business for purposes of testing all plans of the employer for plan years that begin in the testing year (other than a plan tested under the special rule for employer-wide plans in § 1.414(r)-1(c)(3)(ii) for such a plan year). Conversely, if an employer is not treated as operating qualified separate lines of business for purposes of section 401(a)(26) in accordance with § 1.414(r)-1(b) for a testing year, the requirements of section 401(a)(26) must be applied on an employer-wide basis for purposes of testing all plans of the employer for plan years that begin in the