Permissive Disaggregation is a testing method that can be used to improve the results of a plan’s nondiscrimination testing. This guide explains the method as well as when, why and how it is allowed to be used.

One of the annual nondiscrimination tests required for a plan sponsor to maintain a qualified defined contribution retirement plan is the Actual Deferral Percentage (ADP) test.

The ADP test ensures the plan’s average deferral percentage for its highly compensated employees (HCEs) does not exceed the average deferral percentage of the non-highly compensated employees (NHCEs) by a certain amount.

**IMPORTANT TIP:** Certain safe harbor plan designs permit plan sponsors to bypass ADP testing.

The ADP test is calculated using the year-end participant data for the plan(s) being tested. Specific data needed for ADP testing includes the compensation, deferrals, hire date, birth date and, if applicable, the termination dates of every employee for the year being tested.

About 1/3 of retirement plans will fail the ADP test in any given plan year. Failing the ADP test requires the plan sponsor to take corrective action to fix the failure. Many times this correction involves refunding excess deferrals to the HCEs or making corrective contributions to NHCEs. Because of this, plan administrators are often looking for other options to improve their plan’s ADP test results. One of those options includes using the permissive disaggregation testing method.

**NOTE:** Fidelity’s Testing & Reporting Services utilizes the permissive disaggregation method for testing whenever possible.
Provided the plan’s eligibility rules are more liberal than the maximum allowable rules (age 21, one year of service or 1,000 hours and an entry date that does not exceed six months after meeting those requirements), the IRS allows the plan to be split up into subgroups and those subgroups tested separately or permissively disaggregated.

**NOTE:** Permissive Disaggregation must also be used for the 401k Minimum Coverage test if it is used for the ADP test. It may also be used for the Actual Contribution Percentage (ACP) and 401m Minimum Coverage tests.

This elective testing technique allows the plan to divide eligible participants into two subgroups:

- Non-Excludable Group – Eligible employees who have met the maximum allowable age, service and entry requirements
- Excludable Group – Eligible employees who have NOT met the maximum allowable age, service and entry requirements

Using Permissive Disaggregation, the plan’s employees are separated into the new excludable and non-excludable groups. Then, the ADP test is recalculated separately on each new group. Often, this grouping will result in a better test result because the excludable group tends to include mostly newer NHCEs, who tend to contribute less. Separating them can improve the average for the non-excludable test.

**Example**

- The ABC Plan provides that an employee becomes a participant in the plan as of the first day of the month following completion of the plan’s age 18 and 30 days of service eligibility requirements.
- The plan year is the calendar year.
- Bill is hired on April 4, 2015 and becomes a participant in the plan on June 1, 2015.
- Claire is hired on September 21, 2015 and becomes a participant on November 1, 2015.
- Both Bill and Claire are over age 21.
- The plan utilizes the Permissive Disaggregation method for testing.
2015 Plan Year

Bill has already satisfied the maximum allowable age requirement (age 21), but he will not satisfy the maximum allowable service requirement (1 year) until April 3, 2016. Therefore, Bill is in the excludable testing group for the 2015 plan year.

Claire has already satisfied the maximum allowable age requirement (age 21), but she will not satisfy the maximum allowable service requirement (1 year) until September 20, 2016. Therefore, Claire is in the excludable testing group for the 2015 plan year.

2016 Plan Year

Bill satisfies the maximum allowable service requirement as of April 3, 2016 and he satisfies the maximum allowable entry date requirement (six months after meeting the maximum age and service requirements) during the plan year. Therefore, Bill is in the non-excludable testing group for the 2016 plan year.

Claire satisfies the maximum allowable service requirement as of September 20, 2016, but she doesn’t satisfy the maximum allowable entry date requirement (six months after meeting the maximum age and service requirements) until the 2017 plan year. Therefore, Claire is in the excludable testing group for the 2016 plan year. Claire will be in the non-excludable testing group for the 2017 plan year.

NOTE: If testing is being performed for a prior plan year, Permissive Disaggregation may NOT be used if its use results in a failed ADP or ACP test and the client will need to correct the failures under a preapproved correction program of the Employee Plans Compliance Resolution System (EPCRS). EPCRS correction programs are generally provided only to plan sponsors who have made a critical mistake in the administration of their plan and wish to remedy the mistake and avoid plan disqualification.
Frequently Asked Questions

Why is Permissive Disaggregation allowed?

If a plan has more liberal eligibility requirements than the maximum of 1 year, age 21 with semi-annual entry dates, Congress did not want to penalize an employer for having a generous plan design. By using Permissive Disaggregation, the testing is still required for each group, but the otherwise excludable employees do not have a negative impact on the ADP or ACP test.

Where can I find my plan’s eligibility rules?

A plan’s eligibility rules should be located in the plan document. Any changes to the eligibility rules would need to be addressed in a plan amendment. Plan amendments to eligibility would have an impact only on the participants who have not yet met the eligibility rules. An amendment to eligibility that would trigger the ability to use Permissive Disaggregation would need to be in place prior to the end of the plan year being tested. Contact a member of your client service team for more information on plan amendments.

How is Permissive Disaggregation used to improve my test results?

Younger workers who are less than 21 and new hires typically have lower participation than employees who have been working for the company for multiple years. By disaggregating this group and testing them separately, this group with historically lower participation will not be included in the average deferral percentage for the non-excludable group. If for some reason this group will improve the test results, the use of Permissive Disaggregation is discretionary, not required, and will not be used.

How will Fidelity use the data provided to test the plan using Permissive Disaggregation?

If a plan’s eligibility requirements are less than 1 year and/or less than age 21, Fidelity will use the birth date, hire date and termination date provided to determine whether an employee would have met the 1 year of service, age 21 and semi-annual entry date requirement criteria, which is the most restrictive requirements in the regulations. The employees who would have met these requirements
are included in the non-excludable group. The employees who would not have met these requirements are in the otherwise excludable group which is tested separately.

**Why does my ADP and/or ACP test show non-excludable and excludable groups?**

Both groups are shown because the plan’s test population was split into those groups in an effort to improve test results.

**Do I need to provide direction to Fidelity in order to use Permissive Disaggregation if my plan initially fails the ADP or ACP test?**

Provided a plan’s eligibility rules are less than the maximum allowable amount, an ACP or ADP test failure will automatically be rerun using Permissive Disaggregation.

**Will Fidelity use the hours worked method instead of elapsed time method for my plan’s testing?**

Long-term part time employees who have never worked 1,000 hours in a given anniversary year should also be in the excludable group for testing. Provided the plan’s data file includes a list of employees who never completed 1,000 hours worked, the hours worked method may be used. This information would need to be provided to Fidelity at the time the data file is submitted.