

Guide to Nondiscrimination Testing for Code Section 403(b) Plans

For Employers



Table of contents

PREFACE	III
Question and Answers about Nondiscrimination Testing for Section 403(b) Tax-Sheltered Annuity Plans	1
1. What are the nondiscrimination tests which apply to retirement plans?	1
2. Are all 403(b) plans subject to the nondiscrimination requirements?	1
3. What would happen if my organization does not satisfy the nondiscrimination tests?	1
4. Okay, I can't ignore the requirements. What are the nondiscrimination requirements for Code section 403(b) Plans?	2
5. What are safe harbor tests?	2
6. What are Facts and Circumstances Tests?	2
7. Who is the Employer for purposes of the nondiscrimination tests?	3
8. What are the Qualified Separate Line of Business rules?	6
9. What is a "plan" for the purposes of the Nondiscrimination Tests?	6
10. No HCEs Benefit under my organization's plan. How does this affect the nondiscrimination tests?	7
11. What does compensation mean?	7
12. What is Standard Compensation?	8
13. What is Eligible to Participate Compensation and why is it needed?	11
14. What is Contributions Compensation?	12
15. What is NDT Compensation?	12
16. What are the statutory rules which apply to Employee Salary Reduction Contributions?	14
17. What is the 414(v) Universal Availability Requirement?	15
18. What are the Coverage Test requirements?	15
19. What are the requirements of the Ratio/Percentage Test?	17
20. What are the requirements of the Average Benefit Test?	18
21. What are the requirements of the Nondiscriminatory Classification Test?	18
22. What are the requirements of the Average Benefit Percentage Test?	21
23. What is the General Nondiscrimination Test?	22
24. What is the Contributions Test under the General Nondiscrimination Test?	24
25. What is the Availability Test under the General Nondiscrimination Test?	27
26. What are the requirements for crediting service?	28
27. What is the Special Circumstances Test under the General Nondiscrimination Test?	30
28. What is the Maximum Compensation Limit?	31
29. What is the Actual Contribution Percentage Test (ACP Test)?	31
30. What is the Current Plan Year Election and how does it affect the ACP Test?	32
31. Is there a safe harbor for the ACP Test?	32
32. What is the Three-Year Testing Cycle Guideline?	32
33. What are the rules related to the Three-Year Testing Cycle Guideline?	32
34. What does the law mean when it talks about an employee Benefiting under the plan?	33
35. Do I have to include ALL the employees in each of the tests or only those employees who make or receive contributions to the retirement plan?	33
36. Which employees may be excluded in processing the nondiscrimination tests?	34
37. Why is it important to specify in my plan document the employee groups which are excluded from eligibility to participate?	35
38. In practice I can make individual exceptions to the eligibility requirements which are written in the plan document or Adoption Agreement, can't I?	35
39. My plan covers union employees. Do special rules apply?	35
40. Can benefits for former employees impact our nondiscrimination tests?	36
41. My organization leases some personnel. How are these persons treated?	36
42. What is the impact of contingent employees or independent contractors?	37
43. Who are Highly Compensated Employees?	37

44.	How are HCEs determined under the Statutory HCE Definition?	37
45.	What is the Top 20% Paid Group?	38
46.	What happens if my retirement plan fails to comply with the nondiscrimination requirements in the 403(b) regulations?	38
47.	What happens if my plan fails the ACP Test?	39
48.	When must the corrective distributions under the ACP Test be made? Is there a deadline?	39
49.	Are there alternative methods for correcting failures of the nondiscrimination tests?	39
50.	What does my organization need to do so that the nondiscrimination tests can be performed?	39
51.	What can I do if it looks like my plan may have difficulty meeting the nondiscrimination requirements?	40
52.	This is complicated; will it ever get simpler?	40

GLOSSARY.....41

Glossary of terms used in Nondiscrimination Testing	41
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CHARTS52

Nondiscrimination Tests for Code Section 403(b) Plans (Applied with or without the reasonable, Good Faith Interpretation Standard)	52
Comparison of definitions of compensation.....	53
The meaning of compensation for different purposes.....	56
Timetable for nondiscrimination testing for the calendar year plan year	57
Determining HCEs under the statutory HCE definition for the 2009 plan year	58
Coverage Test chart.....	59
General Nondiscrimination Test chart	60
Actual Contribution Percentage (ACP) Test chart	61
Aggregation and disaggregation rules	62

Preface

The *Employer's Guide to Nondiscrimination Testing for Section 403(b) Plans* (the "Guide") was prepared by the Compliance Department of GuideStone Financial Resources of the Southern Baptist Convention ("GuideStone"). The Guide was prepared for those Employers utilizing GuideStone's NDT testing services.

The format of the Guide has been designed for ease of use. The reader will find that in addition to extensive cross-references, some material is repeated at several places in the Guide. Although the Guide is designed to be utilized by laymen, it can be a useful tool for plan counsel.

The Guide is published and privately distributed by GuideStone for informational use by Employers utilizing the 403(b) plan provided by GuideStone. GuideStone cannot provide legal advice concerning the nondiscrimination requirements and this Guide does not purport to offer legal advice in any form and is not an in-depth legal assessment. The information provided in this Guide is intended only as a general discussion of the nondiscrimination requirements, reflecting our current understanding of the rules as they affect the 403(b) retirement plan adopted by most Employers. Application of the material in this Guide to a particular situation is dependent upon the facts of the situation. You should consult your legal counsel regarding the application of the nondiscrimination requirements to your 403(b) tax-sheltered annuity plan. GuideStone specifically disclaims any liability for loss or risk incurred as a consequence of information presented in this Employer's Guide to Nondiscrimination Testing for Code section 403(b) Plans.

Question and Answers about Nondiscrimination Testing for Section 403(b) Tax-Sheltered Annuity Plans

The focus of this Questions and Answers Section is on the nondiscrimination requirements as they apply to the 403(b) retirement plan as generally adopted by Employers. The typical 403(b) retirement plan adopted by Employers is a defined contribution program which meets the requirements for income tax deferral as retirement income accounts under section 403(b)(9) of the Internal Revenue Code (IRC or “Code”). Code section 403(b)(9) retirement income accounts may be maintained only by certain Church-related Employers. Somewhat different rules may apply to other types of 403(b) retirement plans, maintained by Employers which are not eligible to maintain retirement income accounts, and to plans qualified under IRC Code section 401(a).

The answers provided in this Questions and Answers Section are based on the information available at this time and reflect our current understanding of the nondiscrimination requirements as they affect the typical 403(b) retirement plan adopted by Employers. Certain terms have specialized meanings, as set forth in the Glossary Section of this Guide.

The nondiscrimination rules are complex and the information provided here is only a general discussion of the requirements. The exact application of the rules to your plan may be different. For more detailed information on the nondiscrimination requirements, you may contact the Compliance Department at GuideStone.

1. What are the nondiscrimination tests which apply to retirement plans?

The nondiscrimination tests which apply to retirement plans are designed to ensure that retirement plans do not unlawfully favor Highly Compensated Employees (HCEs) either in design or operation. It is your organization’s responsibility to determine if your organization’s 403(b) retirement plan complies with the nondiscrimination requirements. GuideStone can provide assistance and guidance in performing the nondiscrimination tests based on our current interpretation and understanding of the requirements, but it cannot provide legal advice concerning the rules. Therefore, we suggest that you review the application of the nondiscrimination requirements to your 403(b) retirement plan with your legal counsel. Be aware that the IRS will continue to closely scrutinize 403(b) retirement plans. IRS guidelines indicate that one of the key areas an IRS agent is likely to examine in an audit is an organization’s nondiscrimination testing results.

2. Are all 403(b) plans subject to the nondiscrimination requirements?

No. Only a plan maintained by an Employer which is not a Church or Qualified Church-Controlled Organization (QCCO) is subject to the nondiscrimination requirements.

If your organization is a Church or QCCO, the nondiscrimination requirements discussed in this Guide do not apply to your 403(b) retirement plan. However, you must certify your organization’s status to GuideStone.

The determination of whether an organization is a Church or QCCO is one of the most critical determinations that an Employer must make. Each Employer participating in the 403(b)(9) Retirement Plan provided by GuideStone must make a determination of its status and certify such status to GuideStone. A [Status Certification Form](#) has previously been mailed to Employers who have adopted the 403(b)(9) Retirement Plan. The form will assist you in determining the status of your organization.

- If your organization has not completed the Status Certification Form, please complete the form and return it to your Relationship Manager at GuideStone immediately. If you have not received a copy of the [Status Certification Form](#), you should contact your Relationship Manager at GuideStone so we can send you a copy.
- Your organization should review its status periodically to determine if there has been any change. If your organization’s status changes, complete a new Status Certification Form and return it to your Marketing representative at GuideStone. From time to time, GuideStone may request that each organization update its Status Certification Form.

3. What would happen if my organization does not satisfy the nondiscrimination tests?

If your organization is subject to the nondiscrimination tests and your plan is found to unlawfully favor HCEs, then your plan could lose its tax-favored status.

It is possible that all vested 403(b) retirement plan contributions (to the extent not previously included in income) could become taxable to all participating employees in the year in which the plan loses its tax-favored status. In addition, earnings on contributions would become currently taxable. Finally, employees would lose the ability to rollover their 403(b) retirement plan accumulations to another eligible retirement plan or to an IRA.

If you do not use GuideStone's nondiscrimination testing services, GuideStone requires certification that your organization's 403(b) retirement plan satisfies the nondiscrimination requirements or, in the alternative, certification that your organization is a Church or a QCCO and is exempt from the requirements. A Certification of Compliance with IRC section 403(b)(12) Nondiscrimination Requirements Form is provided for Employers who do not use the testing services assistance provided by GuideStone.

4. Okay, I can't ignore the requirements. What are the nondiscrimination requirements for Code section 403(b) Plans?

Code section 403(b) Plans are subject to various nondiscrimination rules which are set forth in the Code. These are referred to in this Guide as Nondiscrimination Tests. IRS regulations provide guidance concerning the application of the statutory rules.

The chart on page 52 in the **Charts Section** outlines the nondiscrimination tests and preliminary considerations associated with nondiscrimination testing. This chart should be helpful in understanding the alternatives and multiple components of tests.

Nondiscrimination Tests. There are four different Nondiscrimination Tests which can apply to a 403(b) plan. Different tests apply to different types of contributions. Which Nondiscrimination Tests apply to your organization's plan depends on the types of contributions provided for under the plan.

- A Universal Availability requirement applies to Employee Salary Reduction Contributions (See Question and Answers 16 and 17).
- An Actual Contributions Percentage Test (ACP Test) applies to Employer Matching Contributions and Employee Tax-Paid Contributions (See Question and Answer 29).
- Two other Nondiscrimination Tests apply to all contributions other than Employee Salary Reduction Contributions. These tests are the Coverage Test (See Question and Answer 18) and the General Nondiscrimination Test (See Question and Answer 23). These tests, which are generally the same as those that apply to Code section 401(a) Plans, apply to Employer Matching Contributions, Employer Non-Matching Contributions, Employee Tax-Paid Contributions, and Employee Required Salary Reduction Contributions.

Some of the Nondiscrimination Tests consist of multiple tests and/or alternative tests. In addition, IRS regulations may provide "safe harbor tests" under some of the Nondiscrimination Tests.

5. What are safe harbor tests?

Safe harbor tests are special rules provided by the IRS for complying with specific nondiscrimination requirements. A safe harbor test is an alternative to the general requirement. A safe harbor test is just what its name implies, if the special rules of the safe harbor test are met, a plan will automatically satisfy the requirement.

Different safe harbor tests may be available under different requirements or for specific types of Employers or plans. For example, there are safe harbor tests available with respect to certain aspects of the General Nondiscrimination Test. These safe harbor tests are available to most types of plans.

If your organization wishes to take advantage of the safe harbor provided by the special rule, it is essential that all of the rules which apply to a safe harbor test be satisfied.

6. What are Facts and Circumstances Tests?

Some nondiscrimination tests impose objective, numerical requirements. Whether a plan satisfies the requirement is evident from the numerical test results. These tests include, for example, the ACP Test and the Coverage Test.

Other tests are more subjective. Whether a plan complies with the requirement is determined based on the particular facts and circumstances of the plan, the Employer and employees concerned. These tests are referred to as Facts and

Circumstances Tests. IRS regulations may provide guidance concerning the types of factors to be taken into account in determining compliance with the requirement. However, the test result is rarely clear cut.

GuideStone does not provide test results concerning Facts and Circumstances Tests as a part of its testing services, as it is not in a position to make the subjective determinations required related to these tests.

Cross-references:

- Facts and Circumstances Tests are generally noted on pages 52.

7. Who is the Employer for purposes of the nondiscrimination tests?

A. Non-Control Group Employers and Control Group Employers. In most cases, the individual Employer is treated as the Employer for purposes of the nondiscrimination tests. This type of Employer is referred to as a Non-Control Group Employer. However, as a part of the nondiscrimination requirements, certain related Employers must be treated as if they were a single Employer. Related Employers who are required to be treated as a single Employer are referred to as a Control Group.

Generally, under the Control Group rules, all employees of all Employers in the Control Group are treated as if they are employed by one Employer. If your organization is part of a Control Group, you will need to gather compensation and contributions information about the employees of other Employers in the Control Group, as well as employees on your organization's payroll. Both your organization's employees and employees of these other Employers must be considered in determining if your organization's plan satisfies the nondiscrimination requirements.

B. Statutory Control Group. The Control Group rules have applied to Code section 401(a) Plans for some time. The final 403(b) regulations do not reflect a change in the IRS thinking, but it does for the first time formally require tax-exempt entities to apply the control group rules to their 403(b) plans.

Generally, a Statutory Control Group consists of two or more organizations which are related by Common Control or which are part of an Affiliated Service Group. The "Employer" in a controlled group includes not only the organization whose employees participate in the 403(b) plan, but also other tax exempt organization(s) under "Common Control."

- **Common Control.**

- **Multiple tax-exempt organizations.** The final Code section 414(c) regulations formally require tax-exempt entities to apply control group rules to 403(b) plans. These regulations specify that Common Control exists between one tax-exempt organization and another organization if at least 80% of the directors or trustees of the other organization are either representatives of, or directly or indirectly controlled by, the tax-exempt organization.
- **Taxable organizations and tax-exempt organizations related to taxable organizations.** Common Control, for the purpose of determining if a taxable organization is included in a Statutory Control Group, is based on stock ownership in a corporation or ownership of the profits interest in a non-corporate trade or business. A Statutory Control Group may be a parent-subsidiary group, a brother-sister group or a combination of the two.
 - A parent-subsidiary Control Group consists of one or more chains of organizations which are connected through at least 80% of the vote or value of stock of another organization other than the parent. For example, if a tax-exempt organization owns 80% of the stock of a taxable organization, the two organizations are members of the Statutory Control Group.
 - A brother-sister Control Group is a group in which (1) the same five or fewer individuals, estates or trusts own at least 80% of the stock or the profits interest of each organization and (2) these same five or fewer persons own at least 50% of the stock or profits interest of the organization, taking into account the ownership of a person only to the extent ownership is identical with respect to each organization.

- A combined Control Group is a group in which (1) each organization is a member of a brother-sister or parent-subsiary control group and (2) at least one organization is both a common parent of the parent-subsiary group and also a member of the brother-sister group.

Generally, the concept of ownership is inapplicable to a non-stock, tax-exempt organization. However, in some instances tax-exempt organizations own stock or profits interests in taxable organizations. For example, a tax-exempt organization may own the stock of a taxable subsidiary. If a sufficient percentage of stock is owned, the IRS takes the position that the tax-exempt organization and the taxable organization constitute a Statutory Control Group.

- **Affiliated Service Groups.** A Statutory Control Group can also exist based on the Affiliated Service Group rules. The Affiliated Service Group rules are very complex rules which focus on organizations engaged in the performance or delivery of services to each other or to third parties.
- **In General.** There are three basic types of Affiliated Service Groups: (1) the A Test Affiliated Service Group, (2) the B Test Affiliated Service Group, and (3) the Management Functions Affiliated Service Group. It is unclear how a group of Employers consisting solely of tax-exempt Employers could ever constitute an A Test or B Test Affiliated Service Group, although such a group could theoretically constitute a Management Functions Affiliated Service Group.
 - The A Test and B Test Affiliated Service Groups both consist of a group of entities that includes:
 - An initial service organization, referred to as the First Service Organization (FSO), and
 - Related organizations which meet either the A Test requirements (A Organizations) or the B Test requirements (B Organizations) described below.

A service organization is an organization whose principal business is the performance of services. Any type of entity may be a service organization, regardless of its ownership format. An organization is **automatically** a service organization if it is engaged in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting or insurance. An organization is also a service organization if capital is not a material income-producing factor, such as where the income of the business consists mainly of fees, commissions or other compensation for services performed by an individual. If an organization is an FSO with respect to multiple A organizations and/or B organizations, **all** of the related organizations form a single Affiliated Service Group. Certain ownership attribution rules apply to the A Test and B Test.

The Management Functions Affiliated Service Group consists of (1) an organization that provides management functions for another organization and (2) the organization for which such services are provided. Other entities related to either of the foregoing may also be a part of the group.

- **A Test Affiliated Service Group.** An A Test Affiliated Service Group exists if there is (1) an FSO which is a professional service organization and (2) another service organization (the A Organization) which meets the following requirements:
 - The A Organization is a shareholder or partner (of any amount or percentage) in the FSO; and
 - The A Organization is regularly associated with the FSO in performing services for third persons. (The A Organization does not have to perform services for the FSO.)

A corporation cannot be an FSO under the A Test unless it is a “professional service corporation.” A professional service corporation is a corporation organized under state law to provide professional services, with at least one shareholder who is licensed to render such services.

A tax-exempt organization generally is not an FSO under the A Test, but could be an A Organization.

- **B Test Affiliated Service Group.** The B Test Affiliated Service Group exists when there is an FSO and **any other** organization (the B Organization) if the following requirements are met:

- A significant portion of the B Organization’s business consists of the performance of services for the FSO (or for a related A Organization) which were historically performed by employees in the service field of the FSO (or related A Organization); and
- At least 10% of the ownership in the B Organization is held by persons who are HCEs of the FSO (or related A Organization).

The B Organization does not have to be a service organization. In addition, under the B Test, the FSO does not have to be a professional service corporation, merely a service organization. For example, a tax-exempt hospital can be an FSO under the B Test. In the B Test there does not have to be any actual ownership link between the FSO and the B Organization, only ownership of the B Organization by HCEs of the FSO.

The service for the FSO (or A Organization) is a “significant portion” of the B Organization’s business under the following circumstances:

- At least 10% of the B Organization’s total receipts are derived from services for the FSO (or related A Organization) or
 - When the B Organization’s receipts from services for the FSO (or related A Organization) are less than 10%, whether the B Organization’s services to the FSO (or related A Organization) is a significant portion of the B Organization’s business is determined based on the facts and circumstances. However, if the services to the FSO (or related A Organization) are less than 5% of the B Organization’s total receipts, the services are not a significant portion.
- **Management Functions Affiliated Service Group.** A Management Functions Affiliated Service Group is a group consisting of:
 - An organization (the Management Organization) whose principal business is performing “management functions” on a regular and continuing basis for one other organization, (or for one organization and other organizations related to such one organization) and
 - The organization (and related organizations) for which the Management Organization performs these functions (the Recipient Organization).

In addition to the Management Organization and the Recipient Organization, the Management Functions Affiliated Services Group also includes the following organizations:

- All organizations related to the Management Organization or Recipient Organization by Common Control,
- All organizations in any A Test or B Test Affiliated Service Group that includes the Management Organization or the Recipient Organization, and
- Any other organizations that are related to the Recipient Organization by Common Control, **using a reduced 50% ownership test**, for which the Management Organization performs management functions.

Management functions include the following:

- Management activities historically performed by employees, such as determining, implementing or supervising an entity’s daily business activities, long-term planning, personnel matters or employee benefit programs or
- Any “professional” service, if it is the same type of service that is performed by the Recipient Organization for third persons. For example, if a doctor, as an independent contractor, renders medical services for a hospital (which renders the same type of services to third parties), such services would be management functions.

Management functions constitute the principal business of a Management Organization if, using a two-year test period if possible, receipts to the Management Organization for the performance of both management functions **and other functions** constitute more than 50% of the Management Organization’s gross receipts.

The Affiliated Service Group rules are extremely complex. Employers should consult their legal counsel to determine if they are part of an Affiliated Service Group.

- C. **Anti-abuse Rule.** The IRS has the right to determine whether the structure of one or more exempt organizations has the effect of avoiding or evading any retirement plan non-discrimination testing. In such case, the IRS may treat an entity as under common control.

8. What are the Qualified Separate Line of Business rules?

An Employer or members of a Control Group treated as a single Employer may be able to apply certain Nondiscrimination Tests separately to each Qualified Separate Line of Business, if the Employer elects to do so.

The Qualified Separate Line of Business rules may be used in applying the Coverage Test, General Nondiscrimination Test, and the Actual Contribution Percentage Test.

General requirements for a Qualified Separate Line of Business. There are three basic steps an Employer must take to determine whether it can be treated as operating Qualified Separate Line of Business:

- Identify the Employer's lines of business based on varying products or services.
- Show that each separate line of business is organized and operated separately from the remainder of the Employer. Demonstrate that each separate line of business is qualified based on the following criteria:
 - (1) Separate organizational unit
 - (2) Separate financial accountability
 - (3) Separate employee workforce
 - (4) Separate management
- To be considered qualified each separate line of business must have at least 50 employees. The following employees must be excluded in determining if there are 50 employees:
 - Employees who have not completed six months of service;
 - Employees who Normally Work less than 17½ Hours per Week;
 - Employees who Normally Work less than Six Months;
 - Employees who have not reached age 21.
- The Employer must notify the IRS that the line of business is being treated as separate by filing IRS Form 5310-A no later than October 15 following the end of the testing year.
- The separate line of business must meet IRS guidelines or the Employer must obtain an IRS determination that the line of business may be treated as separate.
- The Qualified Separate Line of Business rules cannot be used to separate employees in Affiliated Service Groups from other employees of the Employer.

9. What is a "plan" for the purposes of the Nondiscrimination Tests?

Each 403(b) retirement plan of an Employer must comply with the nondiscrimination requirements as if it were one plan. Thus, if an Employer offers one 403(b) retirement plan to one group of employees and another 403(b) retirement plan to other employees, both plans must comply with the nondiscrimination requirements as if they were a single plan.

The rules concerning what constitutes a separate "plan" for this purpose may be different for different nondiscrimination tests. An Employer may be also permitted to break up (or restructure) a single plan into separate plans in order to satisfy some of the nondiscrimination testing requirements. In addition, some of the testing requirements apply separately to different features of a plan.

For the purpose of this Guide, component elements of a plan which may be subject to testing on a separate basis are referred to as “plan structures.” Generally, the following circumstances may create separate plan structures:

- **Union employees.** The collectively-bargained portion of a plan is generally tested separately from the portion of a plan that covers non-union employees.
- **Different types of contributions.** If a plan provides for more than one type of contribution, each type of contribution may constitute a separate plan for purposes of some of the nondiscrimination tests. (Not all types of contributions are subject to all tests.) For example, each of the following types of contributions may constitute a separate plan:
 - Employee Salary Reduction Contributions. (Subject to only the Salary Reduction Contribution Test for Code section 403(b) Plans.)
 - Employer Non-Matching Contributions and Employee Required Salary Reduction Contributions. (Subject to Coverage Test and General Nondiscrimination Test.)
 - Employer Matching Contributions and Employee Tax-Paid Contributions. (Subject to Coverage Test, General Nondiscrimination Test, and ACP Test.)
- **Additional benefits for former employees.** If a plan provides for additional contributions or new benefits for former employees, the portion of the plan Benefiting former employees may have to be tested separately. To satisfy the General Nondiscrimination and Coverage Tests, under all relevant facts and circumstances, the additional contributions or new benefits for former employees cannot discriminate significantly in favor of HCEs.

In general, an individual is treated as a former employee beginning on the day after the day on which the individual ceases performing services for the Employer. Therefore, the individual can be both an employee and a former employee during the same year. Notwithstanding the preceding sentence, an individual is considered an employee (and not a former employee) for a Plan Year to the extent that he is credited with service as an employee under the plan.

Since the test for former employees is a Facts and Circumstances Test, GuideStone does not perform this test as part of its testing services.

10. No HCEs Benefit under my organization’s plan. How does this affect the nondiscrimination tests?

If no HCE makes or receives any contributions except Employee Salary Reduction Contributions under your organization’s plan at any time during the Plan Year, your organization’s plan will automatically satisfy the Nondiscrimination Tests, provided the plan is not combined with any other plan for purposes of the Coverage Test or the General Nondiscrimination Test.

If your organization’s plan provides that HCEs are not permitted (1) to receive any Employer contributions or (2) make any employee contributions except Employee Salary Reduction Contributions, the plan will automatically satisfy the Nondiscrimination Tests.

11. What does compensation mean?

The term compensation has different meanings for different purposes. These different purposes include determining contributions to the plan, the limit on Annual Additions, which employees are HCEs, and if the plan satisfies the applicable nondiscrimination requirements. A different definition of compensation may be used for each of these purposes.

- **Determining contributions to the plan.** Compensation for this purpose is referred to as Contributions Compensation. This is the definition of compensation stated in your 403(b) retirement plan upon which all contributions to the plan are based.
 - The amount of Contributions Compensation taken into account is limited by the Maximum Compensation Limit.
 - Contributions Compensation may be used as NDT Compensation if it is (i) a definition that is automatically permissible as NDT Compensation or (ii) passes the nondiscrimination requirements applicable to alternative definitions of NDT Compensation.

- **Determining the statutory limit on Annual Additions.** Compensation for this purpose is referred to as includible compensation.
- **Determining which employees are HCEs.** Compensation for this purpose is referred to as HCE Compensation.
 - Although recent changes to the Code indicate that the only acceptable definition of HCE Compensation is Includible Compensation, the Internal Revenue Service has indicated informally that any permissible definition of Standard Compensation may be used as HCE Compensation. See Q&A 12 for a definition of Standard Compensation.
- **Determining if plans satisfy nondiscrimination requirements.** Compensation for purposes of determining if a plan satisfies the Nondiscrimination Tests is referred to as NDT Compensation. Almost any definition of compensation may be used as NDT Compensation, provided that the definition does not discriminate in favor of HCEs. Some definitions are automatically deemed nondiscriminatory. Other definitions must meet additional requirements to qualify as NDT Compensation.

NDT Compensation is used to determine if the plan satisfies the following requirements:

- Contributions Test of the General Nondiscrimination Test;
- ACP Test;
- Average Benefit Test alternative of the Coverage Test;

Cross-references:

- The chart on page 56 compares the meaning of compensation for different purposes under a retirement plan.
- Standard Compensation is discussed in Question and Answer 12.
- HCE Compensation is discussed in Question and Answer 43 and 44.
- NDT Compensation is discussed in Question and Answer 15.
- The chart on pages 53-55 compares various elements of pay included in General 415 Compensation, Adjusted 415 Compensation, General W-2 Compensation, Adjusted W-2 Compensation, and Includible Compensation.

12. What is Standard Compensation?

Standard Compensation is a term used to refer to any of the four definitions of compensation permissible under Code section 415.

- A. Purposes for which Standard Compensation is used.** Standard Compensation is used in connection with at least two different determinations regarding retirement plans. A plan may use different definitions of Standard Compensation for different purposes.
- **Determining Highly Compensated Employees.** HCEs are determined based on HCE Compensation. According to informal IRS guidance, any definition of Standard Compensation may be used for purposes of HCE Compensation.
 - **Determining if a plan satisfies the nondiscrimination requirements.** Some of the nondiscrimination requirements are based on NDT Compensation. Standard Compensation may be used as NDT Compensation, as a component in NDT Compensation or as a means to determine if an alternative definition of compensation may be used as NDT Compensation. It is not necessary for the plan to specify which definition of Standard Compensation is used for this purpose.
- B. Four definitions of Standard Compensation.** There are four definitions of Standard Compensation:
1. General 415 Compensation. Compensation as defined B(1) below.
 2. Adjusted 415 Compensation. Compensation as defined in B(2) below.
 3. General W-2 Compensation. Compensation as defined in B(3) below.

4. Adjusted W-2 Compensation. Compensation as defined in B(4) below.

These four definitions are similar, but are not identical. One advantage of using General W-2 Compensation is that this amount is already required to be determined for other purposes.

The chart on pages 53-55 compares various elements of pay under the definitions of Standard Compensation and includes a Safe Harbor Alternative Definition.

(1) General 415 Compensation. General 415 Compensation is the compensation defined in IRS regulations section 1.415(c)-2(b). Basically, General 415 Compensation includes the taxable compensation of the employee from the Employer.

- **Inclusions.** General 415 Compensation includes the following:
 - Wages, salaries, fees for professional services, and other amounts received (regardless of whether the amount is paid in cash) for personal services rendered in the course of employment with the Employer. These amounts include tips, bonuses, commissions, fringe benefits, reimbursements, and expense allowances. These amounts are included only to the extent they are includible in the employee's gross income.
 - Accident and health benefits, to the extent includible in the employee's gross income.
 - Moving expenses paid or reimbursed by the Employer, to the extent not deductible by the employee.
 - Deferred compensation amounts included in gross income as the result of the employee's election to recognize income under Code section 83(b).
 - Earned income from sources outside the United States, regardless of whether it is excludable from gross income under Code section 911.
 - Elective deferrals under Code sections 402(g), 125, 457 or 132(f)(4), even though these amounts are excludable from the employee's gross income.
 - Amounts included in gross income because of: (1) Failure to satisfy the terms of a 409A plan, (2) Lapse of substantial risk of forfeiture in a Code section 457(f) plan, or (3) Amounts that are constructively received by the employee from a non-qualified deferred compensation plan
 - Regular pay after severance from employment that is received by the later of 2-1/2 months after severance from employment or the end of the limitation year that includes the date of severance from employment.
 - If the plan provides: Leave cashouts and deferred compensation amounts received by the later of 2-1/2 months following severance from employment or the end of the year in which the severance occurs if the amounts are either (1) a payment for accrued bona fide sick, vacation, or leave, but only if it could have been used if employment continued; or (2) received from a nonqualified unfunded deferred compensation plan but only if payment would have been made at the same time if employment continued, and only if payment is includible in gross income. These amounts do not include severance pay.
- **Exclusions.** General 415 Compensation does not include the following:
 - Contributions to unfunded deferred compensation plans, if not includible in the employee's gross income in the year of contribution.
 - Non-taxable premiums for group-term life insurance. (Premiums for insurance up to \$50,000.)
 - Amounts realized from the exercise of a non-qualified stock option or the disposition of stock acquired under a qualified stock option.
 - Distributions from retirement plans, regardless of whether includable in gross income. However, an Employer may elect to include a distribution from an unfunded, non-qualified plan.
 - Other amounts which receive special tax benefits, such as dependent care assistance, educational assistance, and certain other fringe benefits.

- Note that General 415 Compensation does not include a minister's housing allowance.
- (2) **Adjusted 415 Compensation.** Adjusted 415 Compensation is the compensation defined in IRS regulations section 1.415(c)-2(d)(2). Adjusted 415 Compensation is generally based on the total wages from the Employer for the tax year, with certain adjustments.
- **Inclusions.** Adjusted 415 Compensation includes the following:
 - Wages, salaries, fees for professional services, and other amounts received (regardless of whether the amount is paid in cash) for personal services rendered in the course of employment with the Employer. These amounts include tips, bonuses, commissions, fringe benefits, reimbursements, and expense allowances. These amounts are included only to the extent they are includible in the employee's gross income.
 - Elective deferrals under Code section 402(g), 125, 457 or 132(f)(4), even though these amounts are excludable from the employee's gross income.
 - Regular pay after severance from employment that is received by the later of 2-1/2 months after severance from employment or the end of the limitation year that includes the date of severance from employment.
 - If the plan provides, leave cash-outs and deferred compensation amounts received by the later of 2-1/2 months following severance from employment or the end of the year in which the severance occurs if the amounts are either (1) a payment for accrued bona fide sick, vacation, or leave, but only if it could have been used if employment continued; or (2) were received from a nonqualified unfunded deferred compensation plan but only if payment would have been made at the same time if employment continued, and only if payment is includible in gross income. These amounts do not include severance pay.
 - **Exclusions.** Adjusted 415 Compensation does not include the following:
 - Accident and health benefits, to the extent includible in the employee's gross income.
 - Moving expenses paid or reimbursed by the Employer, to the extent not deductible by the employee.
 - Deferred compensation amounts included in gross income as the result of the employee's election to recognize income under Code section 83(b).
 - Earned income from sources outside the United States, regardless of whether it is excludable from gross income under Code section 911.
 - Employer contributions to retirement plans, if not includible in the employee's gross income.
 - Contributions to unfunded deferred compensation plans, if not includible in the employee's gross income in the year of contribution.
 - Non-taxable premiums for group term life insurance. (Premiums for insurance up to \$50,000.)
 - Distributions from retirement plans, regardless of whether includible in gross income. However, an Employer may elect to include a distribution from an unfunded, non-qualified plan.
 - Other amounts which receive special tax benefits, such as dependent care assistance, educational assistance, and certain other fringe benefits.
 - Amounts included in gross income because of: (1) Failure to satisfy the terms of a 409A plan, (2) Lapse of substantial risk of forfeiture in a Code section 457(f) plan, or (3) Amounts that are constructively received by the employee from a non-qualified deferred compensation plan
- (3) **General W-2 Compensation.** General W-2 Compensation is the compensation defined in IRS regulations section 1.415(c)-2(d)(4). General W-2 Compensation is based on the wages taken into account for purposes of income tax withholding (wage reporting purposes).

General W-2 Compensation includes all remuneration for employment, except for specifically excluded items.

Various types of compensation are excluded from General W-2 Compensation based on the nature of the services performed or the nature or location of employment. For example, compensation for services by a duly ordained, commissioned or licensed minister in the exercise of his ministry is excluded from General W-2 Compensation.

- **Adjustments to General W-2 Compensation.** This definition of compensation may be modified to exclude amounts paid or reimbursed by the Employer for moving expenses incurred by an employee, but only to the extent that at the time of the payment it is reasonable to believe that these amounts are deductible by the employee under Code section 217.
- General W-2 Compensation includes elective deferrals under Code sections 402(g), 125, 457 or 132(f)(4), even though these amounts are excluded from the employee's gross income.

(4) Adjusted W-2 Compensation. Adjusted W-2 Compensation is the compensation defined in IRS regulations section 1.415(c)-2(d)(3). Adjusted W-2 Compensation is compensation to an employee for which the Employer is required to withhold income tax. However, the exclusion from compensation based on the nature or location of employment does not apply. The adjustment to General W-2 Compensation is primarily the exclusion of taxable group term life insurance. Elective deferrals under Code sections 402(g), 125, 457 or 132(f)(4) are included.

C. Significant differences between the alternative definitions of Standard Compensation. The chart on pages 53-55 summarizes some of the significant differences between the four alternative definitions of Standard Compensation.

Cross-references:

- Compensation is discussed generally in Question and Answer 11.
- HCE Compensation is discussed in Question and Answer 43 and 44.
- NDT Compensation is discussed in Question and Answer 15.
- The chart on page 56 compares the meaning of compensation for various purposes.

Special rules concerning compensation apply to self-employed participants. If your plan has self-employed participants, contact GuideStone for more information.

13. What is Eligible to Participate Compensation and why is it needed?

Eligible to Participate Compensation is compensation for the portion of the Plan Year during which the employee is eligible to participate or Benefit under the plan.

- The number of months of compensation included in Eligible to Participate Compensation depends on how many months the employee was eligible to participate in the plan.
 - If the employee is covered under the plan for the entire Plan Year, his Eligible to Participate Compensation is his compensation for the entire Plan Year.
 - If the employee meets the eligibility and plan entry date requirements to participate in a plan with a calendar year Plan Year at the beginning of July, his Eligible to Participate Compensation is compensation for the six month period from July 1 through the end of the Plan Year.
- Code section 403(b) Plans must generally permit all employees to make Employee Salary Reduction Contributions. However, in determining the period the employee is eligible to participate in the plan, **disregard** the period of time the employee was **only** eligible to make Employee Salary Reduction Contributions, but was not eligible (1) to receive Employer Non-Matching Contributions, (2) to make contributions on which Employer Matching Contributions are based and/or (3) to make Employee Tax-Paid Contributions.

Eligible to Participate Compensation may be applied to each definition of compensation used to perform the tests. For example, it may apply both to the Standard Compensation definition and to the Contributions Compensation definition.

Eligible to Participate Compensation is designed to help the Employer to pass the **Amount Test** (which is a component of one of the General Nondiscrimination Tests) and/or the ACP Test. Providing data on Eligible to Participate Compensation requires more work by the Employer, but may have significantly positive impact on test results.

- The Amount Test and ACP Test are numerical tests in which contributions are used as the numerator and the employee's compensation is used as the denominator.
- It is important that the numerator bear a proportional relationship to the denominator. If Eligible to Participate Compensation is **not** used, then annual compensation applies. This can result in a nondiscrimination testing failure.
- When the employee is only eligible for a portion of the Plan Year, then the numerator has an improper relationship to the employee's **annual** salary.

Example: John's Employer contributes 5% to the plan on John's behalf. Assume John earns \$15,000 annually. The annual Employer contribution is \$750. \$750 divided by \$15,000 equals 5%. Jane became eligible for the Employer contribution in June. Assume Jane also earns \$15,000 annually. Her Employer contribution begins in June and continues through December, thus is \$437.50. \$437.50 divided by \$15,000 equals 3%. It appears that John receives a 5% contribution from the Employer, but Jane receives only 3%. When Jane's Employer contribution is divided by the compensation she received June through December, Jane's Employer contribution is 5% ($\$437.50 + \$8,750 = 5\%$).

14. What is Contributions Compensation?

Contributions Compensation is the definition of compensation stated in the plan upon which all contributions to the plan are based.

Limitations on Contributions Compensation. The amount of Contributions Compensation taken into account under the plan for the purpose of making contributions for an employee is limited by the Maximum Compensation Limit. If an employee's actual Contributions Compensation exceeds the amount permitted under the Maximum Compensation Limit, the excess amount is disregarded in determining contributions to the plan.

Relationship to NDT Compensation. There is no requirement that Contributions Compensation be a definition that qualifies as NDT Compensation. However, the extent to which a plan's Contributions Compensation deviates from an acceptable definition of NDT Compensation may have a significant impact on nondiscrimination testing. To simplify testing we suggest that you consider having your plan use a definition of Contributions Compensation that qualifies as automatic NDT Compensation.

- NDT Compensation is by definition a nondiscriminatory definition of compensation. Contributions Compensation may be used as NDT Compensation if it is a definition that is automatically permissible as NDT Compensation or if the definition passes the nondiscrimination requirements applicable to alternative definitions of NDT Compensation.
- If the plan's Contributions Compensation definition satisfies NDT Compensation, the plan may be able to take advantage of Uniform Allocation Rate Safe Harbor Test provided with respect to the Contributions Test aspect of the General Nondiscrimination Test. If a plan can take advantage of the Uniform Allocation Rate Safe Harbor Test, numerical testing of the contribution rate may not be required. The safe harbor test is desirable because numerical testing may be difficult to satisfy.
- If the definition of Contributions Compensation does not satisfy a definition of NDT Compensation, safe harbor tests used for the Contributions Test of the General Nondiscrimination Test are not available. Moreover, it is more likely that contributions based on a definition of compensation that does not qualify as NDT Compensation will fail the Contributions Test and, if applicable, the ACP Test.

Cross-references:

- The chart on page 56 compares the meaning of compensation for different purposes.

15. What is NDT Compensation?

- A. NDT Compensation is the compensation used in applying nondiscrimination requirements which take compensation into account. NDT Compensation must either satisfy one of the automatic definitions discussed

below or special nondiscrimination requirements. There is no requirement that the definition of NDT Compensation be stated in the plan, and different definitions may be used from year to year.

Application. NDT Compensation is used in applying the Contributions Test component of the General Nondiscrimination Test, the ACP Test, and the Average Benefit Percentage Test component of the Coverage Test.

Permissible definitions of NDT Compensation. Under the regulations, any definition of compensation may be used as NDT Compensation if the definition does not discriminate in favor of HCEs, is reasonable within the meaning of the regulations, and satisfies a special non-discrimination requirement. Some definitions of compensation are deemed to be nondiscriminatory and may automatically be used as NDT Compensation. These definitions are referred to as Automatic NDT Compensation definitions. Other definitions must meet special nondiscrimination requirements in order to be used as NDT Compensation. These definitions are referred to as Alternative NDT Compensation definitions.

B. Automatic NDT Compensation definitions. The Automatic NDT Compensation definitions are deemed to be nondiscriminatory and may automatically be used as NDT Compensation.

- All of the following definitions of compensation are Automatic NDT Compensation definitions:
 - Any of the four Standard Compensation definitions.
 - Standard Compensation, modified by the reduction method.
 - Standard Compensation, modified by the deferral exclusion method.
 - Standard Compensation, modified by both the reduction method and the deferral exclusion method.
 - **Reduction method modification.** Under the reduction method, Standard Compensation is reduced by all of the following (to the extent included in the definition of Standard Compensation):
 - Reimbursements or other expense allowances
 - Fringe benefits (cash and non-cash)
 - Moving expenses
 - Deferred compensation
 - Welfare benefitsStandard Compensation, modified by the reduction method is sometimes referred to as the “safe harbor alternative definition.”
 - **Deferral exclusion method modification.** Under the deferral exclusions method, Standard Compensation is reduced by employee salary reduction contributions to 403(b), 401(k), 125 (Cafeteria Plans), simplified employee pension plans, and 132(f)(4) (qualified transportation fringe benefits) plans.

C. Alternative NDT Compensation definitions. If one of the Automatic NDT Compensation definitions is not used as NDT Compensation, then **any** other definition of compensation may be used as NDT Compensation, provided the alternative definition satisfies the special nondiscrimination tests.

An Alternative NDT Compensation definition must satisfy all of the following requirements: the Nondiscriminatory Design Test, the Reasonable Definition Test, and the Compensation Ratio Test described below:

- **Nondiscriminatory Design Test.** The alternative definition of compensation cannot by design favor HCEs. The Nondiscriminatory Design Test is a Facts and Circumstances Test. This means that whether the definition favors HCEs by design is determined on the basis of the applicable facts and circumstances.

IRS officials have indicated that a definition of compensation may fail the Nondiscriminatory Design Test if it excludes an element of compensation that is received by a significant number of NHCEs and is not received by HCEs. For example, if all HCEs are salaried employees who do not receive overtime pay and a significant number of NHCEs receive overtime pay, a definition of compensation which excludes overtime pay may fail the Nondiscriminatory Design Test.

Since the Nondiscriminatory Design Test is a Facts and Circumstances Test, GuideStone does not perform this test as a part of its testing services.

- **Reasonable Definition Test.** The definition must be reasonable. This is determined under a Facts and Circumstances Test.

Subject to the applicable facts and circumstances, a reasonable definition is permitted to exclude certain types of compensation. Types of compensation that may be excluded include the following:

- Any type of irregular or additional compensation for employees who perform work outside of their regularly scheduled duties, such as overtime pay, shift differential pay, call-in premiums or bonuses.
- Any type of compensation excluded under the reduction method modifications to Standard Compensation (See Question and Answer 12.B).

Since the Reasonable Definition Test is a Facts and Circumstances Test, GuideStone does not perform this test as a part of its testing services.

- **Compensation Ratio Test.** Under the Compensation Ratio Test, the Alternative NDT Compensation definition is tested by comparing the average compensation ratio of the Employer's NHCEs to average compensation ratio of the Employer's HCEs. The compensation ratio of each employee is determined by dividing the employee's compensation as determined by the alternative definition by the employee's testing compensation (as determined in the next paragraph.)

Under the regulations, testing compensation for this purpose is Standard Compensation or, alternatively, Standard Compensation modified by the deferral exclusion method described above under Automatic NDT Compensation. (Standard Compensation modified by the reduction method may not be used for this purpose.)

The Compensation Ratio Test is satisfied if the average percentage of testing compensation included in the alternative definition for the Employer's HCEs does not exceed the average percentage for NHCEs by more than a de minimis amount. What is "de minimis" is determined under the facts and circumstances, including differences from prior periods. (It is our understanding that a 1% difference would be de minimis; however, the regulations do not provide any specific guidance.) In addition, an isolated instance of more than a de minimis difference due to an extraordinary unforeseeable event (such as a major hurricane) will be disregarded in some instances.

Cross-references:

- Compensation is discussed generally in Question and Answer 11.
- The chart on pages 53-55 compare various elements of pay included in General 415 Compensation, Adjusted 415 Compensation, General W-2 Compensation, Adjusted W-2 Compensation, and Includible Compensation.
- The chart on page 56 compares the meaning of compensation for different purposes.

16. What are the statutory rules which apply to Employee Salary Reduction Contributions?

To comply with the Universal Availability Requirement, all Non-excludable Employees, including employees who have not yet satisfied the plan's minimum age or service requirements, must be eligible to make Employee Salary Reduction Contributions.

Employees who may be excluded. The following classes of employees (Excludable Employees) may be excluded from eligibility to make Employee Salary Reduction Contributions:

- Employees who are not able to make an Employee Salary Reduction Contribution of at least \$200 per year under the plan's maximum deferral rate.
- Employees who are permitted to make Employee Salary Reduction Contributions under another retirement program of the Employer such as 401(k), 403(b) or eligible 457(b) governmental plan, provided that plan also satisfies the effective availability requirement.

- Employees who Normally Work less than 20 Hours per Week. Employers who wish to use this exclusion will be required to look back to the preceding plan year to determine if anyone excluded under this category had worked more than 1,000 hours. Therefore, those Employers with this provision should have counted hours in the previous year to determine if anyone met the 1,000 hours during the year.
- Student employees who are enrolled and regularly attending classes at the Employer.
- Nonresident aliens with no United States source income.

In addition, an Employer must demonstrate that employees are provided with “an effective opportunity” to make elective deferrals. The regulations state that the determination of whether an Employer provides employees with an effective opportunity to make elective deferrals is based on all the relevant facts and circumstances. Such as:

- Annual notice of the availability of making elective deferrals,
- The period of time during which an elective deferral election may be made, and
- Whether any other rights or benefits are conditioned on the employee’s making elective deferrals.

Another part of the Universal Availability Requirement is called the “anti-conditioning” or “contingent benefit rule.” Under this rule, no other right or benefit (other than certain benefits such as Employer matching contributions to the plan) can be conditioned (directly or indirectly) on making or not making salary reduction contributions to the plan. For example, an Employer cannot say it will make contributions to a nonqualified deferred compensation plan if the employee does not make tax sheltered contributions to the 403(b) plan.

An employee cannot be denied the opportunity to make Employee Salary Reduction Contributions solely because the employee has not met the minimum age and service requirements of the plan.

17. What is the 414(v) Universal Availability Requirement?

The 414(v) Universal Availability Requirement is not a numeric test that must be performed each year; rather, it is a condition that an Employer must ensure is true for each retirement plan it sponsors.

The IRC limits the combined amount of annual salary reduction contributions (elective deferrals) that an individual can contribute to certain retirement plans including Code section 403(b) Plans and Code section 401(k) Plans. However, salary reduction contributions that meet the requirements of Code section 414(v) (age 50 catch-up) are not counted against these legal limits. The only Employers who can take advantage of age 50 catch-up contributions are those Employers who ensure that all retirement plans offered that provide for salary reduction contributions contain a provision for age 50 catch-up contributions.

The 403(b) retirement plan permits age 50 catch-up contributions for those Employers that ensure each plan of the Employer offering salary reduction contribution offers age 50 catch-up contributions. If one retirement plan of an Employer offers the ability to make age 50 catch-up contributions, all plans of the Employer must offer age 50 catch-up contributions. This requirement (including plans of other Employers in the Control Group) is known as Universal Availability under 414(v).

18. What are the Coverage Test requirements?

The Coverage Test under Code section 410(b) determines whether the plan covers (Benefits) a nondiscriminatory group of employees. This test applies to all plans which provide for contributions other than voluntary Employee Salary Reduction Contributions. For purposes of the Coverage Test, all members of a Control Group are treated as a single Employer subject to the Qualified Separate Line of Business rules.

Requirements. To comply with the Coverage Test requirement, the plan must pass one of the following two numerical tests: the Ratio/Percentage Test (see Question and Answer 19) or the Average Benefit Test (See Question and Answer 20).

- The Ratio/Percentage Test requires that the plan cover a percentage of NHCEs which is at least 70% of the percentage of HCEs covered by the plan.
- The Average Benefit Test consists of two component tests:

- The Nondiscriminatory Classification Test, which requires that the plan cover a nondiscriminatory classification of employees, and
- The Average Benefit Percentage Test, which requires that the average benefit provided to NHCEs under all of the Employer's retirement plans is at least 70% of the average benefit provided to HCEs.

No HCEs. A plan which does not Benefit any HCEs during the Plan Year will automatically satisfy the Coverage Test for that Plan Year.

Plan Tested. It is important to determine what is being tested (as if it were a single plan) for purposes of the Coverage Test: a plan, (which may include multiple plan documents), or components of a plan.

- All 403(b) plans of the Employer must be combined and tested together for purposes of the Coverage Test. This is referred to as aggregation.
- In applying the Coverage Test, various plan structures within a plan may be considered a separate plan. Each of these arrangements must pass the Coverage Test separately. This is referred to as disaggregation.
 - If a particular plan structure of a plan **must** be tested separately, this is mandatory disaggregation.
 - If a particular plan structure of a plan **may** be tested separately, this is permissive disaggregation.
- The rules concerning aggregation and disaggregation are somewhat different for purposes of the Ratio/Percentage Test, the Nondiscriminatory Classification Test, and the Average Benefit Percentage Test.

Coordination with the General Nondiscrimination Test. The Coverage Test and the General Nondiscrimination Test form a coordinated set of nondiscrimination rules.

- Generally, the same plans or portions of a plan must be tested for both the Coverage Test and the General Nondiscrimination Test. Two 403(b) plans of the Employer must be tested together under the Coverage Test, and the General Nondiscrimination Test. If a plan is divided into component parts for the General Nondiscrimination Test, each of the components must pass the Coverage Test.
- If the Average Benefit Test is used to satisfy the Coverage Test requirement, special rules apply in coordinating the Coverage Test with the General Nondiscrimination Test.
 - Basically, coordination is required between plans or components of plans tested together for purposes of the Nondiscriminatory Classification aspect of the Average Benefit Test. The plans or components of plans tested together for purposes of the Nondiscriminatory Classification Test must also be tested together for purposes of the General Nondiscrimination Test.
 - Under the Average Benefit Test, the Average Benefit Percentage Test must be satisfied in addition to the Nondiscriminatory Classification Test. For the Average Benefit Percentage Test, all components of all 403(b) plans of the Employer are tested together, subject to certain mandatory disaggregation rules. However, the aggregation of plans or components of plans solely for the purposes of the Average Benefit Percentage Test is disregarded in coordinating the Coverage Test with the General Nondiscrimination Test.
- Plans that are restructured into components under the General Nondiscrimination Test must pass the Coverage Test with respect to each component.
 - Components may satisfy either the Ratio/Percentage Test or the Nondiscriminatory Classification Test.
 - If a component does not satisfy the Ratio/Percentage Test, but does satisfy the Nondiscriminatory Classification Test, all plans of the Employer are then combined (subject to certain mandatory disaggregation rules) for purposes of the Average Benefit Percentage Test.

Testing. A Code section 403(b) Plan must satisfy the Coverage Test for a Plan Year using the daily testing option, the quarterly testing option or the annual testing option.

Cross-references:

- The Ratio/Percentage Test is discussed in Question and Answer 19.

- The Average Benefit Test is discussed in Question and Answer 20. (More detailed information concerning the Nondiscriminatory Classification Test is discussed in Question and Answer 21. The Average Benefit Percentage Test is discussed in Question and Answer 22.)
- Information concerning the Coverage Test is summarized in the chart on page 59.
- The chart on pages 62 and 63 compare the various aggregation and disaggregation rules.
- Employees who may be excluded from consideration are discussed in Question and Answer 36.
- The determination of whether an employee is Benefiting under a plan is discussed in Question and Answer 34.

19. What are the requirements of the Ratio/Percentage Test?

The Ratio/Percentage Test is one of the two alternative tests which may be used to satisfy the Coverage Test. In addition, the Ratio/Percentage Test is also one of the alternative tests used to determine if benefits, rights, and features of a plan satisfy the Availability Test under the General Nondiscrimination Test (See Question and Answer 25). To satisfy the Ratio/Percentage Test, the percentage of Non-excludable NHCEs Benefiting under the plan must be at least 70% of the percentage of the Non-excludable HCEs Benefiting under the plan.

Calculation. To calculate the percentage of employees Benefiting under the plan for the HCE and NHCE groups, divide the total employees Benefiting under the plan in the applicable group by the total Non-excludable Employees in the group. (See Question and Answer 34.)

Example 1: Employer X has 98 NHCEs and four HCEs. All of the HCEs and 68 of the NHCEs Benefit under the plan. Assume that there are no Excludable Employees.

- The percentage of HCEs Benefiting under the plan is 100%. [4 divided by 4]
- The percentage of NHCEs Benefiting under the plan is 69%. [68 divided by 98]
- The plan does not pass the Ratio/Percentage Test, because the 69% of the NHCE's Benefiting under the plan is less than the required 70% (70% times 100% equals 70%). In order to pass the test, 69 NHCEs would have to Benefit under the plan (69 NHCE's divided by 98 total employees equals 70%).

Example 2: Employer X has 98 NHCEs and four HCEs. Only 2 of the HCEs and 68 of the NHCEs Benefit under the plan. Assume that there are no Excludable Employees.

- The percentage of HCEs Benefiting under the plan is 50%. [2 divided by 4]
- The percentage of NHCEs Benefiting under the plan is 69%. [68 divided by 98]
- The plan passes the Ratio/Percentage Test, because 69% is more than the 70% of the percentage of eligible HCE's Benefiting (70% times 50% equals 35%).

Aggregation and disaggregation of plans for the Ratio/Percentage Test. For purposes of the Ratio/Percentage Test, the following aggregation and disaggregation rules apply:

- **Mandatory disaggregation.** The following plans structures must be tested separately.
 - The Employer Matching and Employee Tax-Paid Contributions features of a plan are tested separately from the remainder of the plan.
 - The collectively bargained portion of a plan that covers union employees must be tested separately from the portion of a plan that covers non-union employees (See Question and Answer 39).
 - If the plan provides for additional contributions or new benefits for former employees, the portion of the plan Benefiting former employees must be tested separately from the portion that Benefits active employees (See Question and Answer 40).
 - The Employee Salary Reduction Contribution portion of a Code section 403(b) Plan is not subject to the Coverage Test.

- **Permissive aggregation.** If separate plans of an Employer are not required to be tested separately under the mandatory disaggregation rules, they may be aggregated and tested together for purposes of the Ratio/Percentage Test. If separate plans are aggregated and tested together for purposes of the Coverage Test, they must also be aggregated and tested together for purposes of the General Nondiscrimination Test.
 - Example: Assume an Employer offers two Code section 403(b) Plans and one Code section 401(k) Plan. The two 403(b) plans must be aggregated for testing. IRS regulations state that 403(b) plans are permitted but not required to take 401(k) plans into account for testing purposes. However, a 401(k) is not allowed to take 403(b) plans into account to demonstrate compliance of the tests.
- **Permissive disaggregation.** In some cases, the Employer may elect to test components of a plan as if each component were a separate plan.
 - **Separate lines of business.** If an Employer may be divided into Qualified Separate Lines of Business, the Ratio/Percentage Test may be applied separately to each Qualified Separate Line of Business.
- **Restructuring in accordance with the General Nondiscrimination Test.** The General Nondiscrimination Tests provides rules for dividing up a plan into separate testing groups or components. If a plan is disaggregated for the General Nondiscrimination Test, the disaggregated components are tested separately for purposes of the Ratio/Percentage Test.

Cross-references:

- The Coverage Test is discussed in Question and Answer 18 and is summarized in the chart on page 59.
- The Average Benefit Test is discussed in Question and Answer 20.
- The Availability Test is discussed in Question and Answer 25.
- The General Nondiscrimination Test is discussed generally in Question and Answer 23 and is summarized in the chart on page 60.
- The chart on pages 62 and 63 compares the various aggregation and disaggregation rules.
- Qualified Separate Line of Business rules are discussed in Question and Answer 8.

20. What are the requirements of the Average Benefit Test?

The Average Benefit Test is one of two alternative tests which may be used to satisfy the Coverage Test. (If a plan passes the Ratio/Percentage Test alternative of the Coverage Test, it does not have to pass the Average Benefit Test.)

The Average Benefit Test consists of two tests. A plan must satisfy both of these tests in order to pass the Average Benefit Test. The two required tests under the Average Benefit Test are:

- **The Nondiscriminatory Classification Test.** This test, which is discussed in detail in Question and Answer 21, requires that the plan cover (Benefit) a reasonable classification of employees based on valid business criteria which does not discriminate in favor of HCEs.
- **The Average Benefit Percentage Test.** This test, which is discussed in Question and Answer 22, requires that the average benefit percentage of NHCEs Benefiting under all retirement plans of the Employer must be at least 70% of the average benefit percentage of HCEs Benefiting under all such plans.

Cross-references:

- The Nondiscriminatory Classification Test is discussed in Question and Answer 21.
- The Average Benefit Percentage Test is discussed in Question and Answer 22.
- The Coverage Test is discussed generally in Question and Answer 18.

21. What are the requirements of the Nondiscriminatory Classification Test?

As discussed in Question and Answer 18, an Employer may comply with the Coverage Test by satisfying either the Ratio/ Percentage Test or the Average Benefit Test. As discussed in Question and Answer 20, to comply with the

Average Benefit Test an Employer must satisfy both the Nondiscriminatory Classification Test and the Average Benefit Percentage Test.

In addition, the Nondiscriminatory Classification Test is an alternative to the Ratio/Percentage Test in satisfying the Availability Test requirements of the General Nondiscrimination Test. The Average Benefit Percentage Test is not considered for this purpose.

Requirements. In order to satisfy the Nondiscriminatory Classification Test, the classification of employees covered under the plan must be a reasonable classification which is based on objective business criteria. In addition, the plan must pass either: (1) a Safe Harbor Percentage Test or (2) a Facts and Circumstances Test with respect to the employees Benefiting under the plan.

- **Reasonable Classification Test.** The classification of employees Benefiting under the plan must be reasonable and have been established for a valid business reason. Generally, classifications based on job categories or pay categories are considered reasonable. Whether the classification is reasonable is determined under the applicable facts and circumstances. Classifications which specify an employee by name or which have the effect of naming an employee are not reasonable.

Since the Reasonable Classification Test is a Facts and Circumstances Test, GuideStone does not perform this test as a part of its testing services.

- **Safe Harbor Percentage Test.** The Safe Harbor Percentage Test is based on two factors:
 - The concentration percentage of Non-excludable NHCEs in the Employer’s work force, determined by dividing the number of Non-excludable NHCEs in the work force by the total Non-excludable Employees in the work force.
 - The percentage of Non-excludable NHCEs who Benefit under the plan compared to the percentage of Non-excludable HCEs who Benefit under the plan.

For purposes of the Safe Harbor Percentage Test, Non-excludable Employees generally include all employees except union employees and employees who have not satisfied both the lowest service requirement for any plan of the Employer and the lowest age requirement for any plan of the Employer.

In order to satisfy the Safe Harbor Percentage Test, the percentage of Non-excludable NHCEs who Benefit under the plan must be at least the applicable Safe Harbor Percentage of the percentage of Non-excludable HCEs who Benefit under the plan. The applicable Safe Harbor Percentage depends on the NHCE concentration percentage. The greater the concentration of NHCEs in the work force, the lower the applicable Safe Harbor Percentage. If the concentration percentage is 60% or less, the percentage of NHCEs who Benefit must be at least 50% of the percentage of HCEs who Benefit.

The Safe Harbor Percentages for specific concentrations of NHCEs is set forth in the IRS regulations. The following is a sample of the Safe Harbor Percentages in relation to various NHCE concentrations, as well as the corresponding Unsafe Harbor Percentages (discussed later):

NHCE Concentration Percentage (Percent of NHCEs in Employer’s Work Force)	Safe Harbor Percentage	Unsafe Harbor Percentage
60% or less	50.00%	40.00%
65%	46.25%	36.25%
70%	42.50%	32.50%
75%	38.75%	28.75%
80%	35.00%	25.00%
85%	31.25%	21.25%
90%	27.50%	20.00%
95%	23.75%	20.00%
99%	20.75%	20.00%

Example: An Employer has 90 NHCEs and 10 HCEs. Five of the HCEs Benefit under the plan. Assume there are no Excludable Employees.

- The NHCE concentration percentage is 90%. [$90 \div 100$]
- The percentage of HCEs Benefiting is 50% [$5 \div 10$].
- The plan must Benefit 13.75% of the NHCEs [$27.50\% \times 50\%$] (27.50% is the applicable Safe Harbor Percentage for an NHCE concentration percentage of 90%, as shown in the chart above.)
- **Facts and Circumstances Test.** If a plan does not pass the Safe Harbor Percentage Test, it can satisfy the Nondiscriminatory Classification Test by satisfying a Facts and Circumstances Test. This test has two parts:
 - The percentage of NHCEs Benefiting must exceed the applicable Unsafe Harbor Percentage of the percentage of HCEs Benefiting under the plan. This test result is determined in the same way as under the Safe Harbor Percentage Test.
 - The classification must not discriminate in favor of HCEs, as determined on the basis of relevant facts and circumstances. The factors to be considered include the following:
 - The underlying business reason for the classification;
 - The percentage of the total employees in the work force Benefiting under the plan;
 - Whether the number of covered employees in each salary range is representative of the total number of employees in that salary range;
 - How close the classification comes to satisfying the Safe Harbor Percentage Test; and,
 - The extent to which the plan's Average Benefit Percentage exceeds 70%.

Since this is a Facts and Circumstances Test, GuideStone does not perform this test as a part of its testing services.
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Aggregation and disaggregation of plans for the Nondiscriminatory Classification Test. The rules governing aggregation and disaggregation of plans for purposes of the Nondiscriminatory Classification Test are similar to the rules governing application of the Ratio/Percentage Test (See Question and Answer 19):

- **Mandatory disaggregation.** The following components of plans must be tested separately for purposes of the Nondiscriminatory Classification Test:
 - The Employer Matching and Employee Tax-Paid Contributions are tested separately from the remainder of the plan;
 - The collectively bargained portion of a plan is tested separately from the portion Benefiting non-union employees;
 - The portion of the plan Benefiting former employees is tested separately from the portion Benefiting active employees.
- **Permissive aggregation.** Subject to the mandatory disaggregation rules, different plans of an Employer may be tested together for purposes of the Nondiscriminatory Classification Test. However, plans that are tested together for the Nondiscriminatory Classification Test must also be tested together for the General Nondiscrimination Test.
- **Permissive disaggregation.** The following rules apply to the permissive disaggregation of components of plans:
 - A plan cannot be tested on the basis of the Qualified Separate Line of Business (See Question and Answer 8) rules for purposes of the Nondiscriminatory Classification Test.
 - Plans that are restructured into components under the General Nondiscrimination Test (See Question and Answer 23) must pass the Coverage Test (See Question and Answer 18) with respect to each component.
 - Components may satisfy either the Ratio/Percentage Test (See Question and Answer 19) or the Nondiscriminatory Classification Test.

- If a component does not satisfy the Ratio/Percentage Test, but does satisfy the Nondiscriminatory Classification Test, all plans of the Employer are then combined (subject to certain mandatory disaggregation rules) for purposes of the Average Benefit Percentage Test.

Cross-references:

- The Average Benefit Percentage Test is discussed in Question and Answer 22.
- The Coverage Test is discussed generally in Question and Answer 18, and summarized in the chart on page 59.
- The Availability Test is discussed in Question and Answer 25.
- The charts on pages 62 and 63 compare the various aggregation and disaggregation rules.
- Qualified Separate Line of Business rules are discussed in Question and Answer 8.

22. What are the requirements of the Average Benefit Percentage Test?

As discussed in Question and Answer 18, an Employer may comply with the Coverage Test by satisfying either the Ratio/ Percentage Test or the Average Benefit Test. As discussed in Question and Answer 20, to comply with the Average Benefit Test an Employer must satisfy both the Nondiscriminatory Classification Test and the Average Benefit Percentage Test.

Under the Average Benefit Percentage Test, the average benefit percentage of NHCEs under all retirement plans maintained by the Employer (except plans which may be excluded) must be at least 70% of the average benefit percentage of HCEs in all plans.

Aggregation and disaggregation of plans. The Average Benefit Percentage Test is applied to plans and components of plans as follows:

- In applying the Average Benefit Percentage Test, all Code section 403(b) Plans of the Employer (including all components of such plans) are first combined to form a single plan for purposes of the test. (In testing Code section 403(b) Plans, Code section 401(a) Plans may also be added.)
- The mandatory disaggregation rules are ignored and all plans or components of plans to which the mandatory disaggregation rules apply are included in the combined plan (but not Employee Tax- Paid Contributions or after-tax contributions to other plans). The remaining combined plan must satisfy the requirements of the Average Benefit Percentage Test.
- The plans or components of plans to which the mandatory disaggregation rules apply must each separately pass either the Ratio/Percentage Test or the Average Benefit Percentage Test.
- The following mandatory disaggregation rules apply to the Average Benefit Percentage Test:
 - The collectively bargained portion of a plan is tested separately from the portion of a plan that Benefits non-union employees.
 - If the Employer has elected to have the Qualified Separate Line of Business rules apply, the plan or portion of a plan that Benefits employees of one Qualified Separate Line of Business is tested separately from the plans or portions of a plan that Benefit employees of other Qualified Separate Line of Business.
 - When testing Code section 401(a) Plans, Code section 403(b) Plans are not taken into account. However, Code section 401(a) Plans **may** be taken into account when testing a Code section 403(b) Plan.
 - If the Employer elects, defined benefit plans of the Employer may be excluded when testing defined contribution plans (including Code section 403(b) Plans), and defined contribution plans of the Employer may be excluded when testing defined benefit plans.

Note that Employer Matching Contributions and Employee Salary Reduction Contributions are **included** under the Average Benefit Percentage Test and aggregated with other components of the plan in determining the average benefit percentage of employees.

Ordinarily, when plans are tested together for purposes of a Coverage Test, the plans must also be tested together for purposes of the General Nondiscrimination Test. However, when plans are aggregated for purposes of the Average Benefit Percentage Test component of the Average Benefit Test, they do not have to be tested together for purposes of the General Nondiscrimination Test. They also do not have to be aggregated for the Nondiscriminatory Classification Test merely because they are tested together for purposes of the Average Benefit Percentage Test.

Calculation of benefit percentages. Under the Average Benefit Percentage Test, the average benefit percentage of NHCEs is compared to the average benefit percentage of HCEs.

- **Contributions considered.** The following types of contributions are taken into account in calculating benefit percentages for the Average Benefit Percentage Test:
 - Employer Non-Matching Contributions,
 - Employer Matching Contributions,
 - Employee Required Salary Reduction Contributions,
 - Voluntary Employee Salary Reduction Contributions (including Roth elective deferrals).

Employee Tax-Paid Contributions are **not** taken into account for purposes of the Average Benefit Percentage Test.

- **Calculation basis.** Benefit percentages may be calculated on a contributions basis which expresses the annual contributions as a percentage of NDT Compensation. Alternatively, benefits may be calculated on a benefits basis in which the contributions are converted to a benefit which is then expressed as a percentage of NDT Compensation.

In addition, permitted disparity may be taken into account in determining the benefit percentages of employees. The regulations contain specific formulas that determine an adjusted benefit percentage that reflects the amount of permitted disparity that may be taken into account.

The regulations also permit the benefit percentage of an employee to be calculated as an average of benefit percentages for the **Current Plan Year** and the previous two plan years. (Currently, GuideStone does not calculate benefit percentages on this basis as a part of its testing services.)

Cross-references:

- The Coverage Test is discussed in Question and Answer 18 and is summarized in the chart on page 59.
- The Nondiscriminatory Classification Test is discussed in Question and Answer 21.
- The charts on pages 62 and 63 compare the various aggregation and disaggregation rules.
- Qualified Separate Line of Business rules are discussed in Question and Answer 8.

23. What is the General Nondiscrimination Test?

The General Nondiscrimination Test and the Coverage Test are designed to form a single, coordinated nondiscrimination rule. The same Employer, group of employees and Plan Year must be used in applying both tests. The same plan, group of plans or separate components of a plan must satisfy both tests. The General Nondiscrimination Test permits liberal restructuring of a plan into components for testing purposes. Restructuring is limited, however, by the requirement that each restructured component satisfy the Coverage Test.

Description of tests. To satisfy the General Nondiscrimination Test, a plan must meet the Contributions Test, the Availability Test, and the **Special Circumstances Test**. In addition, if a plan (or aggregated group of plans) has multiple vesting schedules, these various vesting schedules must not discriminate in favor of HCEs.

- **The Contributions Test.** Under the Contributions Test, the amount of contributions or benefits under a plan must not discriminate in favor of HCEs.
- **The Availability Test.** While the Contributions Test tests the value of contributions or benefits, the Availability Test focuses on the availability of all other benefits, rights, and features of a plan. Under this requirement, all benefits, rights and features of a plan must be available to a nondiscriminatory group of employees. The availability of each benefit, right or feature must satisfy two tests:

- **Effective Availability Test.** Each benefit, right or feature must be effectively available to a group of employees which does not substantially favor HCEs on the basis of all relevant facts and circumstances.
- **Current Availability Test.** Each benefit, right or feature must be currently available to a group of employees that satisfies either the Ratio/Percentage Test or Nondiscriminatory Classification Test.
- **Special Circumstances Test.** There are also rules for determining if a plan is discriminatory in certain special circumstances. The following tests must be satisfied.
 - **Plan Amendment Test.** A plan does not satisfy the General Nondiscrimination Test if a plan amendment or a series of plan amendments discriminates in favor of HCEs. The Plan Amendment Test is a Facts and Circumstances Test.
 - **Past Service Safe Harbor.** A plan does not satisfy the General Nondiscrimination Test if a plan amendment providing past service credits has the effect of discriminating **significantly** in favor of HCEs. This is a Facts and Circumstances Test. However, there is also a safe harbor rule which provides that the Past Service Safe Harbor is satisfied if the period for which credit is granted does not exceed five years.
 - **Plan Termination Test.** This test requires that a plan termination not have the effect of discriminating significantly in favor of HCEs. Currently, IRS guidance concerning this test does not apply to Code section 403(b) Plans.

Aggregation and disaggregation of plans. The General Nondiscrimination Test and the Coverage Test are a coordinated set of rules. This coordination affects the aggregation and disaggregation of plans for purposes of the General Nondiscrimination Test.

- The General Nondiscrimination Test is generally applied to the plan, group of plans or component of a plan used to satisfy the Ratio/Percentage Test or the Nondiscriminatory Classification Test under the Coverage Test.
- If mandatory disaggregation of a plan applies for purposes of the Ratio/Percentage Test or the Nondiscriminatory Classification Test, it also applies for purposes of the General Nondiscrimination Test. (Aggregation for purposes of the Average Benefit Percentage Test does not affect the General Nondiscrimination Test.)
 - The Employer Matching and Employee Tax Paid Contributions portions of a plan are tested separately from the remainder of the plan.
 - The collectively bargained portion of a plan is tested separately from the portion of the plan that Benefits non-union employees.
 - The portion of a plan that benefits former employees is tested separately from the portion that Benefits active employees.
 - If two or more plans or portions of plans are aggregated and tested together for purposes of the Ratio/Percentage Test or the Nondiscriminatory Classification Test, they are also aggregated and tested together for purposes of the General Nondiscrimination Test.
- The General Nondiscrimination Test also provides rules for the restructuring (or disaggregation) of plans into component parts which are tested as separate plans. However, if a plan is restructured into component parts, each component must pass both the General Nondiscrimination Test and the Coverage Test. If each of the separate components passes these tests as if it were a separate plan, then the plan passes the tests.
 - The Employer may select the group of employees for each component plan in any manner.
 - The composition of the groups may be changed from Plan Year to Plan Year.
 - An employee may only be included in one component plan.
 - Each component plan must consist of all the contributions and other benefits, rights, and features provided to participants covered by the component plan.

While restructuring may help a plan satisfy the safe harbor rules, in most cases restructuring will not simplify the testing process.

Testing. The General Nondiscrimination Test is applied on a Plan Year basis.

Cross-references:

- The General Nondiscrimination Test is summarized in the chart on page 60.
- The charts on pages 62 and 63 compare the aggregation and disaggregation rules.
- The Ratio/Percentage Test is discussed in Question and Answer 19.
- The Nondiscriminatory Classification Test is discussed in Question and Answer 21.
- The Average Benefit Percentage Test is discussed in Question and Answer 22.

24. What is the Contributions Test under the General Nondiscrimination Test?

The Contributions Test is one of three different sets of tests a plan must pass in order to satisfy the General Nondiscrimination Test.

To satisfy the Contributions Test, a plan must show that either:

- The rate of contributions does not discriminate in favor of HCEs or,
- The rate of benefits produced by contributions does not discriminate in favor of HCEs.

Contributions taken into account for purpose of the Contributions Test.

- Only the following contributions are taken into account in the Contributions Test:
 - Employer Non-Matching Contributions, and
 - Employee Required Salary Reduction Contributions.
- Contributions are only taken into account to the extent they are made to the plan, plans or components of plans being tested. For example, if a plan is restructured into component parts, only contributions to the component being tested are taken into account in testing that component.

Testing on a contributions basis.

- **Generally.**
 - **Alternative tests.** If a plan is tested on a contributions basis, it may satisfy the Contributions Test by satisfying either the Uniform Allocation Rate Safe Harbor Test or the Amount Test.
 - **Restructuring.** A plan or group of plans may be restructured into component plans for purposes of testing under the General Nondiscrimination Test. Restructuring may assist some plans in complying with the Contributions Test. However, each component must satisfy the Coverage Test and the remaining tests under the General Nondiscrimination Test, including the Availability Test.
- **The Uniform Allocation Rate Safe Harbor Test.** This is a design-based safe harbor which requires no numerical testing. A plan satisfies this test if contributions are made for participants under a single uniform formula under which each participant receives the same percentage of compensation or the same dollar amount.
 - To satisfy this test, the plan's Contributions Compensation must satisfy a definition of NDT Compensation.
 - Example: The plan provides that the Employer will contribute for each participant a contribution equal to 5% of the participant's General W-2 Compensation.
 - Code section 401(l) permits a limited disparity between the rate of contributions below a designated compensation level and the rate of contributions above that level. To the extent that a plan formula is uniform except for the fact that it includes a level of disparity permitted by Code section 401(l), it will satisfy the Uniform Allocation Rate Safe Harbor Test.
 - Example: The plan provides that the Employer will contribute for each participant a contribution of 5% of the Participant's General W-2 Compensation up to the Social Security Wage Base and 10% of the Participant's Includible Compensation over the Social Security Wage Base. Because the level of

disparity in the formula is permitted by Code section 401(l), the formula satisfies the Uniform Allocation Rate Safe Harbor Contribution Test.

- **Special limits.** The following types of limitation will not preclude a contribution rate from being considered uniform, provided the limit is applied uniformly to all employees in the plan or alternatively, to all HCEs in the plan:
 - Contributions limited to a maximum dollar amount.
 - Contributions limited to a maximum percentage of compensation.
 - A limitation on the amount of compensation taken into account in determining the amount of contributions.
 - The plan provides for lower allocations for HCEs.

A plan may also provide that Employer contributions for an employee will not be made unless the employee is employed on the last day of the Plan Year or completes a minimum number of hours of service during the Plan Year (not to exceed 1,000). This provision is appropriate only for contributions made on an annual basis as of the end of the year.

- **The Amount Test.** A plan satisfies the Amount Test if each rate group under the plan satisfies the Coverage Test as if it were a separate plan. A separate rate group exists for each HCE and consists of the HCE and all other employees in the plan (both HCEs and NHCEs) who have a contribution rate equal to or greater than the HCEs contribution rate.
- An employee's contribution rate is determined by dividing the contributions taken into account under the Amount Test for the employee for the Plan Year by the employee's NDT Compensation. As discussed in Question and Answer 15, NDT Compensation may be based on compensation for the entire Plan Year or may be limited to compensation for the period during which the employee was eligible for the contributions.
 - Example: Some plans impose age and/or service eligibility requirements which an employee must satisfy before becoming eligible to receive Employer contributions. An employee who satisfies those requirements during the Plan Year may be eligible to participate in the plan for only a portion of the Plan Year. Similarly, some plans do not permit employees in specified job categories to receive Employer contributions. An employee may move from a covered job category to a non-covered job category during the Plan Year and, therefore, would not be eligible to receive Employer contributions for the entire Plan Year.
 - If NDT Compensation during the period of plan participation is used to calculate contribution rates, this method must be used on a reasonably consistent basis for all employees from year to year in a reasonably consistent manner which does not discriminate in favor of HCEs.
 - The limitations of NDT Compensation to the period of plan participation can significantly affect test results.
 - Example: Assume a plan bases Employer contributions on base salary and that this definition does **not** satisfy the requirements to be used as NDT Compensation. Employee A has participated in the plan during the entire Plan Year has received Employer contributions of \$1,500 and has NDT Compensation of \$30,000. Employee B completed the eligibility requirements in the middle of the Plan Year, has participated in the plan for 6 months, and has received Employer contributions of \$500. The NDT Compensation of Employee B for the plan year is \$20,000, but is only \$10,000 for the 6 months in which Employee B has participated in the plan.
 - The contribution rate for Employee A is 5% [$\$1,500 \div \$30,000$].
 - If NDT Compensation for the Plan Year is used to calculate the contribution rate for Employee B, the contribution rate for Employee B is only 2.5% [$\$500 \div \$20,000$].

However, if NDT Compensation for the period of plan participation is used to calculate contribution rates, the contribution rate for Employee B is 5% [$\$500 \div \$10,000$].

In applying the Amount Test, permitted disparity may be taken into account. The regulations contain specific formulas that determine an adjusted contribution rate that reflects the amount of the permitted disparity that may be taken into account.

- **Special formulas.** Special rules apply if the contribution for an employee is determined under multiple formulas such as: (1) the greater of the amount determined under two or more formulas or (2) as the sum of two or more formulas. These formulas satisfy the Amount Test if: (1) they are the only formulas under the plan, and (2) each formula separately satisfies the Amount Test.

Testing on a benefits basis. If a plan must be tested on a benefits basis to demonstrate compliance with the Contributions Test, it must first pass one of three tests, sometimes referred to as a “Gateway Test”. If the plan passes a Gateway Test, it may then be tested on a benefits basis.

- **Gateway Tests.** The plan must pass one of the following three Gateway Tests:
 - Broadly Available Contributions Test;
 - Gradual Age or Service Schedule Test; or
 - Minimum Allocation Gateway Test.

In applying these Gateway Tests, the contribution rates are determined in the same way as under the Contributions Test, except that permitted disparity under Code section 401(l) is disregarded for purposes of the Gradual Age and Service Schedule Test and the Minimum Allocation Gateway Test.

Broadly Available Contributions Test. Under the Broadly Available Contributions Test, each contribution rate under the plan must be available during the plan year to a group of employees that satisfies the Coverage Test (without regard to the Average Benefit Test). Even if the plan has a contribution schedule that appears to be uniform, (e.g., five percent of compensation), separate contribution rates may result if contributions are based on compensation that is not NDT Compensation.

Gradual Age or Service Schedule Test. If a plan provides for different contribution rates to employees who satisfy different age or years of service conditions (or a condition based on the sum of age and years of service), the contribution rates under the schedule must increase smoothly at regular intervals.

To increase smoothly, (i) the contribution rate for each “band” within the schedule must increase by no more than five percentage points, and (ii) the ratio between each band and the next higher band must be no more than 2.0 nor exceed the ratio of the contribution rates between the two immediately preceding bands. Consider the following hypothetical contribution schedule:

<u>Completed Years of Service</u>	<u>Contribution Rate (based on NDT Compensation)</u>
0-5	3%
6-10	5%
11-15	7%
16+	9%

Each band in this example increases by two percentage points (which is less than the five percentage point maximum), and the ratios between the bands are no more than 2.0 and, as shown on the following chart, do not increase:

<u>Completed Years of Service</u>	<u>Ratio of Contribution Rate for Band to Contribution Rate for Immediately Preceding Band</u>
0-5	N/A
6-10	$5\% / 3\% = 1.67$
11-15	$7\% / 5\% = 1.4$
16+	$9\% / 7\% = 1.29$

In this example, the plan’s contribution schedule increases smoothly.

Generally, to satisfy the requirement that the contribution schedule increase at regular intervals, each band (other than the highest band and, under certain circumstances, the lowest band) must be of the same length. Under the hypothetical contribution schedule described above, all of the bands (other than the highest) are five years long, so the increases occur at regular intervals. Therefore, this plan’s contribution schedule satisfies the Gradual Age or Service Schedule Test.

Minimum Allocation Gateway Test. The Minimum Allocation Gateway Test is satisfied if each NHCE has a contribution rate that is at least one third of the contribution rate of the HCE with the highest contribution rate. A plan is deemed to satisfy the Minimum Allocation Gateway Test if each NHCE receives a contribution of at least 5% of the NHCE's General 415 Compensation for either the plan year or the NHCE's period of plan participation.

- **Conversion of contributions to benefits.** If a plan demonstrates it passes a Gateway Test, it can then see if contributions satisfy the Amount Test on a benefits basis. In order to test a plan in which Employer contributions are made to employees' accounts on a benefits basis, the contributions taken into account under the Amount Test must first be converted to equivalent benefit accrual rate. Converting contributions to equivalent benefits involves a series of mathematical steps based on actuarial rules:
 - Determine the amount of contributions taken into account under the Contributions Test for the Plan Year.
 - Calculate the projected value of the employee's contributions for the year as of a selected uniform testing age (such as age 65), assuming a reasonable rate of interest for each year until the testing age.
 - Convert the projected value to a single life annuity commencing at the testing age, using certain specified annuity factors based on the testing age.
 - Express the annual annuity payment as a dollar amount or as a percentage of the employee's NDT Compensation for the Plan Year being tested. This result is the employee's benefit accrual rate.

Converting contributions to benefits will tend to produce larger benefits for younger participants and smaller benefits for older participants.

It appears that, for purposes of testing on a benefits basis, NDT Compensation for the entire Plan Year must be used even if the employee was not eligible to receive Employer contributions for the entire Plan Year.

- **Satisfying the test on a benefits basis.** A plan satisfies the Contributions Test on a benefit basis if each rate group under the plan satisfies the Coverage Test as if it were a separate plan. A separate rate group exists for each HCE and consists of the HCE and all other employees in the plan (both HCEs and NHCEs) who have an equivalent benefit accrual rate equal to or greater than the HCE's equivalent benefit accrual rate.

In testing on a benefits basis, permitted disparity may be taken into account. The regulations contain specific formulas that determine an adjusted benefit accrual rate that reflects the amount of the permitted disparity that may be taken into account.

Aggregation, disaggregation and restructuring for purposes of the Amount Test. The aggregation, disaggregation and restructuring rules applicable to the General Nondiscrimination Test are discussed in Question and Answer 23.

25. What is the Availability Test under the General Nondiscrimination Test?

While the Contributions Test tests the value of contributions or benefits, the Availability Test focuses on the availability of all other benefits, rights, and features of a plan. Under this requirement, all benefits, rights, and features of a plan must be available to a nondiscriminatory group of employees.

Benefits, rights, and features.

- Each benefit, right or feature (being more than insignificant value) that is not available to employees on substantially the same terms must be tested separately. The following are some examples of benefits, rights or features under a plan:
 - The right to make a particular rate of tax-paid or tax-sheltered contributions;
 - Multiple vesting schedules;
 - Forms of distribution, if there are any distinctions in the form of benefit permitted, timing, payment schedule, and for election rights;
 - Early retirement benefits and disability benefits; and
 - Investment fund choices.

Two tests. The availability of each feature must satisfy two tests:

- **Current Availability Test.** Each benefit, right or feature must be currently available to a group of employees that satisfies either the Ratio/Percentage Test or the Nondiscriminatory Classification Test.
 - Under the Ratio/Percentage Test, the benefit, right or feature must be available to a percentage of the Non-excludable NHCEs that is at least 70% of the percentage of the Non-excludable HCEs to whom the benefit, right or feature is available.
 - Under the Nondiscriminatory Classification Test, the availability of the benefit, right or feature must satisfy a reasonable classification requirement and either the Safe Harbor Percentage Test or a Facts and Circumstances Test.
 - **The reasonable classification requirement.** Employees to whom the benefit, right or feature is available must constitute a reasonable classification of employees. A classification is reasonable if, based on all the facts and circumstances, it is established based on objective business criteria that readily identifies the employees. Examples of reasonable classifications include: job categories, salaried or hourly, or geographic location. Any category that has the effect of identifying employees by name is not reasonable.
 - **The Safe Harbor Percentage Test.** Based on the concentration of NHCEs in the Employer’s work force, the percentage of NHCEs to whom the benefit, right or feature is available must be at least the applicable Safe Harbor Percentage of the percentage of HCEs to whom the benefit, right or feature is available.

The Facts and Circumstances Test. Based on the concentration of NHCEs in the Employer’s work force: (1) the percentage of NHCEs to whom the benefit, right or feature is available must exceed the applicable Unsafe Harbor Percentage of the percentage of HCEs to whom the feature is available, and (2) the classification must not discriminate in favor of HCEs based on the applicable facts and circumstances. (See Question and Answer 6 for a discussion of the Facts and Circumstances Test.)

Since this is a Facts and Circumstances Test, GuideStone does not perform this test as part of its testing services.

- **Effective Availability Test.** Each feature must be effectively available, under all the relevant facts and circumstances, to a group of employees which does not substantially favor HCEs.

Since the **Effective Availability Test** is a Facts and Circumstances Test, GuideStone does not perform this test as a part of its testing services.

Cross-references:

- The General Nondiscrimination Test is discussed generally in Question and Answer 23 and is summarized in the chart on page 60.
- The Amount Test is discussed in Question and Answer 24.
- The Ratio/Percentage Test is discussed in Question and Answer 19.
- The Nondiscriminatory Classification Test is discussed in Question and Answer 21.

26. What are the requirements for crediting service?

In General:

Code section 401(a)(4) provides rules for crediting service as it affects: (1) benefit formulas, (2) accrual methods, (3) vesting schedules, (4) entitlements to benefits, rights, and features, and (5) eligibility to participate. Generally, a plan’s service crediting method satisfies these requirements if, on the basis of all relevant facts and circumstances, the manner in which service is credited for all purposes under the plan does not discriminate in favor of HCEs.

For a particular purpose, such as eligibility or vesting, a plan may use different methods of crediting service for different categories of employees. However, in order for the methods of service to be considered nondiscriminatory, one of the following two requirements must be satisfied:

- The methods must be deemed equivalent under Department of Labor rules.

- Alternatively, each of the methods of crediting service must satisfy the Availability Test discussed in Question and Answer 25.

Other than actual service with the Employer:

IRS regulations provide rules for determining whether other than actual service with the Employer may be taken into account. Other than actual service with the Employer generally falls into three categories for testing purposes:

- Plan amendments that grant past service.
- Pre-participation service.
- Imputed service.

The regulations define each of these types of service.

- **Past Service** – Generally the granting of past service occurs when an Employer adopts a new plan or amends an existing plan to expand coverage and grants service for all employment with the Employer prior to the inception of the plan (or, in the case of an amendment, the effective date of the amendment).
- **Pre-Participation Service** – Grants of pre-participation service generally occur when an Employer credits service with an unrelated Employer for eligibility and/or vesting purposes.
- **Imputed Service** – Any service credited for periods after an employee begins participation in a plan but while he is not currently performing service as an employee of the Employer constitutes imputed service.

In determining whether grants of past service are nondiscriminatory, the timing of the plan amendment granting such service must satisfy the Special Circumstances Test (See Question and Answer 27).

IRS regulations provide that grants of pre-participation or imputed service will satisfy the nondiscrimination requirements only if the Employer’s plan meets the following requirements:

- All similarly-situated employees are treated in the same manner. For example, employees who enter a plan as a result of a particular acquisition and who participated in the same plan of a prior Employer are generally similarly situated and, therefore, must be treated in the same manner.
- There is a legitimate business reason for crediting the service. (It is our understanding that crediting denominational service will meet this criteria.) Relevant facts and circumstances considered in determining whether a legitimate business reason exists include the following:
 - Whether one Employer has a significant relationship with or significant ownership control or similar interest in another Employer (though not enough for the Employers to be considered a Control Group).
 - Whether the two Employers share interrelated business operations.
 - Whether the Employers share similar attributes, such as operation in the same industry or the same geographical area.
 - Whether the employees are in an acquired group of employees or the employees became employed by the other Employer in a transaction between the two Employers that was a stock or asset acquisition, merger or other similar transaction involving a change in the Employer of the employees of a trade or business.
 - Other relevant factors, such as the type of service being credited (e.g., vesting service as compared with eligibility service).
 - Crediting of military service as service with the Employer is deemed to be a legitimate business reason.
- The practice does not discriminate significantly in favor of HCEs. In determining whether the practice discriminates significantly in favor of HCEs, the IRS will consider the following factors relevant:
 - The extent to which the credited service duplicates benefits or merely makes an employee whole.
 - The degree of business ties between the current Employer and the prior Employer.
 - The degree of excess coverage under Code section 410(b) of NHCEs, taking into account employees who are credited with pre-participation service.

- The extent to which the other Employer maintains a plan for its employees.
- The existence of reciprocal service credit under the other plans of the Employer or prior Employer.
- The circumstances underlying the employee’s transfer into the group of employees covered by the plan.
- The relative number of employees other than the most highly-paid HCEs of the Employer who receive credit for pre-participation or imputed service.

In general, if an Employer’s crediting of pre-participation service (e.g., denominational service, educational service, etc.) satisfies the requirements described above, the crediting of pre-participation service is permissible service deemed to satisfy the requirements for crediting pre-participation service. Therefore, other than actual service with the Employer may be taken into account in determining whether the Employer’s 403(b) retirement plan meets the requirement that contributions under the plan are nondiscriminatory. (However, if a defined contribution plan is tested on a benefits basis (i.e., the contributions are converted to equivalent benefit accruals) only years in which the employee benefits under the plan may be taken into account.)

Employers whose 403(b) retirement plan credits pre-participation service (e.g., denominational, educational, etc.) will have a choice for demonstrating compliance. If the Employer determines the plan’s crediting of pre-participation service satisfies the facts and circumstances requirements, the pre-participation service can be taken into account in determining whether the Employer’s 403(b) retirement plan is nondiscriminatory with respect to contributions under the plan. Whether the facts and circumstances requirements for crediting pre-participation service is satisfied will depend upon the validity of the Employer’s specific practices.

Alternatively, if the plan’s crediting of pre-participation service does not satisfy the facts and circumstances requirements, the Employer may elect to test the plan as if it were two plans; one for the otherwise Excludable Employees and one for the other employees Benefiting under the plan. If the Employer chooses this option, the facts and circumstances requirements will not apply and the Employer will generally be able to rely on the numerical results.

Employers who elect to perform the Coverage Test as if the plan were two plans will have more flexibility when it is necessary to perform the Average Benefit Percentage Test. The final Coverage Test regulations provide that it is permissible to perform separate Average Benefit Percentage Tests - one for the “under 21 and one plan” and another for the “21 and one plan.”

27. What is the Special Circumstances Test under the General Nondiscrimination Test?

The regulations also contain rules for determining if a plan is discriminatory in certain special circumstances. The following tests must be satisfied:

- **Plan Amendment Test.** A plan does not satisfy the General Nondiscrimination Test if a plan amendment or a series of plan amendments discriminates in favor of HCEs. The Plan Amendment Test is a Facts and Circumstances Test.
- **Past Service Safe Harbor.** A plan amendment that credits (or increases benefits because of) years of service for a period in the past does not satisfy the General Nondiscrimination Test if the amendment providing past service credit has the effect of discriminating **significantly** in favor of HCEs. This is a Facts and Circumstances Test. However, there is also a safe harbor rule which provides that the Past Service Safe Harbor is satisfied if:
 - The period for which past service is granted does not exceed five years.
 - The past service is granted on a reasonably uniform basis to all employees.
 - Benefits attributable to the period are determined by applying the current plan formula.
 - The past service is one of the types of service permitted under the IRC and related regulations, e.g., related industry service.
- **Plan Termination Test.** This test requires that a plan termination not have the effect of significantly discriminating in favor of HCEs. Currently, IRS guidance concerning this test only applies to defined benefit plans and money purchase pension plans and does not apply to Code section 403(b) Plans.

Since the Special Circumstances Test is a Facts and Circumstances Test, GuideStone does not perform this test as part of its testing services.

Cross-references:

- The General Nondiscrimination Test is discussed generally in Question and Answer 23 and is summarized in the chart on page 60.

28. What is the Maximum Compensation Limit?

The Maximum Compensation Limit under Code section 401(a)(17) limits the annual compensation which may be taken into account for an employee under a plan for a year. This limitation is \$245,000 (as adjusted to reflect increases in the cost of living). This means that in making contributions to a plan for an employee, no more than \$245,000 (as adjusted) in annual compensation can be taken into account. In addition, in performing the Nondiscrimination Test, the amount taken into account as NDT Compensation is subject to the Maximum Compensation Limit.

29. What is the Actual Contribution Percentage Test (ACP Test)?

Under the ACP Test in Code section 401(m), Employer Matching Contributions and Employee Tax-Paid Contributions are tested to make sure that the average contribution percentage for eligible HCEs does not exceed the average contribution percentage of all other eligible employees by more than a certain amount.

Requirement. The ACP Test requires that the greater of the following two alternatives must be met:

- The average contribution percentage for eligible HCEs cannot be more than 1.25 times greater than the average contribution percentage of all other eligible employees for the preceding Plan Year.
- The average contribution percentage for eligible HCEs cannot exceed the average contribution percentage of all other eligible employees for the preceding Plan Year by more than 200% or, if **less**, by more than two percentage points.

Calculation of average contribution percentages.

- **Calculation method.** To calculate the average contribution percentage for each group of employees (HCEs and NHCEs):
 - First, calculate the individual contribution percentage for each eligible NHCE. Generally, this is calculated by dividing the total of the Employer Matching Contributions and Employee Tax-Paid Contributions made for the NHCE for the Current Plan Year by the employee's NDT Compensation for the current Plan Year. If the Current Year Election is not made, then Employer Matching Contributions, Employee Tax-Paid Contributions and NDT Compensation are based on the NHCE data for Prior Plan Year.
 - Second, calculate the individual contribution percentage for each HCE. This is calculated by dividing the total of the Employer Matching Contributions and Employee Tax-Paid Contributions made for the HCE, for the Current Plan Year by the employee's NDT Compensation for the Current Plan Year.
 - Third, calculate the average contribution percentage for the NHCE and HCE groups by dividing the total of the individual contribution percentages for the employees in the applicable group by the total number of employees in the group.
 - Finally, determine whether the average contribution for HCEs exceeded the requirements described above.
- **NDT Compensation taken into account.** Compensation for the purpose of calculating the contribution percentages is NDT Compensation. Generally, NDT Compensation for the entire Plan Year is used in performing the test. However, for employees who are not participants in the plan for the entire Plan Year, it is permissible to compute the contribution percentage based on NDT Compensation during the portion of the Plan Year during which the employee was eligible to make an Employee Tax-Paid Contribution or a contribution on which an Employer Matching Contributions is based.

Employees taken into account in the ACP Test. All employees **eligible** to make an Employee Tax-Paid Contribution or to make a contribution on which an Employer Matching Contribution is based must be included in this test.

- If an employee is eligible to make a contribution on which an Employer Matching Contribution is based or is eligible to make an Employee Tax-Paid Contribution, but elects not to make a contribution, the employee is included in the test with a zero contribution percentage.
- If an employee would be eligible to make a contribution on which an Employer Matching Contribution is based, but is suspended from making contributions due to a hardship withdrawal or an election not to participate in the plan, the employee must be included in the test with a zero contribution percentage.

Aggregation and restructuring. The Employer Matching Contributions and Employee Tax-Paid Contribution portion of the plans of an Employer may be aggregated and tested as one plan for purposes of the ACP Test. The aggregated plans would have to pass the Coverage Test and the Availability Test component of the General Nondiscrimination Test as if they were a single plan.

Plan Year basis. The ACP Test applies to contributions made for the entire Plan Year.

Corrective distributions. If contributions for HCEs exceed the maximum permitted under the ACP Test, the excess contributions and earnings must be distributed to the employees (See Question and Answer 47 and 48). A plan satisfies the ACP Test if any necessary distributions of excess contributions are made on a timely basis.

Cross-references:

- Corrective distributions are discussed in Question and Answers 47 and 48.
- The chart on page 61 summarizes information concerning the ACP Test.

30. What is the Current Plan Year Election and how does it affect the ACP Test?

The **Current Plan Year Election** allows an Employer to base the calculation of the individual contribution percentages for the ACP Test for both NHCEs and HCEs on data for the Current Plan Year. Thus, the Current Plan Year Election both greatly simplifies the data-gathering process and, in practicality, allows Employers more flexibility with regard to when nondiscrimination-testing data for the ACP Test must be submitted.

The 403(b) retirement plan provides that the ACP Test is based on contributions for the Plan Year being tested for both NHCEs and HCEs. Employers who have not specifically provided in their Adoption Agreement to the 403(b) retirement plan that the ACP Test is based on NHCE data for the Prior Plan Year do not need to make the Current Plan Year Election. They need only provide nondiscrimination testing data for the Plan Year being tested. If an Employer's Adoption Agreement has modified the 403(b) retirement plan with regard to the ACP Test, the Employer will be notified prior to the Plan Year being tested to provide data for NHCEs for purposes of the ACP Test based on contributions for the Plan Year prior to the Plan Year being tested.

31. Is there a safe harbor for the ACP Test?

There is a safe harbor for satisfying the ACP Test with respect to Employer Matching Contributions. However, this safe harbor does not apply to Employee Tax-Paid Contributions. Any Employer's plan that permits Employee Tax-Paid Contributions will be required to satisfy the ACP Test with respect to those contributions. If you are interested in the specific requirements of this safe harbor, contact the Compliance Department at GuideStone.

32. What is the Three-Year Testing Cycle Guideline?

Under the **Three-Year Testing Cycle Guideline**, Employers are not required to perform certain nondiscrimination tests more than once every three years, provided that the Employer's retirement plan meets certain requirements. Specifically, if there is no significant change in the make-up of your workforce, no major change to your salary structure, no amendment to your plan during a Plan Year, and the plan's most recent test results indicate the plan satisfies the nondiscrimination requirements with a comfortable pass margin, you may rely for two years on the results of a test which demonstrated compliance with the applicable nondiscrimination requirements.

33. What are the rules related to the Three-Year Testing Cycle Guideline?

The Three-Year Testing Cycle Guideline may be used to demonstrate compliance with the Coverage Test, the General Nondiscrimination Test and the Compensation Ratio Test. If your 403(b) retirement plan is subject to the ACP Test,

your plan still will be required to demonstrate compliance with this test each year. (The ACP Test takes into account Employer Matching Contributions and/or Employee Tax-Paid Contributions.)

In order to rely on the results of a previous Plan Year's Coverage Test, General Nondiscrimination Test and/or Compensation Ratio Test, the Employer must "reasonably conclude" that there have been no "significant changes" since the tests upon which the Employer is relying were performed. The following conditions may constitute a significant change to the plan:

- 1) A change in plan provisions;
- 2) A change in the Employer's workforce;
- 3) A change in compensation practices.

In addition, the "relative margin" by which the plan has satisfied the nondiscrimination requirements, and the likelihood that the change would eliminate this pass margin, should be taken into consideration in determining whether a change is significant.

For example, if a plan satisfied the Coverage Test or the Availability Test by a close margin, a very small change in the workforce might be significant, and it is likely the change would cause the plan to fail the test in the year of the change. Plans which exclude categories of employees from participation which cannot be excluded from testing (Non-excludable Ineligible Employees), as well as plans with features that are available to limited groups of employees, may be particularly vulnerable. Therefore, the Three-Year Testing Cycle Guideline may not be available for these plans.

Employers will need to examine previous nondiscrimination test results, plan provisions and employee demographics in order to determine whether significant changes have occurred. **If there is any doubt, testing is the better option.**

Finally, if it is possible to isolate a change in a plan provision from the effect of other plan provisions, and it can be demonstrated that the effect of the isolated change is nondiscriminatory, the Employer may continue to rely on prior tests in the interim two years by testing only the change. This is a positive option because only limited data may be required.

34. What does the law mean when it talks about an employee Benefiting under the plan?

For purposes of the Coverage Test and General Nondiscrimination Test an employee is treated as Benefiting under the plan in the following circumstances:

- **Regarding Employer Non-Matching Contributions.** An employee is Benefiting under this portion of the plan if an Employer Non-Matching Contribution, regardless of amount, is allocated to the employee's account during the year.
- **Regarding Employee Tax-Paid Contributions.** An employee is treated as Benefiting under this portion of the plan if the employee is eligible to make a contribution, regardless of whether the employee elects to do so.
- **Regarding Employer Matching Contributions.** An employee is treated as Benefiting under this portion of the plan if the employee is eligible to make a contribution upon which an Employer Matching Contribution is based, regardless of whether the employee elects to do so.
- An employee will be treated as Benefiting under a portion of the plan if the employee is eligible to receive a contribution, but did not receive the contribution because of the Code section 415 limits on Annual Additions.

35. Do I have to include ALL the employees in each of the tests or only those employees who make or receive contributions to the retirement plan?

ALL employees of the Employer during the Plan Year must be considered at the start of each test. The initial employee data which the Employer gathers should include anyone that receives compensation from the Employer. Be sure to include:

- Full-time employees
- Part-time employees
- Temporary employees

- Student employees
- Leased Employees
- Former employees (only if you add new contributions for former employees or increase previous benefits)

If the Employer is a member of a Control Group, it is our current understanding that all employees of all Employers in the Control Group must be considered initially (See Question and Answer 7).

Each test does provide certain exclusions before arriving at the final results. However, each test must initially include **ALL** employees.

36. Which employees may be excluded in processing the nondiscrimination tests?

For purposes of some of the tests, certain employees are Excludable Employees and may be excluded from the test group in performing the nondiscrimination tests.

Employees who may be excluded under the applicable tests are discussed below:

Nondiscrimination Tests:

- **Universal Availability Requirement.** Employees who may be excluded under the Universal Availability Requirement are discussed in Question and Answer 17.
- **Coverage Test.** The following employees may be excluded under the Coverage Test:
 - Employees who have not met the minimum age and service requirements for participation in the plan, if all such employees are excluded from participation. Special rules may apply if plans with differing requirements are tested together.

It is currently our understanding that minimum age and service requirements cannot exceed the limits in Code section 410(a)(1) in order for this exclusion category to apply. The minimum age and service conditions permitted under Code section 410(a)(1) are age 21 and one year of service. Two years of service are permissible if there is 100% vesting. Educational institutions may use age 26 if there is 100% vesting and no more than one year of service is required.
 - Nonresident Aliens with no United States source earned income are excluded, if all such employees are excluded under the plan.
 - Students who are enrolled and regularly attending classes at the Employer (for schools, colleges and universities only), if **all** such employees are excluded under the plan.
 - Employees who did not receive a contribution solely because they failed to satisfy a minimum service requirement or a requirement to be employed on the last day of the Plan Year may be excluded if they terminated service prior to the end of the Plan Year and completed less than 500 hours of service during the Plan Year.
 - Employees covered under a collective bargaining agreement, if benefits were the subject of good faith bargaining.
 - Employees of qualified separate lines of business (QSLOBS.)
 - Employees who Normally Work less than 20 Hours per Week.
- **ACP Test.** Employees who are **not eligible** to make a contribution on which an Employer Matching Contribution is based or to make an Employee Tax-Paid Contribution are excluded from the test. All other employees are included, regardless of whether the employee makes a contribution. An employee who is suspended from making a contribution on which an Employer contribution is based because of a hardship distribution or an election not to participate in the plan is included in the test.
- **General Nondiscrimination Test.**
 - **Contributions Test.** The same rules concerning Excludable Employees apply to the Contributions Test as apply to the Coverage Test.

- **Availability Test.** The same rules concerning Excludable Employees apply to the Availability Test as apply to the Coverage Test.

For many of the tests special rules concerning Excludable Employees apply to plans covering union employees.

Don't forget: when gathering your data for the tests, you must include **all** employees of all Employers in the Control Group in your documentation. The exclusions only apply in **processing** the data.

37. Why is it important to specify in my plan document the employee groups which are excluded from eligibility to participate?

Many of the retirement nondiscrimination tests provide that certain employees may be excluded from the test group during the performance of these tests. This reduces the number of employees to whom the nondiscrimination requirements apply. The exclusions usually make the tests easier to pass since many of the exclusions apply to employees who frequently are not covered under a retirement plan.

However, in order to take advantage of an exclusion, in most cases, your plan document or Adoption Agreement must specifically provide that employees in the exclusion category are not eligible to participate in the plan.

38. In practice I can make individual exceptions to the eligibility requirements which are written in the plan document or Adoption Agreement, can't I?

If you make an exception, **any exception**, to an eligibility requirement included in your plan document or Adoption Agreement, then you may not exclude any employees in that category during the performance of your nondiscrimination tests.

- Example: Plan X requires employees to complete a year of service to be eligible to participate in the plan. However, the Employer decides to permit one new employee to participate after six months of service. Therefore, no employees may be excluded from the nondiscrimination tests on the basis of the service that is less than a year but more than six months.

The loss of the ability to exclude employees in a particular category of Excludable Employees could make compliance with the nondiscrimination requirements more difficult.

39. My plan covers union employees. Do special rules apply?

Special rules may apply if your work force includes union employees. Generally, union employees are employees included in a unit of employees covered by a collective bargaining agreement. (The collective bargaining agreement must meet certain requirements.)

For purposes of the Coverage Test and the General Nondiscrimination Test, the following general rules apply:

- A plan (or a portion of a plan) that benefits union employees is tested separately from a plan (or a portion of a plan) that benefits non-union employees.
- Union employees may be excluded in testing a plan (or a portion of a plan) that benefits non-union employees. Non-union employees may be excluded in testing a plan (or a portion of a plan) that benefits union employees.
- Because of special rules, the portion of a plan that benefits union employees automatically satisfies the Coverage Test and the General Nondiscrimination Test.
- However, if more than 2% of the Employer's employees covered by a collective bargaining agreement are professional employees, the union rules will not apply. Professional employees are HCEs who at any time during the Plan Year perform services for the Employer as a certified or other accountant, actuary, architect, attorney, chiropodist, chiropractor, executive, investment banker, medical doctor, dentist, optometrist, osteopath, podiatrist, engineer, psychologist, stockbroker or veterinarian. The IRS may expand this list.

If you believe your plan may be affected by the special rules which apply to plans which cover union employees, you should consult with your legal counsel. You may also contact the Compliance Department at GuideStone for more information.

40. Can benefits for former employees impact our nondiscrimination tests?

Generally, if former employees receive a new benefit, their benefits are increased or they receive an additional contribution after termination of employment, the additional benefits must not discriminate significantly in favor of former HCEs. This determination is made under a Facts and Circumstances Test.

In general, an individual is treated as a former employee beginning on the day after the day on which the individual ceases performing services for the Employer. Therefore, the individual can be both an employee and a former employee during the same year. Notwithstanding the preceding sentence, an individual is considered an employee (and not a former employee) for a Plan Year to the extent that he is credited with service as an employee under the plan.

41. My organization leases some personnel. How are these persons treated?

Some Employers lease individuals to perform certain services. For example, the Employer may lease support staff to perform secretarial, clerical, billing, security, computer, laboratory, food or maintenance services. Or, the Employer may enter into arrangements with independent contractors to provide such services.

Leased Employees. In an employee leasing situation, a leasing organization leases persons to a recipient Employer for whom the Leased Employee performs services. Generally, a Leased Employee is a person who performs services for a recipient Employer and is not otherwise an employee of the recipient Employer.

- **Requirements to be considered a Leased Employee.** A worker will not be considered a Leased Employee for purposes of inclusion in nondiscrimination tests unless the following conditions are met:
 - The services are provided pursuant to an agreement which may be written, oral or merely a mutual understanding.
 - The services are provided by the person on a substantially full-time basis and have been so provided for at least one year.
 - The services are performed under the primary direction and control of the service recipient.
- **Factors that are relevant in determining whether primary direction or control exists include:**
 - Whether the individual is required to comply with instructions of the service recipient;
 - When, where and how the individual is to perform the services;
 - Whether the services must be performed by a particular person;
 - Whether the individual is subject to the supervision of the service recipient; and
 - Whether the individual must perform services in the order or sequence set by the service recipient.
- **Substantially full-time service for one year means:**
 - At least 1500 hours of service or, if less,
 - At least 75% of the median hours worked by employees of the Employer performing similar work.

Alternatively, the Employer may elect that substantially full-time service means at least 1000 hours of service. If the Employer makes this election, hours worked by employees performing similar services do not have to be considered.

- A person is not counted as a Leased Employee until after the close of the one-year period.
- An independent contractor may be a Leased Employee.

Effect on Testing. If individuals or independent contractors are considered Leased Employees, it is our current understanding they generally must be counted for purposes of the nondiscrimination tests which apply to Code section 403(b) Plans. However, the law is not clear on this issue.

Special rules may apply if the Leased Employee is covered by a retirement plan of the leasing organization.

If your organization leases employees, you should contact your legal counsel. You may also contact the Compliance Department at GuideStone for more information.

42. What is the impact of contingent employees or independent contractors?

Many Employers use outsourcing or other creative staffing arrangements for various business functions. Such initiatives have created a group of non-traditional employees. The term non-traditional employees include contingent workers such as part-time, casual, per diem, shared or temporary employees or seasonal workers. The term may also include independent contractors or consultants.

Generally, Employers do not consider these workers as employees for purposes of payroll and benefit plans. However, these workers are in a situation similar to leased employees. This means that the IRS may reclassify some or all of the contingent employees as common law employees or as being dually employed. Generally, the outcome turns on who is the real Employer or who are the common law employees. The IRS will hold that the recipient Employer is ultimately liable for the payment of payroll taxes if there is any reclassification.

If you have questions concerning the appropriate employment status of any contingent workers, please consult your legal counsel.

43. Who are Highly Compensated Employees?

Generally, HCEs are identified on the basis of their HCE Compensation.

- For Code section 403(b) Plans, HCEs are determined under the Statutory HCE Definition (See Question and Answer 44). Under the Statutory HCE Definition, HCE Compensation is determined on the basis of compensation for the year preceding the year being tested. Employers may elect to limit HCEs to the Top 20% Paid Group.

General principles. The following general principles apply in determining HCEs:

- HCEs are determined on the basis of all employees of all Employers in the entire Control Group. (Special rules may apply for purposes of determining the Control Group for the Non-Salary Reduction Safe Harbor Test.)
- Compensation for purposes of determining HCEs means HCE Compensation. HCE Compensation is the Standard Compensation received by the employee from all Employers in the Control Group during the Plan Year. Minister's housing allowance is not a part of HCE Compensation.

44. How are HCEs determined under the Statutory HCE Definition?

Determination of HCEs under the statutory definition:

- An HCE under the Statutory HCE Definition is any active employee who performs services for the Employer during the Plan Year being tested during the Plan Year being tested or the immediately preceding Plan Year or:
 - Receives HCE Compensation in excess of \$110,000 (as adjusted) during the immediately preceding Plan Year, and if the Employer elects,
 - Is in the top 20% of employees in terms of HCE Compensation (the Top 20% Paid Group),
- An active employee is any employee who performs services for the Employer at any time during the Current Plan Year.

Former Employees. Under the Statutory HCE Definition, HCEs may include former employees.

- A Highly Compensated Former Employee is any former employee who was an HCE at separation from service or at any time after attaining age 55.

Cross-references:

- HCE Compensation is discussed in Question and Answers 11 and 43.
- Generally, Highly Compensated Former Employees are not taken into account in performing the nondiscrimination tests unless the portion of a plan Benefiting former employees is being tested.

Control Group. In identifying HCEs, all employees of all Employers in the Control Group are considered.

- Exclusions apply only in determining the Top 20% Paid Group.

45. What is the Top 20% Paid Group?

The Top 20% Paid Group is the group consisting of the top 20% of the Employer's Non-excludable Employees when ranked from highest to lowest on the basis of HCE Compensation.

- Identification of the employees in the Top 20% Paid Group is a two-step process.
 - First, you must determine the number of employees that will be in the group. For this purpose, certain categories of employees are excluded. The number of employees in the Top 20% Paid Group equals 20% times the difference between total employees and Excludable Employees.
 - Second, you must identify the particular employees in the Top 20% Paid Group. For this purpose, total employees **without exclusions** are used.
 - Rank all employees on the basis of HCE Compensation from highest to lowest. Using the number calculated in step one, count down the number of employees in the Top 20% Paid Group. It is possible that an employee excluded in the first step will be in the Top 20% Paid Group.
 - Example: An Employer has 120 employees. Thirty employees are Excludable Employees.
 - Step 1. 120 employees minus 30 employees = 90
 $90 \times 20\% = 18$
18 = the number of employees in the Top 20% Paid Group
 - Step 2. Rank all 120 employees on the basis of HCE Compensation from highest to lowest. The highest paid 18 employees are the individual employees in the Top 20% Paid Group.
 - Generally, the following employees are excluded in determining the number of employees in the Top 20% Paid Group:
 - Nonresident Aliens with no United States source earned income.
 - Employees who have not attained age 21 by the end of the year.
 - Employees who have not completed six months of service by the end of the year.
 - Employees who Normally Work less than 17½ Hours per Week. (This determination can be made on an individual employee basis or on the basis of particular job categories.) (See Normally Works in the Glossary.)
 - Employees who Normally Work less than Six Months during the year. If an employee works one day during the month, the employee is counted as working for that month. (This can be determined on an individual or a job category basis.) (See Normally Works in the Glossary.)
 - Employees covered by a collective bargaining agreement if:
 - 90% of all employees are covered under a collective bargaining agreement, and
 - The plan being tested only covers other employees.

46. What happens if my retirement plan fails to comply with the nondiscrimination requirements in the 403(b) regulations?

Compliance with the retirement plan nondiscrimination testing requirements is an explicit condition for a plan to be a Code section 403(b) Plan.

The IRS could take the position that a plan loses its tax-favored status if it does not satisfy all of the requirements. This could mean that all vested contributions to the plan and any other Code section 403(b) contract purchased for an individual by the Employer could become taxable to the participating employees in the year of the failure, regardless of whether the employee is an HCE.

Testing information. As a general rule, Code section 403(b) Plans must satisfy the nondiscrimination requirements every day of the Plan Year. However, there are some variations.

- **Coverage Test.** A plan must satisfy the Coverage Test based on one of the following options:

- Daily testing.
- Quarterly testing – as long as quarterly testing reasonable represents coverage of the plan over the entire Plan Year.
- Annual testing.
- **General Nondiscrimination Test.** A plan must satisfy each of the three General Nondiscrimination Tests on the basis of data and plan provisions in effect for the entire Plan Year.
- **ACP Test.** If the Current Plan Year Election is made, this test is based on contributions for the entire Plan Year. If the Current Plan Year Election is not made, this test is based on NHCE contributions for the entire year prior to the Plan Year and HCE contributions for the entire Plan Year.

Retroactive correction. In some cases, a failure to comply with a nondiscrimination requirement can be retroactively corrected.

- **Coverage and General Nondiscrimination Tests.** Under certain circumstances, a plan can be amended retroactively and the new provisions implemented by the 15th day of the 10th month after the Plan Year to correct a failure to satisfy any of these tests. It is our understanding that the correction generally must be accomplished by expanding (rather than reducing) coverage, contributions or other benefits.
- **ACP Test.** If a plan fails the ACP Test, excess contributions and earnings must be distributed to affected HCEs. Generally, the corrective distributions must be made by the end of the Plan Year following the failure, but they must be made within 2½ months following the end of the Plan Year to avoid a penalty tax on the Employer. If the corrective distributions are made, the plan will be deemed to satisfy the ACP Test. (See Questions 47 and 48 for more information on plans that fail the ACP Test.)

47. What happens if my plan fails the ACP Test?

The ACP Test is discussed in Question and Answer 29. This test only applies to Employer Matching Contributions and Employee Tax-Paid Contributions.

If your plan fails the ACP Test at the end of the Plan Year, then the contributions for HCEs which exceed the maximum permitted under the test, and earnings on such contributions, must be distributed to the employee. Otherwise, the plan could lose its tax-favored status. Excess Employer Matching Contributions and earnings distributed to an employee are included in the income of the employee.

48. When must the corrective distributions under the ACP Test be made? Is there a deadline?

If the corrective distributions have not been made by the close of the Plan Year following the year in which excess contributions were made, the plan could lose its tax-favored status. Generally, if the corrective distributions have not been made within 2½ months following the close of the Plan Year, the Employer will have to pay a penalty tax equal to 10% of the excess contributions.

49. Are there alternative methods for correcting failures of the nondiscrimination tests?

Yes. The IRS has introduced a comprehensive system of correction programs for Code section 403(b) Plans and other retirement plans. These programs are known collectively as the **Employee Plans Compliance Resolution System (EPCRS)**. Under EPCRS various programs exist that permit a plan sponsor to correct violations of certain nondiscrimination testing failures that might otherwise cause a plan to lose its tax-favored status. Depending upon the nature of the failure, the correction can be made with or without IRS involvement.

There are requirements for utilizing EPCRS as well as certain correction principles that must be followed. If an Employer feels they may Benefit from participating in EPCRS, they should talk with their attorney or contact the Compliance Department for more information.

50. What does my organization need to do so that the nondiscrimination tests can be performed?

Accurate data collection is a vital part of compliance with the nondiscrimination rules. Organizations are required to maintain accurate information concerning employee service, compensation and other information required for the tests. Additionally, your organization will be required to identify HCEs, so you will need to be able to track

individuals as they move into the HCE group. You will also need to determine whether you have any Leased Employees.

Depending on the size of your organization and the nature of your recordkeeping systems, you may find it time-consuming and complex to assemble the data necessary to perform the tests. Some organizations do not customarily keep track of all of the required information. Many Employers may find that they need to modify their recordkeeping systems to more easily gather the information required for the tests.

If you would like GuideStone to assist you in performing the tests, please see the **Testing Services Section** for further information.

You should also review the 403(b) retirement plan and your Adoption Agreement to determine if the provisions of your plan create problems related to nondiscrimination testing. For example, some Employers who have adopted the 403(b) retirement plan have different contribution rates or different vesting schedules for different groups of employees. Some organizations have had undocumented retirement plan arrangements. These situations may cause your other plans to have trouble passing the nondiscrimination tests. It is your responsibility to review the 403(b) retirement plan and your Adoption Agreement to ensure that all special arrangements concerning the plan are included in your plan provisions.

51. What can I do if it looks like my plan may have difficulty meeting the nondiscrimination requirements?

Contact your Relationship Manager at GuideStone for plan design alternatives or other ideas to help satisfy the nondiscrimination requirements.

52. This is complicated; will it ever get simpler?

Probably not, but as you begin to test your plans, the procedures will become easier and will seem simpler because you will be more familiar with them. Once you are familiar with the data required for the tests, modifications to your recordkeeping systems could make it easier for you to gather data. Further, after you identify and correct any nondiscrimination problems in the design of your plan, your plan should have less trouble passing the requirements in later years.

Since the regulations are so complex, the **Charts Section** contains charts which summarize some of the major provisions and definitions of the nondiscrimination tests and regulations. Using the charts in conjunction with the information contained in the **Questions and Answers Section** and the **Glossary** will help clarify some of the complex nondiscrimination testing requirements.

The information contained in this **Guide** reflects our current understanding of the nondiscrimination requirements as they affect the 403(b) retirement plan as adopted by most Employers. Bear in mind, however, that the tax law is constantly changing, and while the Compliance Department at GuideStone endeavors to keep you informed of such changes, the ultimate responsibility for awareness of and compliance with the law rests with your organization.

Moreover, the information provided in this **Guide** is intended as only a general discussion concerning the nondiscrimination requirements. The exact application of the rules to your plan may be different. GuideStone cannot provide legal advice to you concerning the nondiscrimination requirements. We suggest that you consult with your legal counsel regarding the application of the nondiscrimination requirements to your Code section 403(b) Plan. GuideStone specifically disclaims any liability for loss incurred as a consequence of information presented in this *Employer's Guide to Nondiscrimination Testing for Code Section 403(b) Plans*.

Glossary

Glossary of terms used in Nondiscrimination Testing

Abbreviations:

HCE:

Highly Compensated Employee.

IRC:

Internal Revenue Code (“Code”).

IRS:

Internal Revenue Service.

NHCE:

Non-Highly Compensated Employee.

QCCO:

Qualified Church-Controlled Organization.

Actual Contribution Percentage Test (ACP Test):

The ACP Test is a Nondiscrimination Test which limits the Employer Matching Contributions and Employee Tax-Paid Contributions for HCEs. The limit is the greater of the following two alternatives:

- The average contribution percentage for eligible HCEs cannot be more than 1.25 times greater than the average contribution percentage of all other eligible employees.
- or
- The average contribution percentage for eligible HCEs cannot exceed the average contribution percentage of all other eligible employees by more than 200%, or if less, by more than 2 percentage points.

Cross-references:

- The ACP Test is discussed in Questions 29, 30 and 31 and is summarized in the chart on page 61.

Adjusted 415 Compensation:

Adjusted 415 Compensation is defined in Question and Answer 12.B (2).

Adjusted W-2 Compensation:

Adjusted W-2 Compensation is defined in Question and Answer 12.B (4).

Cross-references:

- Adjusted W-2 Compensation is discussed in Question and Answer 12.
- The chart on pages 53-55 compares various elements of pay included in Adjusted W-2 Compensation.

Affiliated Service Group:

An Affiliated Service Group is a relationship between Employers which may make Employers part of a Control Group. The Affiliated Service Group rules focus on organizations which are engaged in the performance or delivery of services to each other or to third parties.

Cross-references:

- Affiliated Service Groups are discussed in Question and Answer 7.

Alternative NDT Compensation:

Alternative NDT Compensation is discussed in Question and Answer 15.

Amount Test:

Amount Test is discussed in Question and Answer 24.

Annual Addition:

Annual Additions are the contributions and forfeitures allocated to a participant for a tax year.

Automatic NDT Compensation:

The Automatic NDT Compensation definitions are definitions of compensation which are deemed to be nondiscriminatory and may automatically be used as NDT Compensation. These definitions are set out in Question & Answer 15.B.

Availability Test:

The Availability Test is one of three required tests which apply to the General Nondiscrimination Test. It is described in Question and Answer 25.

Average Benefit Test:

The Average Benefit Test, which is one of the alternative permissible tests under the Coverage Test, is described in Question and Answer 20.

Average Benefit Percentage Test:

The Average Benefit Percentage Test is one of two component tests under the Average Benefit Test, which is one of the Coverage Tests. To satisfy the Average Benefit Percentage Test, the average benefit percentage of NHCEs under all retirement plans maintained by the Employer (including the plan being tested) must be at least 70% of the average benefit percentage of HCEs in all plans. The Average Benefit Percentage Test is described in Question and Answer 22.

Benefiting:

Benefiting is discussed in Question and Answer 34.

Broadly Available Contributions Test:

Broadly Available Contributions Test is defined in Question and Answer 24.

Cafeteria Plan:

A Cafeteria Plan is a plan described in Code section 125.

Church:

As defined in Code section 3121(w), Church means a church, a convention or association of churches, or an elementary school or secondary school which is controlled, operated, or principally supported by a church or by a convention or association of churches.

Common Control:

Common Control is a relationship between Employers which makes certain related Employers are part of a Control Group for purposes of the Nondiscrimination Tests. The rules for determining Common Control are discussed in Question and Answer 7.

Compensation Ratio Test:

The Compensation Ratio Test is one of three requirements an alternative definition of compensation must satisfy in order to be used as NDT Compensation. The Compensation Ratio Test is discussed in Question and Answer 15.

Code section 132(f)(4):

Under Code section 132(f)(4), an employee can elect to reduce their compensation by amounts contributed for qualified transportation fringe benefits. A qualified transportation fringe benefit is defined as including:

- Employer-provided transportation in a commuter highway vehicle between the employee's home and office
- Transit passes
- Qualified parking

Code section 401(a) Plan:

A Code section 401(a) Plan is a retirement plan qualified under Code section 401(a). Code section 401(a) Plans are broadly classified as defined benefit plans or defined contributions plans. Defined contribution plans include, for example, profit sharing plans, money purchase pension plans, stock bonus plans and employee stock ownership plans (ESOPs). A profit sharing plan may include a qualified cash or deferred arrangement referred to as a Code section 401(k) Plan.

Code section 401(k) Plan:

A Code section 401(k) Plan is a Code section 401(a) Plan which includes a cash or deferred arrangement qualified under Code section 401(k); a cash or deferred arrangement which permits Employee Salary Reduction Contributions.

Code section 403(b) Plan:

A Code section 403(b) Plan is a plan that satisfies the applicable requirements of Code section 403(b).

Code section 457(b) Plan:

A Code section 457(b) Plan is a deferred compensation plan available to certain governmental and certain tax-exempt Employers.

Contributions Compensation:

Contributions Compensation is discussed in Question and Answer 14.

Contributions Test:

The Contributions Test is one of three required tests which apply to the General Nondiscrimination Test. The Contributions Test is discussed in Question and Answer 24.

Control Group:

Control Group is a group of related Employers as described in Question and Answer 7. Certain related Employers must be treated as a single Employer in applying for nondiscrimination rules. In most cases, the individual Employer is treated as the Employer for purposes of the nondiscrimination tests. This type of Employer is referred to in this Guide as a "Non-Control Group Employer."

Coverage Test:

The Coverage Test, which is described in Question and Answer 18 is a Nondiscrimination Test under Code section 410(b). The test determines whether the plan covers or "Benefits" a nondiscriminatory group of employees. To comply with the requirement, a plan must satisfy either the Ratio/Percentage Test or the Average Benefit Test.

Cross-references:

- The Ratio/Percentage Test is discussed in Question 19.
- The Average Benefit Test is discussed in Question 20.

Current Availability Test:

The Current Availability Test, which is described in Question and Answer 25 is one of two required tests under the Availability Test aspect of the General Nondiscrimination Test. In order to satisfy the Current Availability

Test, each feature of a plan must be currently available to a group of employees that satisfies either the Ratio/Percentage Test or the Nondiscriminatory Classification Test.

Cross-references:

- The Ratio/Percentage Test is discussed in Question 19.
- The Nondiscriminatory Classification Test is discussed in Question 21.

Current Plan Year:

The Current Plan Year is the plan year being tested. The term is used most frequently in connection with the ACP Test.

Example: Assume that the plan year is the calendar year.

If the Employer in January 2010 wishes to test the Plan Year which ended on December 31, 2009, then the Current Plan Year would be the period from January 1, 2009 to December 31, 2009.

Current Plan Year Election:

The Current Plan Year Election is an election that applies to the Actual Contribution Percentage Test and affects the employee data which must be considered. Under the Current Plan Year Election, the data required for the ACP Test for both NHCEs and HCEs is for the same Plan Year. Unless otherwise affirmatively elected in an Employer's Adoption Agreement, all 403(b)(9) retirement plans automatically provide for the Current Plan Year Election.

Cross-references:

- The Current Plan Year Election is discussed in Question 30.

Eligible to Participate Compensation:

Eligible to Participate Compensation is discussed in Question and Answer 13.

Employee Required Salary Reduction Contribution:

An Employee Required Salary Reduction Contribution is a contribution to a retirement plan pursuant to the employee's one time irrevocable election made at the time of initial eligibility to participate in the plan.

Like Employee Salary Reduction Contributions, Employee Required Salary Reduction Contributions are made on a pre-tax basis; they reduce the employee's salary, decreasing the amount subject to income tax.

A contribution is not an Employee Required Salary Reduction Contribution if the employee may later change or suspend the salary reduction agreement. For example, if an employee may later elect to stop making salary reduction contributions or may change from contributions made by salary reduction agreement to Employee Tax-Paid Contributions, the contribution is not an Employee Required Salary Reduction Contribution.

For purposes of the nondiscrimination tests, Employee Required Salary Reduction Contributions are generally treated as Employer Non-Matching Contributions.

<p>NOTE: Very few Employers in the 403(b) retirement plan have true Employee Required Salary Reduction Contributions. Consult your Adoption Agreement provisions.</p>
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Employee Roth Contribution:

An Employee Roth Contribution is an after-tax contribution to a retirement plan on behalf of an employee pursuant to the employee's voluntary election to enter into a salary reduction agreement. An Employee Roth Contribution does NOT reduce the amount of salary subject to income tax. Employee Roth Contributions are treated as an Employee Salary Reduction Contribution for NDT purposes.

Employee Salary Reduction Contribution:

An Employee Salary Reduction Contribution is a pre-tax contribution (or after-tax in the case of Roth contributions) to a retirement plan on behalf of an employee pursuant to the employee's voluntary election to enter into a salary reduction agreement. A pre-tax contribution as an Employee Salary Reduction Contribution

reduces the amount of salary subject to income tax. An Employee Required Salary Reduction Contribution is not considered an Employee Salary Reduction Contribution.

NOTE: When Employee Salary Reduction Contributions are considered for purposes of the nondiscrimination tests, contributions should include only those contributions made to the plan being tested during the Plan Year being tested, unless otherwise informed. Employee Salary Reduction Contributions made to all retirement plans of all Employers in the Control Group must be considered in determining if an employee is an HCE.

Employee Tax-Paid Contribution:

An Employee Tax-Paid Contribution is a contribution to a retirement plan which is deducted from an employee's pay AFTER income tax has been withheld. These contributions are made on an after- tax basis and do not reduce the amount of salary subject to income tax.

NOTE: Employee Tax-Paid Contributions should include only those contributions made to the retirement plan being tested during the plan year being tested, unless otherwise informed. For purposes of the ACP Test, if the employee is an HCE, Employee Tax-Paid Contributions to all plans of all Employers in the Control Group must be considered. Roth elective deferrals, even though made on an after-tax basis, are not included in the ACP test.

Employer:

Employer is discussed in Question and Answer 7.

Employer Matching Contribution:

An Employer Matching Contribution is a contribution made on behalf of an employee by an Employer to a retirement plan which is contingent upon an employee contribution to the retirement plan. Employer contributions which match Employee Required Salary Reduction Contributions generally are not treated as Employer Matching Contributions, but rather as Employer Non-Matching Contributions for purposes of the nondiscrimination tests.

NOTE: Employer Matching Contributions should include only those contributions made to the retirement plan being tested during the Plan Year being tested, unless otherwise informed. For purposes of the ACP Test, if the employee is an HCE, Employer Matching Contributions to all plans of all Employers in the Control Group must be considered.

Employer Non-Matching Contribution:

An Employer Non-Matching Contribution is a contribution made on behalf of an employee by an Employer to a retirement plan which is NOT contingent upon an employee contribution to a retirement plan. In addition, Employee Required Salary Reduction Contributions are generally treated as Employer Non-Matching Contributions for purposes of the nondiscrimination tests.

Facts and Circumstances Test:

A Facts and Circumstances Test is a subjective test rather than an objective, numerical requirement. Whether a plan complies with the requirement is determined based on the particular facts and circumstances of the plan, and the Employer and employees concerned. IRS regulations may provide guidance concerning the types of factors to be taken into account in determining compliance with the requirement. However, the test result is rarely clear cut.

GuideStone does not provide test results concerning Facts and Circumstances Tests as a part of its testing services.

Gateway Test:

Gateway Test is defined in Question and Answer 24.

General 415 Compensation:

General 415 Compensation is discussed in Question and Answer 12.B (1).

General Nondiscrimination Test:

The General Nondiscrimination Test is a Nondiscrimination Test which requires that contributions or benefits provided under a plan not discriminate in favor of HCEs. In order to satisfy the General Nondiscrimination Test, the plan must satisfy three tests: the Contributions Test, the Availability Test, and the Special Circumstances Test.

Cross-references:

- The General Nondiscrimination Test is discussed generally in Question and Answer 23 and is summarized in the chart on page 60.
- The Amount Test is discussed in Question 24.
- The Availability Test is discussed in Question 25.
- The Special Circumstances Test is discussed in Question 27.

General W-2 Compensation:

General W-2 Compensation is defined in Question and Answer 12.B (3).

Gradual Age or Service Schedule Test:

Gradual Age or Service Schedule Test is defined in Question and Answer 24.

HCE Compensation:

HCE Compensation is defined in Question and Answer 11 and 43.

Highly Compensated Employee (HCE):

A Highly Compensated Employee is defined in Question and Answer 43.

Leased Employee:

Leased Employee is defined in Question and Answer 41.

Maximum Compensation Limit:

The Maximum Compensation Limit is the maximum amount of an employee's compensation that may be taken into account under the plan for a year. This limitation is \$245,000 (as adjusted). Maximum Compensation Limit is discussed in Question and Answer 28.

Minimum Allocation Gateway Test:

Minimum Allocation Gateway Test is defined in Question and Answer 24.

Non-Control Group Employer:

The Non-Control Group Employer is an Employer which is not part of a Control Group.

Nondiscrimination Tests:

Nondiscrimination Tests are nondiscrimination requirements which are set forth in the IRC. These tests, which are discussed in Question and Answer 4, consist of a Universal Availability Requirement (see Question and Answer 17), an Actual Contributions Percentage Test (See Question and Answer 29), the Coverage Test, and a General Nondiscrimination Test (see Question and Answer 23).

Nondiscriminatory Classification Test:

The Nondiscriminatory Classification Test, which is discussed in Question and Answer 21, is used for two purposes: the Coverage Test and the Availability Test component of the General Nondiscrimination Test.

Cross-references:

- The Nondiscriminatory Classification Test is discussed in Question and Answer 21.
- The Coverage Test is discussed in Question and Answer 18.

- The Availability Test is discussed in Question and Answer 25.

Non-excludable Employee:

A Non-excludable Employee is an employee of an Employer who must be included in nondiscrimination testing because he is not one of the Statutorily Excludable Employees. A person who meets all of the requirements for participation in the Employer's plan is a Non-excludable Employee.

Non-excludable Ineligible Employee:

Non-excludable Ineligible Employees are employees other than Statutorily Excludable Employees who are excluded by the terms of a plan from receiving Employer contributions and/or making tax-paid contributions to the Employer's plan. Adjunct professors, for example, are frequently Non-excludable Ineligible Employees.

Nonresident Alien:

Foreign aliens are treated as Nonresident Aliens unless they can qualify as resident aliens.

To qualify as a resident alien, the foreign alien must satisfy two tests:

- The "green card" test – foreign aliens with green cards are lawful citizens of the United States and are considered a resident alien and taxed similar to U.S. citizens.
- The "substantial presence" test – in general, a foreign alien can spend 120 days each year in the country and still be considered a nonresident.

A foreign alien who cannot satisfy these two tests is considered a Nonresident Alien.

Nonresident Aliens with no United States source earned income can be excluded from certain nondiscrimination tests, if all such employees are excluded under the plan.

Normally Works:

The term Normally Works applies in two contexts:

- In the context of determining Excludable Employees for purposes of the Nondiscrimination Tests, generally, an employee who Normally Works less than 20 Hours a Week may be excluded. (The exclusion should be written into your Adoption Agreement.)
- In the context of determining the number of employees in the Top 20% Paid Group for purposes of determining HCEs under the Statutory HCE Definition, employees who Normally Work less than 17½ Hours per Week and employees who Normally Work less than Six Months during the year may be excluded.

Normally Works less than 20 Hours per Week:

Under the final 403(b) regulations, an employee Normally Works less than 20 hours per Week if, (1) for the 12-month period beginning on the date the employee's employment commenced, the employer reasonably expects the employee to work fewer than 1,000 hours of service and, (2) for each Plan Year ending after the close of that 12-month period, the employee has actually worked fewer than 1,000 hours of service. Once an individual in this category works 1,000 hours or more, they are no longer allowed to be excluded under this category.

If your plan includes this category of exclusion, in order to exclude these employees for the 2010 Plan Year, you must determine whether any employee in this category actually worked more than 1,000 hours during 2009. If they did, they can no longer be excluded under the Normally Works less than 20 Hours per Week exclusion and should be allowed to participate in the employer's plan.

Normally Works less than 17½ Hours per Week:

Temporary regulations provide that an employee who works less than 17½ hours a week for at least 50% of the hours the employee works each year will be considered to Normally Work less than 17½ Hours per Week. An Employer can make this determination based on groups of employees that fall into a certain category of employee. As long as 80% of the employees in that job category Normally Work less than 17½ Hours per Week, all of the employees in that category can be excluded.

Normally Works less Than Six Months:

Temporary regulations provide that whether an employee Normally Works less than Six Months during the year is determined on the basis of the facts and circumstances of the Employer's experience in prior years. If an employee works one day during a month, the employee is counted as working during that month. Like the Normally Works less than 17½ Hours per Week exclusion, the determination of whether an employee Normally Works Less Than Six Months can be made on the basis of job categories. Employees who normally work less than six months during the plan year are excluded in calculating the number of employees in the Top 20% Paid Group in determining HCEs under the Statutory HCE Definition. (See Question and Answer 44 and 45.)

NDT Compensation:

NDT Compensation is defined in Question and Answer 15.

Past Service Safe Harbor:

The Past Service Safe Harbor is a safe-harbor for the Plan Amendment Test for plan amendments that grant credit for past service. The Past Service Safe Harbor requires that plan amendments providing past service credits must not have the effect of discriminating significantly in favor of HCEs. This is a Facts and Circumstances test. However, there is a safe harbor rule which provides that the Past Service Safe Harbor is satisfied if:

- The period for which the service credit is granted does not exceed five years.
- The service is granted on a reasonably uniform basis to all employees.
- Contributions attributable to the period are determined by applying the current plan formula.
- The service credited is service with the Employer or service with a previous Employer that may be taken into account under the regulations.

Cross-references:

- The Past Service Safe Harbor is discussed in Question and Answer 27.

Plan Amendment Test:

The Plan Amendment Test is one of the two required tests under the Special Circumstances Test aspect of the General Nondiscrimination Test. The Plan Amendment Test requires that a plan amendment, or a series of plan amendments, must not discriminate in favor of HCEs. The Plan Amendment Test is a facts and circumstances test.

Cross-references:

- The Plan Amendment Test is discussed in Question and Answer 27.

Plan Termination Test:

The Plan Termination Test is one of the two required tests under the Special Circumstances Test aspect of the General Nondiscrimination Test. The Plan Termination Test requires that a plan must not discriminate in favor of HCEs in connection with plan terminations. Currently, the IRS guidance concerning this test does not apply to Code section 403(b) Plans.

Cross-references:

- The Plan Termination Test is discussed in Question and Answer 27.

Plan Year:

The Plan Year is the calendar year.

Prior Plan Year:

The Prior Plan Year is the 12-month period immediately preceding the Plan Year being tested. In the regulations, the Prior Plan Year is referred to as the "look-back year."

Example: If the Plan Year being tested is January 1, 2009 to December 31, 2009, then the Prior Plan Year is January 1, 2008 to December 31, 2008.

Qualified Church-Controlled Organization (QCCO):

As defined in Code section 3121(w), a Qualified Church-Controlled Organization is any church-controlled, tax-exempt organization described in Code section 501(c)(3), other than an organization which:

- offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities which are sold at a nominal charge which is substantially less than the cost of providing such goods, services, or facilities; and
- normally receives more than 25 percent of its support from:
 - governmental sources,
 - receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in activities which are not unrelated trades or businesses, or
 - both of the above.

Cross-references:

- A QCCO is discussed in Question and Answer 2.

Qualified Separate Line of Business:

A Qualified Separate Line of Business is a separate line of business of an Employer Control Group to which certain Nondiscrimination Tests may be applied separately. The rules for determining a Qualified Separate Line of Business are discussed in Question and Answer 8.

Ratio/Percentage Test:

The Ratio/Percentage Test is one of two permissible alternative tests which may be used to satisfy the Coverage Test. In addition, the Ratio/Percentage Test is one of the alternative tests used to determine if benefits, rights, and features of a plan satisfy the Availability Test under the General Nondiscrimination Test. The Ratio/Percentage Test is discussed in Question and Answer 19.

Reasonable Classification Test:

The Reasonable Classification Test, which is discussed in Question and Answer 21 is one of two tests a plan must satisfy in order to satisfy the Nondiscrimination Classification Test.

Safe Harbor Percentage:

The Safe Harbor Percentage is the percentage designated as such in the IRS regulations, which is described in Question and Answer 21.

Safe Harbor Percentage Test:

The Safe Harbor Percentage Test, discussed in Question and Answer 21, is one of two alternative tests that a plan may satisfy to pass a portion of the Nondiscriminatory Classification Test.

Simplified Employee Pension Plan:

A Simplified Employee Pension Plan is a plan under Code section 408(k)(i).

Special Circumstances Test:

The Special Circumstances Test is one of two tests required by the General Nondiscrimination Test. The Special Circumstances Test examines whether the plan is nondiscriminatory in special circumstances.

Cross-references:

- The Special Circumstances Test is discussed in Question and Answer 27.

Standard Compensation:

Standard Compensation is a term used to refer to any of the four definitions of compensation permissible under Code section 415. The permissible definitions of Standard Compensation are described in Question and Answer 15.

Statutorily Excludable Employees:

Statutorily Excludable Employees are employees which may be excluded for the purposes of processing a nondiscrimination test. The employee who may be excluded often varies test to test because applicable Code sections, regulations, or other guidance provide specifically for the exclusions. Generally, a particular exclusion must be specifically written into the plan document if the Employer wishes to apply it and employees may be excluded from testing only if no employee within the particular category is permitted to participate.

Cross-references:

- See Questions and Answer 36 for more information on Excludable Employees for purposes of the nondiscrimination tests.
- Certain employees may also be excluded in determining the number of employees in the Top 20% Paid Group in determining HCEs under the Statutory HCE Definition. See Question and Answer 44 and 45.

Statutory Control Group:

A Statutory Control Group is a Control Group used for purposes of the Nondiscrimination Tests. The rules for determining the Statutory Control Group is discussed in Question and Answer 7.

Statutory HCE Definition:

Statutory HCE Definition is discussed in Question and Answer 44.

Three-Year Testing Cycle Guideline:

Under the Three-Year Testing Cycle Guideline, Employers are not required to perform certain nondiscrimination tests more than once every three years provided that the Employer's retirement plan meets certain requirements. Specifically, if there is no significant change in the make-up of the Employer's workforce, no major change to salary structure, no amendment to the plan during a Plan Year, and the plan's most recent test results indicate the plan satisfies the nondiscrimination requirements with a comfortable pass margin, an Employer may rely for two years on the results of a test which demonstrated compliance with the applicable nondiscrimination requirement.

Uniform Allocation Rate Safe Harbor Test:

The **Uniform Allocation Rate Safe Harbor Test** is one of the safe harbor tests under the Contributions Test aspect of the General Nondiscrimination Test. This design-based safe harbor test requires no numerical testing. A plan satisfies this test if contributions are made to employees under a single uniform formula under which each employee Benefiting under the plan receives that same percentage of compensation or the same dollar amount.

Compensation for this purpose must be compensation determined under a definition of compensation which satisfies the requirements of NDT Compensation.

Cross-references:

- The Uniform Allocation Rate Safe Harbor Test is discussed in Question and Answer 24.
- The General Nondiscrimination Test is discussed generally in Question and Answer 23.
- NDT Compensation is discussed in Question and Answer 15.
- The General Nondiscrimination Test Chart is found on page 60.

Universal Availability Requirement:

A Nondiscrimination Test which applies to Employee Salary Reduction Contributions. If the opportunity to make Employee Salary Reduction Contributions is available to any employee, it must be available to all employees, including employees who have not met minimum age or service requirements of the plan. Certain employees may be excluded. In addition, the plan may require a minimum employee salary reduction of \$200 per year. The **Universal Availability Requirement** does not apply to Employee Required Salary Reduction Contributions.

Cross-references:

- The Universal Availability Requirement is discussed in Question 17.

Unsafe Harbor Percentages:

Unsafe Harbor Percentages is discussed in Question and Answer 21.

Charts

Nondiscrimination Tests for Code Section 403(b) Plans (Applied with or without the reasonable, Good Faith Interpretation Standard)

- I. Universal Availability Requirement
- II. Maximum Compensation Limit
- III. Coverage Test – One of following alternatives:
 - A. Ratio/Percentage Test
 - B. Average Benefit Test – Two components:
 - 1. Nondiscriminatory Classification Test – Two components:
 - a. Reasonable classification test (facts and circumstances test)
 - b. One of the following:
 - (1) Safe Harbor Percentage Test
 - (2) A Facts and Circumstances Test
 - 2. Average Benefit Percentage Test
- IV. General Nondiscrimination Test – Three components:
 - A. Contributions Test – One of the following alternatives:
 - 1. Contributions Basis – One of the following alternatives:
 - a. Uniform Allocation Rate Safe Harbor Test
 - b. Amount Test – One of the following alternatives:
 - 2. Benefits Basis:
 - Amount Test on the basis of equivalent benefit accrual rates.
 - B. Availability Test – Two components:
 - 1. Current Availability Test – One of the following alternatives:
 - a. Ratio/Percentage Test
 - b. Nondiscriminatory Classification Test – Two components:
 - (1) Reasonable classification test (Facts and Circumstances Test)
 - (2) One of the following:
 - i. Safe Harbor Percentage Test
 - ii. Facts and Circumstances Test
 - 2. Effective Availability Test (Facts and Circumstances Test)
 - C. Special Circumstances Test – All of the following:
 - 1. Plan Amendment Test (Facts and Circumstances Test)
 - 2. Past Service Safe Harbor:
 - 3. Plan Termination Test
- V. ACP Test

Comparison of definitions of compensation

Type of Remuneration	General 415 Compensation	Adjusted 415 Compensation	General W-2 Compensation	Adjusted W-2 Compensation	Safe Harbor Alternative Definition
General Principles	Compensation of all forms is generally included in General 415 Compensation to the extent includible in the gross income of the employee. In addition, certain salary reduction contributions are included, even though excludible from gross income.	Adjusted 415 Compensation is the same definition of compensation as General 415 Compensation with the exception that certain items included in General 415 Compensation are excluded from Adjusted 415 Compensation.	Compensation of all forms is generally included in General W-2 Compensation except certain compensation is excluded based on the nature or location of employment or the services performed.	Adjusted W-2 Compensation is the same definition of compensation as General W-2 Compensation except that taxable group term life insurance is excluded.	Any of the Standard Compensation definitions (the first four in this chart) modified to exclude all of certain items.
Wages, salaries, fees, bonuses, tips, commissions, fringe benefits, reimbursements, and expense allowances, to the extent included in gross income Regular pay after severance from employment that is received by the later of 2-1/2 months after severance from employment or the end of the limitation year that includes the date of severance from employment.	Included	Included	Included	Included (subject to exclusion noted in General Principles)	See exclusions listed below

Type of Remuneration	General 415 Compensation	Adjusted 415 Compensation	General W-2 Compensation	Adjusted W-2 Compensation	Safe Harbor Alternative Definition
Accident and health benefits, to the extent includible in the employee's gross income	Included	Excluded	Included	Included	Excluded
Group term life insurance to the extent includible in the employee's gross income	Included	Included	Included	Excluded	Excluded
Moving expenses paid or reimbursed by the Employer, to the extent not deductible by the employee	Included	Excluded	Included	Included	Excluded
Value of nonqualified stock options, to the extent includible in gross income in the year granted	Included	Excluded	Included	Included	
Amounts included in gross income as the result of the employee's election to recognize income under Code section 83	Included	Excluded	Included	Included	Excluded
Nonqualified unfunded plan distributions	Permitted to be excluded or included	Excluded	Included	Included	Excluded
Earned income from sources outside the United States, regardless of whether it is excludable from gross income under Code section 911	Included	Included	Included	Included	

Type of Remuneration	General 415 Compensation	Adjusted 415 Compensation	General W-2 Compensation	Adjusted W-2 Compensation	Safe Harbor Alternative Definition
Salary reduction contributions under Code sections 402(g), 125, 457, or 132(f)(4)	Included	Included	Included	Included	Excluded
Amounts included in gross income because of: (1) Failure to satisfy the terms of a 409A plan, (2) Lapse of substantial risk of forfeiture in a Code section 457(f) plan, or (3) Amounts that are constructively received by the employee from a non qualified deferred compensation plan	Included	Excluded	Included	Included	Excluded
If the plan provides: Leave cashouts and deferred compensation amounts received by the later of 2½ months following severance from employment or the end of the year in which the severance occurs if the amounts are either (1) a payment for accrued bona fide sick, vacation, or leave, but only if it could have been used if employment continued; or (2) were received from a nonqualified unfunded deferred compensation plan but only if payment would have been made at the same time if employment continued, and only if payment is includible in gross income. These amounts should not include severance pay.	Include if plan provides	Include if plan provides	Include if plan provides	Include if plan provides	Excluded

The meaning of compensation for different purposes

Purpose	Name	Elements	
Determining Contributions to a plan	Contributions Compensation	Contributions Compensation is the definition of compensation stated in the plan upon which contributions are based	
Determining HCEs under the Statutory HCE Definition	HCE Compensation	HCE Compensation is Standard Compensation for the Prior Plan Year (under one of the four permissible definitions), and Employee Salary Reduction Contributions to all plans of the Employer, including elective deferrals under Code sections 402(g), 125, 457(b) or 132(f)(4) Transportation Fringe Benefit Plans.	
Determining if a plan satisfies the nondiscrimination requirements	NDT Compensation	NDT Compensation is one of the following alternatives: <ul style="list-style-type: none"> • Automatic NDT Compensation 	Automatic NDT Compensation is one of the following alternatives: <ul style="list-style-type: none"> • Any of the Standard Compensation definitions, without modifications; • Standard Compensation modified by the reduction method; • Standard Compensation modified by the deferral exclusion method; or <ul style="list-style-type: none"> • Standard Compensation modified by both the reduction method and the deferral exclusion method.
		<ul style="list-style-type: none"> • Alternative NDT Compensation 	Alternative NDT Compensation is any definition of compensation which meets all of the following requirements: <ul style="list-style-type: none"> • The Nondiscriminatory Design Test; • The Reasonable Definition Test; and • The Compensation Ratio Test.

Timetable for nondiscrimination testing for the calendar year plan year

If you wish GuideStone to assist you with your nondiscrimination testing for your 403(b) retirement plan, the following timetable applies to the 2009 plan year if your Plan Year is January 1 through December 31, 2009.

Matching Plans:

Deadline to submit cumulative data for the entire 2009 Plan Year for year-end testing

Deadline for distribution of excess contributions and earnings to HCEs resulting from the ACP Test to avoid the 10% penalty tax on the Employer

Deadline for distribution of excess contributions and earnings to HCEs resulting from the ACP Test to avoid the possibility of losing the tax-favored status of the plan

Non-Matching Plans:

Deadline to submit cumulative data for the entire 2009 Plan Year for year-end testing

Deadline for making any retroactive amendments and additional Employer contributions or extended eligibility for contributions to comply with the Coverage Test or Amount Test

Not Later Than:

February 1, 2010

March 15, 2010*

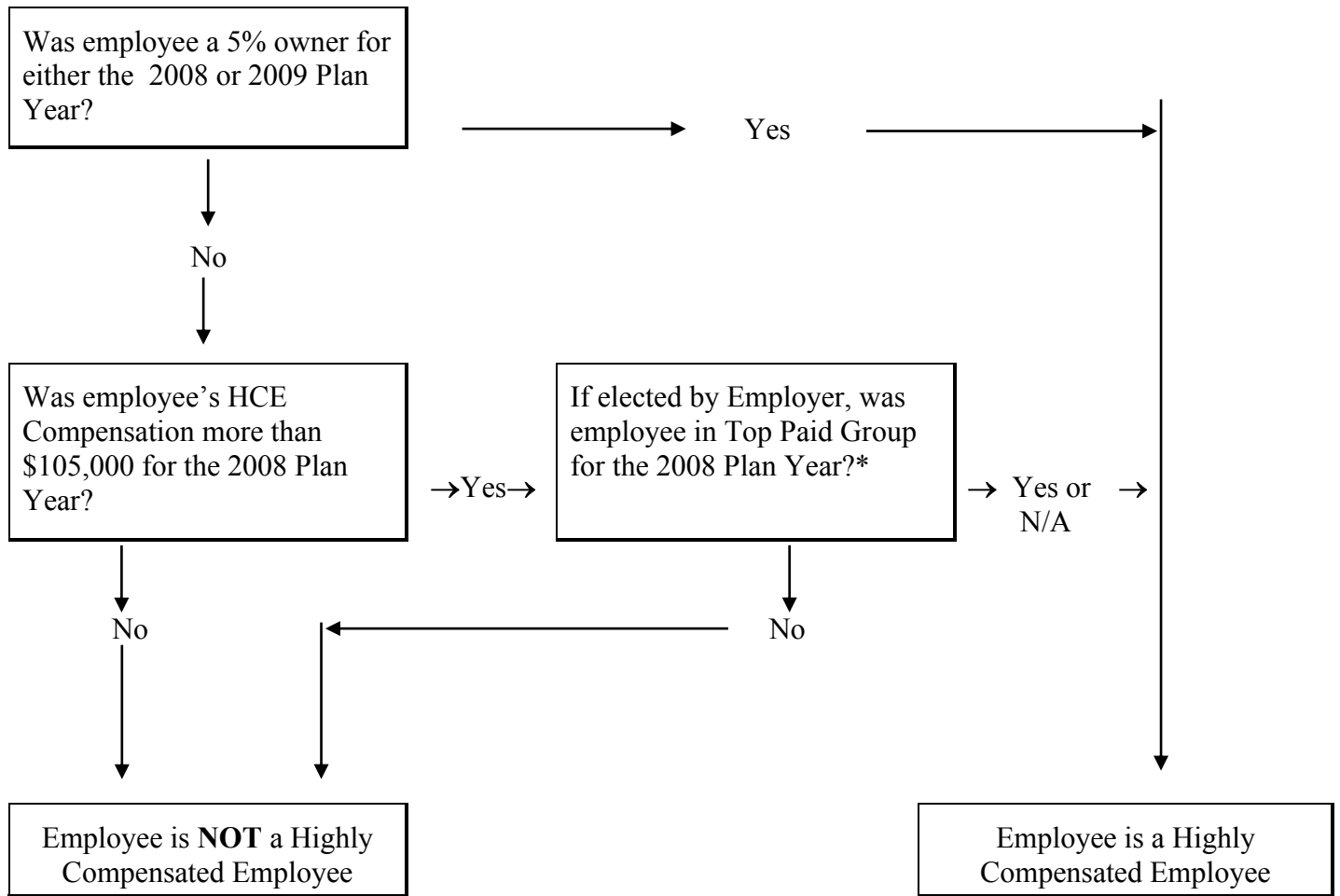
December 31, 2010

March 15, 2010

October 15, 2010

*Except for plans that have an eligible automatic contribution arrangement (EACA). To avoid the 10% penalty, the deadline for distribution is July 1, 2010.

Determining HCEs under the statutory HCE definition for the 2009 plan year



- Basically, the “Top Paid Group” is the top 20% of employees ranked on the basis of the compensation paid during the applicable year. For some Employers, this election may limit the number of HCEs. If you would like more information regarding this election, contact the Compliance Department.

Coverage Test chart

Purpose	This test is designed to ensure that the selection or coverage of employees Benefiting under a Code section 403(b) Plan does not unreasonably favor HCEs			
Description of Tests	Ratio/Percentage Test	Average Benefit Test		
<p>Each plan, or separate “plan” within a plan, must satisfy one of the two alternative Coverage Tests: the Ratio/Percentage Test or the Average Benefit Test.</p> <p>A plan which does not benefit any HCE will automatically satisfy this test.</p>	<p>To satisfy this test, the percentage of Non-excludable NHCEs Benefiting under the plan must be at least 70% of the percentage of Non-excludable HCEs Benefiting under the plan</p>	This test has two parts. The plan must satisfy both.		
		Nondiscriminatory Classification Test	Average Benefit Percentage Test	
		<p>To satisfy this test, the classification of employees Benefiting under the plan must be a reasonable classification based on valid business criteria. It also must not discriminate in favor of HCEs, which is tested either by a numerical Safe Harbor Percentage Test or by a Facts and Circumstances Test.</p>	<p>To satisfy this test, the average benefit percentage of Non-excludable active NHCEs under all retirement plans of the Employer must be at least 70% of the average benefit percentage of Non-excludable active HCEs in all such plans.</p>	
Separate “Plans” Within a Plan	<p>Certain features of a plan are treated as separate “plans” for the Coverage Test and these features or separate “plans” must each pass the Coverage Test separately. For example, the portion of a plan which provides for Employer Matching Contributions and Employee Tax-Paid Contributions, or the portion of a plan Benefiting union employees, or the portion of a plan Benefiting former employees will each be tested as separate “plans.”</p>			
Combining Multiple Plans of an Employer	<p>In some cases, multiple Code section 403(b) Plans (and other retirement plans) offered by an Employer may be combined in testing for the Coverage Test. Generally, plans or portions of plans required to be treated as separate “plans” cannot be combined. Plans combined for the Coverage Test must be tested together for the General Nondiscrimination Test. For the Average Benefit Percentage Test, most plans of the Employer must be combined.</p>			
Employees Included in Testing and Time Period Tested	<p>Generally, all Non-excludable Employees of all Employers in the Control Group during the Plan Year must be included in the testing. The plan may choose to satisfy the Coverage Test on either a daily, quarterly or annual basis. For plans subject to the ACP Test (e.g., plans with Employer Matching Contributions), annual testing is the only option.</p>			
Definition of “Benefiting” Under the Plan for the Coverage Tests	<ul style="list-style-type: none"> • For Employer Non-Matching Contributions, an employee Benefits under the plan if an Employer Non-Matching Contribution, regardless of amount, is allocated to his account during the Plan Year. • For Employer Matching Contributions and Employee Tax-Paid Contributions, an employee Benefits under the plan if he is eligible to make Employee Tax-Paid Contributions or a contribution on which an Employer Matching Contribution is based. • Employee Salary Reduction Contributions are not subject to the Coverage Test. 			
Special Rules Regarding Benefiting Under the Plan	<p>An employee is treated as Benefiting under the plan if he satisfies all the conditions for receiving a benefit, but fails to do so because of IRC Code section 415 limitations or other uniform maximum benefit limits under the plan.</p>			

General Nondiscrimination Test chart

Purpose	The General Nondiscrimination Test is designed to ensure that contributions or benefits do not discriminate in favor of HCEs.
Each plan must satisfy three requirements	
<ul style="list-style-type: none"> • Contributions Test 	<p>The value of contributions or benefits must not discriminate in favor of HCEs. The plan can be tested either on a contributions basis or a benefits basis.</p> <ul style="list-style-type: none"> • Contributions Basis. The contribution rate must be nondiscriminatory. The plan must satisfy one of the following alternative tests: the Uniform Contributions Rate Safe Harbor Test or the Amount Test. • Benefits Basis. The benefits produced by contributions must be nondiscriminatory. The plan must satisfy the Amount Test on the basis of equivalent benefit accrual rates. In order to test contributions on the basis of equivalent benefits, the plan must satisfy a Gateway Test.
<ul style="list-style-type: none"> • Availability Test 	<p>All Features of a plan must be available to a nondiscriminatory group of employees. The plan must satisfy two tests:</p> <ul style="list-style-type: none"> • Current Availability Test. Each benefit, right or feature must be currently available to a group of employees that satisfies either the Ratio/Percentage Test or the Nondiscriminatory Classification Test. • Effective Availability Test. Each benefit, right or feature must be effectively available, under the facts and circumstances, to a group of employees which does not substantially favor HCEs.
<ul style="list-style-type: none"> • Special Circumstances Test 	<p>The plan must not discriminate in special circumstances. The plan must pass three tests:</p> <ul style="list-style-type: none"> • Plan Amendment Test. A plan amendment, or series of plan amendments may not discriminate in favor of HCEs. • Past Service Safe Harbor. A plan amendment providing past service credits is deemed to not have the effect of discriminating significantly in favor of HCEs if (1) the period for which the service is granted does not exceed five years, (2) the service is granted on a reasonably uniform basis to all employees, (3) benefits for the period of past service are based on the current formula, and (4) the service is a type the regulations permit to be taken into account. • Plan Termination Test. A plan amendment terminating a plan must not discriminate in favor of HCEs.

Actual Contribution Percentage (ACP) Test chart

Purpose	This test is designed to ensure that the Actual Contribution Percentage of Employer Matching Contributions and Employee Tax-Paid Contributions for HCEs does not exceed the Actual Contribution Percentage of the Employer Matching Contributions and Employee Tax-Paid Contributions for NHCEs by more than certain prescribed limits.
Description of the Test	<p>The individual employee contribution percentages are calculated by dividing the Employee Tax-Paid Contributions and Employer Matching Contributions by the employee's compensation. The individual contribution percentages of the HCE group and the individual contribution percentages of the NHCE group are each averaged to determine the Actual Contribution Percentage (ACP) for each group.</p> <p>The Actual Contribution Percentage (ACP) for HCEs may not exceed the ACP for NHCEs by the greater of either: (1) 125%, or (2) the lesser of 200% or 2 percentage points.</p>
Employees Included in Testing	For the ACP Test, every employee who was eligible at any time during the Plan Year to make an Employee Tax-Paid Contribution or to make a contribution upon which an Employer Matching Contribution is based is included in the test, regardless of whether the employee made a contribution.
Contributions Included in Testing	Employee Tax-Paid Contributions and Employer Matching Contributions must be included in the ACP Test. Additionally, Employee Tax-Paid Contributions and Employer Matching Contributions made by or on behalf of HCEs to another retirement plan offered by the Employer must be included in the ACP Test, even though they may also be tested under the other plan.
Compensation Included in Testing	The compensation used in the ACP Test is NDT Compensation.
Aggregation of Multiple Code Section 403(b) Plans in Testing	If multiple plans of an Employer are combined for the Coverage Test, they must be combined for the ACP Test. The Employer may elect to combine plans to assist passage of the ACP Test, but all plans so combined must also be combined for the Coverage Test.
Distribution of Excess Contributions	If corrective distributions have not been made by the close of the Plan Year following the Plan Year in which excess contributions are made, the plan could lose its tax-favored status. If the corrective distributions have not been made within 2 ½ months following the close of the Plan Year (or 6 months if the plan is an EACA), the Employer will have to pay a penalty tax equal to 10% on all excess contributions.

Aggregation and disaggregation rules

Types of Plans or Components of Plans	Ratio/Percentage Test	Nondiscriminatory Classification Test	Average Benefit Percentage Test	General Nondiscrimination Test
General Principles			Combine all Code section 403(b) Plans of Employer. (In testing Code section 403(b) Plans, all Code section 401(a) Plans may also be added.) Then disaggregate plans or components as required by Reg. 1.410(b)-7(e)(i). The remaining plan must satisfy the Average Benefit Percentage Test.	
Code section 401(a) Plans/Code section 403(b) Plans	Permissive aggregation	Permissive aggregation	Mandatory disaggregation of Code section 403(b) Plans when testing Code section 401(a) Plans. Permissive aggregation of Code section 401(a) Plans when testing Code section 403(b) Plans.	
Union/Non-Union Plans or Components	Mandatory disaggregation	Mandatory disaggregation	Mandatory disaggregation	Mandatory disaggregation
Code section 401(k) Plan or Components/Other Plans or Remainder of Plan	Mandatory disaggregation	Mandatory disaggregation	Mandatory aggregation	Mandatory disaggregation

Types of Plans or Components of Plans	Ratio/Percentage Test	Nondiscriminatory Classification Test	Average Benefit Percentage Test	General Nondiscrimination Test
Qualified Separate Line of Business/Other Separate Lines of Business	Mandatory disaggregation if Employer elects to have Qualified Separate Line of Business rules apply	Permissive disaggregation, but all employees taken into account	Mandatory disaggregation if Employer elects to have Qualified Separate Line of Business rules apply	Mandatory disaggregation if Employer elects to have Qualified Separate Line of Business rules apply
Portion of Plan Benefiting Former Employees/Active Employees	Mandatory disaggregation	Mandatory disaggregation	Mandatory disaggregation	Mandatory disaggregation
Portion of Plan Benefiting Employees Who May Be Excluded Under Maximum Permissible Age and Service Exclusion/Portion Benefiting Remaining Employees	Permissive disaggregation	Permissive disaggregation	Permissive disaggregation	Permissive disaggregation
Plan Maintained by Multiple Employers Who Are Not Part of the Same Control Group	Mandatory disaggregation	Mandatory disaggregation	Mandatory disaggregation	Mandatory disaggregation