

(iii) The ADP for the HCEs (Employee A) is 4.34%. The ADP for the NHCEs is 3.78% $((4.77\% + 2.78\%)/2)$. Because 4.34% is less than 4.73% (3.78% multiplied by 1.25), the plan satisfies the ADP test under paragraph (a)(1)(i) of this section.

Example 2. (i) The facts are the same as in *Example 1*, except that elective contributions are made pursuant to a salary reduction agreement throughout the plan year, and no bonuses are paid. As provided by section 414(s)(2), Employer X includes elective

contributions in compensation. During the year, B and C defer the same amount as in *Example 1*, but A defers \$5,770. Thus, the compensation and elective contributions for A, B, and C are:

Employee	Gross compensation	Elective contributions	ADR
A	\$100,000	\$5,770	5.77%
B	60,000	2,860	4.77
C	45,000	1,250	2.78

(ii) The ADP for the HCEs (Employee A) is 5.77%. The ADP for the NHCEs is 3.78% $((4.77\% + 2.78\%)/2)$. Because 5.77% exceeds 4.73% (3.78% x 1.25), the plan does not satisfy the ADP test under paragraph (a)(1)(i) of this section. However, because the ADP for the HCEs does not exceed the ADP for the NHCEs by more than 2 percentage points and the ADP for the HCEs does not exceed the

ADP for the NHCEs multiplied by 2 (3.78% x 2 = 7.56%), the plan satisfies the ADP test under paragraph (a)(1)(ii) of this section.

Example 3. (i) Employees D through L are eligible employees in Plan T, a profit-sharing plan that contains a cash or deferred arrangement. The plan is a calendar year plan that uses the prior year testing method. Plan T provides that elective contributions are

included in compensation (as provided under section 414(s)(2)). Each eligible employee may elect to defer up to 6% of compensation under the cash or deferred arrangement. Employees D and E are HCEs. The compensation, elective contributions, and ADRs of Employees D and E for the 2006 plan year are shown below:

Employee	Compensation for 2006 plan year	Elective contributions for 2006 plan year	ADR for 2006 plan year
D	\$100,000	\$10,000	10%
E	95,000	4,750	5

(ii) During the 2005 plan year, Employees F through L were eligible NHCEs. The compensation, elective contributions and

ADRs of Employees F through L for the 2005 plan year are shown in the following table:

Employee	Compensation for 2005 plan year	Elective contributions for 2005 plan year	ADR for 2005 plan year
F	\$60,000	\$3,600	6%
G	40,000	1,600	4
H	30,000	1,200	4
I	20,000	600	3
J	20,000	600	3
K	10,000	300	3
L	5,000	150	3

(iii) The ADP for 2006 for the HCEs is 7.5%. Because Plan T is using the prior year testing method, the applicable year for determining the NHCE ADP is the prior plan year (*i.e.*, 2005). The NHCE ADP is determined using the ADRs for NHCEs eligible during the prior plan year (without regard to whether they are eligible under the plan during the plan year). The ADP for the NHCEs is 3.71% (the sum of the individual ADRs, 26%, divided by 7 employees). Because 7.5% exceeds 4.64% (3.71% x 1.25), Plan T does not satisfy the ADP test under paragraph (a)(1)(i) of this section. In addition, because the ADP for the HCEs exceeds the ADP for the NHCEs by more than 2 percentage points, Plan T does not satisfy the

ADP test under paragraph (a)(1)(ii) of this section. Therefore, the cash or deferred arrangement fails to be a qualified cash or deferred arrangement unless the ADP failure is corrected under paragraph (b) of this section.

Example 4. (i) Plan U is a calendar year profit-sharing plan that contains a cash or deferred arrangement and uses the current year testing method. Plan U provides that elective contributions are included in compensation (as provided under section 414(s)(2)). The following amounts are contributed under Plan U for the 2006 plan year: (A) QNECs equal to 2% of each employee's compensation; (B) Contributions equal to 6% of each employee's

compensation that are not immediately vested under the terms of the plan; (C) 3% of each employee's compensation that the employee may elect to receive as cash or to defer under the plan. Both types of nonelective contributions are made for the HCEs (employees M and N) and the NHCEs (employees O through S) for the plan year and are contributed after the end of the plan year and before the end of the following plan year. In addition, neither type of nonelective contributions is used for any other ADP or ACP test.

(ii) For the 2006 plan year, the compensation, elective contributions, and actual deferral ratios of employees M through S are shown in the following table:

Employee	Compensation	Elective contributions	Actual deferral ratio
M	\$100,000	\$3,000	3%
N	100,000	2,000	2
O	60,000	1,800	3