

(ii) In February 2007, Employer M determines that D's actual deferral ratio must be reduced to 6%, or \$12,000, which requires a recharacterization of \$3,000 as an employee contribution. This increases D's actual contribution ratio to 5.25% (\$7,500 in matching contributions plus \$3,000 recharacterized as employee contributions, divided by \$200,000 in compensation). Since D's actual contribution ratio must be limited to 4% for Plan X to satisfy the actual contribution percentage test, Plan X must distribute 1.25% or \$2,500 of D's employee contributions and matching contributions together with allocable income. If \$2,500 in matching contributions and allocable income is distributed, this will correct the excess aggregate contributions and will not result in a discriminatory rate of matching contributions. See *Example 8*.

Example 3. (i) The facts are the same as in Example 2, except that Employee D also had elective contributions under Plan Y, maintained by an employer unrelated to M. In January 2007, D requests and receives a distribution of \$1,200 in excess deferrals from Plan X. Pursuant to the terms of Plan X, D forfeits the \$600 match on the excess deferrals to correct a discriminatory rate of match.

(ii) The \$3,000 that would otherwise have been recharacterized for Plan X to satisfy the actual deferral percentage test is reduced by the \$1,200 already distributed as an excess deferral, leaving \$1,800 to be recharacterized. See § 1.401(k)-2(b)(4)(i)(A). D's actual contribution ratio is now 4.35% (\$7,500 in matching contributions plus \$1,800 in recharacterized contributions less \$600 forfeited matching contributions attributable to the excess deferrals, divided by \$200,000 in compensation).

(iii) The matching and employee contributions for Employee D must be reduced by .35% of compensation in order to reduce the ACP of the HCEs to 4%. The plan must provide for forfeiture of additional matching contributions to prevent a discriminatory rate of matching contributions. See *Example 8*.

Example 4. (i) The facts are the same as in Example 3, except that D does not request a distribution of excess deferrals until March 2007. Employer X has already recharacterized \$3,000 as employee contributions.

(ii) Under § 1.402(g)-1(e)(6), the amount of excess deferrals is reduced by the amount of excess contributions that are recharacterized. Because the amount recharacterized is greater than the excess deferrals, Plan X is neither required nor permitted to make a distribution of excess deferrals, and the recharacterization has corrected the excess deferrals.

Example 5. (i) For the 2006 plan year, Employee F defers \$10,000 under Plan M and \$6,000 under Plan N. Plans M and N, which have calendar plan years, are maintained by unrelated employers. Plan M provides a fully vested, 100% matching contribution, does not take elective contributions into account under section 401(m) or take matching contributions into account under section 401(k) and provides that excess contributions and excess aggregate contributions are corrected by distribution. Under Plan M,

Employee F is allocated excess contributions of \$600 and excess aggregate contributions of \$1,600. Employee F timely requests and receives a distribution of the \$1,000 excess deferral from Plan M and, pursuant to the terms of Plan M, forfeits the corresponding \$1,000 matching contribution.

(ii) No distribution is required or permitted to correct the excess contributions because \$1,000 has been distributed by Plan M as excess deferrals. The distribution required to correct the excess aggregate contributions (after forfeiting the matching contribution) is \$600 (\$1,600 in excess aggregate contributions minus \$1,000 in forfeited matching contributions). If Employee F had corrected the excess deferrals of \$1,000 by withdrawing \$1,000 from Plan N, Plan M would have had to correct the \$600 excess contributions in Plan M by distributing \$600. Since Employee F then would have forfeited \$600 (instead of \$1,000) in matching contributions, Employee F would have had \$1,000 (\$1,600 in excess aggregate contributions minus \$600 in forfeited matching contributions) remaining of excess aggregate contributions in Plan M. These would have been corrected by distributing an additional \$1,000 from Plan M.

Example 6. (i) Employee G is the sole highly compensated employee in a profit sharing plan under which the employer matches 100% of employee contributions up to 2% of compensation, and 50% of employee contributions up to the next 4% of compensation. For the 2008 plan year, Employee G has compensation of \$100,000 and makes a 7% employee contribution of \$7,000. Employee G receives a 4% matching contribution or \$4,000. Thus, Employee G's actual contribution ratio (ACR) is 11%. The actual contribution percentage for the nonhighly compensated employees is 5%, and the employer determines that Employee G's ACR must be reduced to 7% to comply with the rules of section 401(m).

(ii) In this case, the plan satisfies the requirements of section 411 if it distributes the unmatched employee contributions of \$1,000, and \$2,000 of matched employee contributions with their related matches of \$1,000. This would leave Employee G with 4% employee contributions, and 3% matching contributions, for an ACR of 7%. Alternatively, the plan could distribute all matching contributions and satisfy this section. However, the plan could not distribute \$4,000 of Employee G's employee contributions without forfeiting the related matching contributions because this would result in a discriminatory rate of matching contributions. See also *Example 7*.

Example 7. (i) Employee H is an HCE in Employer X's profit sharing plan, which matches 100% of employee contributions up to 5% of compensation. The matching contribution is vested at the rate of 20% per year. In 2006, Employee H makes \$5,000 in employee contributions and receives \$5,000 of matching contributions. Employee H is 60% vested in the matching contributions at the end of the 2006 plan year. In February 2007, Employer X determines that Employee H has excess aggregate contributions of \$1,000. The plan provides that only matching contributions will be distributed as excess aggregate contributions.

(ii) Employer X has two options available in distributing Employee H's excess contributions. The first option is to distribute \$600 of vested matching contributions and forfeit \$400 of nonvested matching contributions. These amounts are in proportion to Employee H's vested and nonvested interests in all matching contributions. The second option is to distribute \$1,000 of vested matching contributions, leaving the nonvested matching contributions in the plan.

(iii) If the second option is chosen, the plan must also provide a separate vesting schedule for vesting these nonvested matching contributions. This is necessary because the nonvested matching contributions must vest as rapidly as they would have had no distribution been made. Thus, 50% must vest in each of the next 2 years.

(iv) The plan will not satisfy the nondiscriminatory availability requirement of section 401(a)(4) if only nonvested matching contributions are distributed because the effect is that matching contributions for HCEs vest more rapidly than those for NHCEs. See § 1.401(m)-1(e)(4).

Example 8. (i) Employer Y maintains a calendar year profit sharing plan that includes a cash or deferred arrangement. Elective contributions are matched at the rate of 100%. After-tax employee contributions are permitted under the plan only for nonhighly compensated employees and are matched at the same rate. No employees make excess deferrals. Employee J, a highly compensated employee, makes an \$8,000 elective contribution and receives an \$8,000 matching contribution.

(ii) Employer Y performs the actual deferral percentage (ADP) and the actual contribution percentage (ACP). To correct failures of the ADP and ACP tests, the plan distributes to A \$1,000 of excess contributions and \$500 of excess aggregate contributions. After the distributions, Employee J's contributions for the year are \$7,000 of elective contributions and \$7,500 of matching contributions. As a result, Employee J has received a higher effective rate of matching contributions than nonhighly compensated employees (\$7,000 of elective contributions matched by \$7,500 is an effective matching rate of 107 percent). If this amount remains in Employee J's account without correction, it will cause the plan to fail to satisfy section 401(a)(4), because only a highly compensated employee receives the higher matching contribution rate. The remaining \$500 matching contribution may be forfeited (but not distributed) under section 411(a)(3)(G), if the plan so provides. The plan could instead correct the discriminatory rate of matching contributions by making additional allocations to the accounts of nonhighly compensated employees. See § 1.401(a)(4)-11(g)(3)(vii)(B) and (6), *Example 7*.

(c) *Additional rules for prior year testing method—(1) Rules for change in testing method.* A plan is permitted to change from the prior year testing method to the current year testing method for any plan year. A plan is permitted to change from the current