

year testing method to the prior year testing method only in situations described in § 1.401(k)-2(c)(1)(ii). For purposes of this paragraph (c)(1), a plan that uses the safe harbor method described in § 1.401(m)-3 or a SIMPLE 401(k) plan is treated as using the current year testing method for that plan year.

(2) *Calculation of ACP under the prior year testing method for the first plan year*—(i) *Plans that are not successor plans.* If, for the first plan year of any plan (other than a successor plan), a plan uses the prior year testing method, the plan is permitted to use either that first plan year as the applicable year for determining the ACP for the eligible NHCEs, or 3% as the ACP for eligible NHCEs, for applying the ACP test for that first plan year. A plan (other than a successor plan) that uses the prior year testing method but has elected for its first plan year to use that year as the applicable year for determining the ACP for the eligible NHCEs is not treated as changing its testing method in the second plan year and is not subject to the limitations on double counting under paragraph (a)(6)(vi) of this section for the second plan year.

(ii) *First plan year defined.* For purposes of this paragraph (c)(2), the first plan year of any plan is the first year in which the plan provides for employee contributions or matching contributions. Thus, the rules of this paragraph (c)(2) do not apply to a plan (within the meaning of § 1.410(b)-7) for a plan year if for such plan year the plan is aggregated under § 1.401(m)-1(b)(4) with any other plan that provides for employee or matching contributions in the prior year.

(iii) *Plans that are successor plans.* A plan is a successor plan if 50% or more of the eligible employees for the first plan year were eligible employees under another plan maintained by the employer in the prior year that provides for employee contributions or matching contributions. If a plan that is a successor plan uses the prior year testing method for its first plan year, the ACP for the group of NHCEs for the applicable year must be determined under paragraph (c)(4) of this section.

(3) *Plans using different testing methods for the ACP and ADP test.* Except as otherwise provided in this paragraph (c)(3), a plan may use the current year testing method or prior year testing method for the ACP test for a plan year without regard to whether the current year testing method or prior year testing method is used for the ADP test for that year. For example, a plan may use the prior year testing method for the ACP test and the current year testing

method for its ADP test for the plan year. However, plans that use different testing methods under this paragraph (c)(3) cannot use—

(i) The recharacterization method of § 1.401(k)-2(b)(3) to correct excess contributions for a plan year;

(ii) The rules of paragraph (a)(6)(ii) of this section to take elective contributions into account under the ACP test (rather than the ADP test); or

(iii) The rules of paragraph § 1.401(k)-2(a)(6) to take qualified matching contributions into account under the ADP test (rather than the ACP test).

(4) *Rules for plan coverage change*—(i) *In general.* A plan that uses the prior year testing method that experiences a plan coverage change during a plan year satisfies the requirements of this section for that year only if the plan provides that the ACP for the NHCEs for the plan year is the weighted average of the ACPs for the prior year subgroups.

(ii) *Optional rule for minor plan coverage changes.* If a plan coverage change occurs and 90% or more of the total number of the NHCEs from all prior year subgroups are from a single prior year subgroup, then, in lieu of using the weighted averages described in paragraph (c)(4)(i) of this section, the plan may provide that the ACP for the group of eligible NHCEs for the prior year under the plan is the ACP of the NHCEs for the prior year of the plan under which that single prior year subgroup was eligible.

(iii) *Definitions.* The following definitions apply for purposes of this paragraph (c)(4)—

(A) *Plan coverage change.* The term *plan coverage change* means a change in the group or groups of eligible employees under a plan on account of—

(1) The establishment or amendment of a plan;

(2) A plan merger or spinoff under section 414(l);

(3) A change in the way plans (within the meaning of § 1.410(b)-7) are combined or separated for purposes of § 1.401(m)-1(b)(4) (e.g., permissively aggregating plans not previously aggregated under § 1.410(b)-7(d), or ceasing to permissively aggregate plans under § 1.410(b)-7(d));

(4) A reclassification of a substantial group of employees that has the same effect as amending the plan (e.g., a transfer of a substantial group of employees from one division to another division); or

(5) A combination of any of the situations described in this paragraph (c)(4)(iii)(A).

(B) *Prior year subgroup.* The term *prior year subgroup* means all NHCEs for the prior plan year who, in the prior

year, were eligible employees under a specific plan that provides for employee contributions or matching contributions maintained by the employer and who would have been eligible employees in the prior year under the plan being tested if the plan coverage change had first been effective as of the first day of the prior plan year instead of first being effective during the plan year. The determination of whether an NHCE is a member of a prior year subgroup is made without regard to whether the NHCE terminated employment during the prior year.

(C) *Weighted average of the ACPs for the prior year subgroups.* The term *weighted average of the ACPs for the prior year subgroups* means the sum, for all prior year subgroups, of the adjusted ACPs for the plan year. The term *adjusted ACP with respect to a prior year subgroup* means the ACP for the prior plan year of the specific plan under which the members of the prior year subgroup were eligible employees on the first day of the prior plan year, multiplied by a fraction, the numerator of which is the number of NHCEs in the prior year subgroup and denominator of which is the total number of NHCEs in all prior year subgroups.

(iv) *Example.* The following example illustrates the application of this paragraph (c)(4). See also § 1.401(k)-2(c)(4) for examples of the parallel rules applicable to the ADP test. The example is as follows:

*Example.* (i) Employer B maintains two plans, Plan N and Plan P, each of which provides for employee contributions or matching contributions. The plans were not permissively aggregated under § 1.410(b)-7(d) for the 2005 testing year. Both plans use the prior year testing method. Plan N had 300 eligible employees who were NHCEs for 2005, and their ACP for that year was 6%. Plan P had 100 eligible employees who were NHCEs for 2005, and the ACP for those NHCEs for that plan was 4%. Plan N and Plan P are permissively aggregated under § 1.410(b)-7(d) for the 2006 plan year.

(ii) The permissive aggregation of Plan N and Plan P for the 2006 testing year under § 1.410(b)-7(d) is a plan coverage change that results in treating the plans as one plan (Plan NP). Therefore, the prior year ACP for the NHCEs under Plan NP for the 2006 testing year is the weighted average of the ACPs for the prior year subgroups.

(iii) The first step in determining the weighted average of the ACPs for the prior year subgroups is to identify the prior year subgroups. With respect to the 2006 testing year, an employee is a member of a prior year subgroup if the employee was an NHCE of Employer B for the 2005 plan year, was an eligible employee for the 2005 plan year under any section 401(k) plan maintained by Employer B, and would have been an eligible employee in the 2005 plan year under Plan NP if Plan N and Plan P had been