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Title 26
Internal Revenue

Part 1 (§§ 1.410 to 1.440)

Revised as of April 1, 2016

Containing a codification of documents
of general applicability and future effect

As of April 1, 2016

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To cite the regulations in this volume use title, part and section number. Thus, 26 CFR 1.410(a)–1 *refers to title 26, part 1, section 1.410(a)–1.*

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Title 1 through Title 16.....as of January 1
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An index to the text of ''Title 3—The President'' is carried within that volume.

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OLIVER A. POTTS,
Director,
Office of the Federal Register.
April 1, 2016.

THIS TITLE

Title 26—INTERNAL REVENUE is composed of twenty-two volumes. The contents of these volumes represent all current regulations issued by the Internal Revenue Service, Department of the Treasury, as of April 1, 2016. The first fifteen volumes comprise part 1 (Subchapter A—Income Tax) and are arranged by sections as follows: §§ 1.0–1.60; §§ 1.61–1.139; §§ 1.140–1.169; §§ 1.170–1.300; §§ 1.301–1.400; §§ 1.401–1.409; §§ 1.410–1.440; §§ 1.441–1.500; §§ 1.501–1.640; §§ 1.641–1.850; §§ 1.851–1.907; §§ 1.908–1.1000; §§ 1.1001–1.1400; §§ 1.1401–1.1550; and § 1.1551 to end of part 1. The sixteenth volume containing parts 2–29, includes the remainder of subchapter A and all of Subchapter B—Estate and Gift Taxes. The last six volumes contain parts 30–39 (Subchapter C—Employment Taxes and Collection of Income Tax at Source); parts 40–49; parts 50–299 (Subchapter D—Miscellaneous Excise Taxes); parts 300–499 (Subchapter F—Procedure and Administration); parts 500–599 (Subchapter G—Regulations under Tax Conventions); and part 600 to end (Subchapter H—Internal Revenue Practice).

The OMB control numbers for Title 26 appear in § 602.101 of this chapter. For the convenience of the user, § 602.101 appears in the Finding Aids section of the volumes containing parts 1 to 599.

For this volume, Michele Bugenhagen was Chief Editor. The Code of Federal Regulations publication program is under the direction of John Hyrum Martinez, assisted by Stephen J. Frattini.

Title 26—Internal Revenue

(This book contains part 1, §§ 1.401 to 1.440)

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Additional supplementary publications are issued covering *Alcohol and Tobacco Tax Regulations, and Regulations Under Tax Conventions.*

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DEFERRED COMPENSATION, ETC.

PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

§ 1.410(a)–1 Minimum participation standards; general rules.

(a) *In general.* A plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) unless the plan satisfies—

(1) The minimum age and service requirements of section 410(a)(1) and § 1.410(a)–3,

(2) The maximum age requirements of section 410(a)(2) and § 1.410(a)–4, and

(3) The minimum coverage requirements of section 410(b)(1) and § 1.410(b)–1.

(b) *Organization of regulations relating to minimum participation standards*—(1) *General rules.* This section prescribes general rules relating to the minimum participation standards provided by Section 410.

(2) *Effective dates.* Section 1.410(a)–2 provides rules under section 1017 of the Employee Retirement Income Security Act of 1974 relating to effective dates under section 410.

(3) *Age and service conditions.* Section 1.410(a)–3 provides rules under section 410(a)(1) relating to minimum age and service conditions.

(4) *Maximum age and time of participation.* Section 1.410(a)–4 provides rules under section 410(a) (2) and (4) relating to maximum age and time of participation.

(5) *Year of service; breaks in service.* For rules relating to years of service and breaks in service, see 29 CFR Part 2530 (Department of Labor regulations relating to minimum standards for employee pension benefit plans). See § 1.410(a)–5 for rules under section 410(a)(3)(B) relating to seasonal industries and for certain rules under section 410(a)(5) relating to breaks in service.

(6) *Breaks in service.* Section 1.410(a)–6 provides special rules under section 1017(f) of the Employee Retirement Income Security Act of 1974 relating to amendment of break in service rules.

(7) *Elapsed time.* Section 1.410 (a)–7 provides rules under sections 410 and 411 relating to the elapsed time method of crediting years of service.

(8) *Coverage.* Section 1.410(b)–1 provides rules relating to the minimum coverage requirements provided by section 410(b)(1).

(9) *Church election.* Section 1.410(d)–1 provides rules relating to the election by a church to have participation, vesting, funding, etc., provisions apply.

(c) *Application of participation standards to certain plans*—(1) *General rule.* Except as provided in subparagraph (2) of this paragraph, section 410 does not apply to—

(i) A governmental plan (within the meaning of section 414(d) and the regulations thereunder),

(ii) A church plan (within the meaning of section 414(e) and the regulations thereunder) which has not made the election provided by section 410(d) and the regulations thereunder,

(iii) A plan which has not provided for employer contributions at any time after September 2, 1974, and

(iv) A plan established and maintained by a society, order, or association described in section 501(c) (8) or (9), if no part of the contributions to or under such plan are made by employers of participants in such plan.

(2) *Participation requirements.* A plan described in subparagraph (1) of this paragraph shall, for purposes of section 401(a), be treated as meeting the requirements of section 410 if such plan meets the coverage requirements resulting from the application of section 401(a)(3) as in effect on September 1, 1974. Such coverage requirements include the rules in § 1.410(b)–1(d) (special rules relating to minimum coverage requirements), that interpret statutory provisions substantially identical to section 401(a)(3) as in effect on September 1, 1974. In applying the rules of that paragraph (d) to plans described in this paragraph (c) employees whose principal duties consist in supervising the work of other employees shall be treated as officers, shareholders, and highly compensated employees.

(d) *Supersession.* Section 11.410(a)–1 through 11.410(d)–1 inclusive, of the Temporary Income Tax Regulation under the Employee Retirement Income Security Act of 1974 are superseded by this section and §§ 1.410(a)–2 through 1.410(d)–1.

(Sec. 410 (88 Stat. 898; 26 U.S.C. 410))

[T.D. 7508, 42 FR 47193, Sept. 20, 1977, as amended by T.D. 7703, 45 FR 40980, June 17, 1980; T.D. 7735, 45 FR 74722, Nov. 12, 1980]

§ 1.410(a)–2 Effective dates.

(a) *Plans not in existence on January 1, 1974.* Under section 1017(a) of the Employee Retirement Income Security Act of 1974, in the case of a plan which was not in existence on January 1, 1974, section 410 and the regulations thereunder apply for plan years beginning after September 2, 1974. See paragraph (c) of this section for time plan is considered in existence.

(b) *Plans in existence on January 1, 1974.* Under section 1017(b) of the Employee Retirement Income Security Act of 1974, in the case of a plan which was in existence on January 1, 1974, section 410 and the regulations thereunder apply for plan years beginning after December 31, 1975. See paragraph (c) of this section for time plan is considered to be in existence.

(c) *Time of plan existence*—(1) *General rule.* For purposes of this section, a plan is considered to be in existence on a particular day if—

(i) The plan on or before that day was reduced to writing and adopted by the employer (including, in the case of a corporate employer, formal approval by the employer's board of directors and, if required, shareholder), even though no amounts had been contributed under the plan as of such day, and

(ii) The plan was not terminated on or before that day.

(2) *Collectively bargained plan.* Notwithstanding subparagraph (1) of this paragraph, a plan described in section 413(a), relating to a plan maintained pursuant to a collective bargaining agreement, is considered to be in existence on a particular day if—

(i) On or before that day there is a legally enforceable agreement to establish such a plan signed by the employer, and

(ii) The employer contributions to be made to the plan are set forth in the agreement.

(3) *Special rule.* If a plan is considered to be in existence on January 1, 1974, under subparagraph (1) of this paragraph, any other plan with which such existing plan is merged or consolidated shall also be considered to be in existence on such date.

(d) *Certain existing plans may elect new provisions*—(1) *In general.* The plan administrator (as defined in section 414(g)) of a plan that was in existence on January 1, 1974, may elect to have the provisions of the Code relating to participation, vesting, funding, and

form of benefit (as in effect from time to time) apply to a plan year selected by the plan year selected by the plan administrator which begins after September 2, 1974, but before the otherwise applicable effective dates determined under section 1017 (b) or (c), 1021, or 1024 of the Employee Retirement Income Security Act of 1974, and to all subsequent plan years. The provisions referred to are the amendments to the Code made by sections 1011, 1012, 1013, 1015, 1016(a) (1) through (11) and (13) through (27), 1021, and 1022(b) of the Employee Retirement Income Security Act of 1974.

(2) *Election is irrevocable.* Any election made under this paragraph, once made shall be irrevocable.

(3) *Procedure and time for making election.* An election under this paragraph shall be made by attaching a statement to either the annual return required under section 6058(a) (or an amended return) with respect to the plan which is filed for the first plan year for which the election is effective or to a written request for a determination letter relating to the qualification of the plan under section 401(a), 403(a), or 405(a) of the Code and, if trusteed, the exempt status under section 501(a) of the Code of a trust consituting a part of the plan. If the election is made with a written request for a determination letter, the election may be conditioned upon issuance of a favorable determination letter and will become irrevocable upon issuance of such letter. The statement shall indicate that the election is made under section 1017(d) of the Employee Retirement Income Security Act of 1974 and the first plan year for which the election is effective.

(e) *Examples.* The rules of this section are illustrated by the following examples:

Example 1. A plan is adopted on January 2, 1974, effective as of Janurary 1, 1974. The plan is not considered to have been in existence on Janurary 1, 1974.

Example 2. A plan was in existence on January 1, 1974, and was amended on November 1, 1974, to increase benefits. The fact that the plan was amended is not relevant and the amended plan is considered to be in existence on January 1, 1974.

Example 3. (i) A subsidiary business corporation is a member of a controlled group of corporations within the meaning of IRC section 1563(a). On November 1, 1974, the plan of the parent corporation is amended to provide coverage for employees of the subsidiary corporation. This amendment of the parent corporation's plan does not affect the effective date of section 410 with respect to the parent corporation's plan. No distinction is made for this purpose between employees of the parent corporation and employees of the subsidiary corporation.

(ii) If the subsidiary adopted a separate plan on November 1, 1974, under paragraph (a) of this section, section 410 would apply to that plan for its first plan year beginning after September 2, 1974. However, the adoption of a different plan by the subsidiary would not affect the time section 410 applies to the plan of the parent corporation. If, instead of adopting its own separate plan, the subsidiary merely executed an adoption agreement under the terms of the parent plan providing that a subsidiary, upon the execution of an adoption agreement, will become part of the parent plan, the effective date of section 410 with respect to such plan will not be affected by the adoption of the plan by the subsidiary.

(Sec. 410 (88 Stat. 898; 26 U.S.C. 410))

[T.D. 7508, 42 FR 47194, Sept. 20, 1977]

§ 1.410(a)–3 Minimum age and service conditions.

(a) *General rule.* Except as provided by paragraph (b) or (c) of this section, a plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) if the plan requires, as a condition of participation in the plan, that an employee complete a period of service with the employer or employers maintaining the plan extending beyond the later of—

(1) *Age 25.* The date on which the employee attains the age of 25; or

(2) *One year of service.* The date on which the employee completes 1 year of service.

(b) *Special rule for plan with 3-year 100 percent vesting.* A plan which provides that after not more than 3 years of service each participant's right to his accrued benefit under the plan is completely nonforfeitable (within the meaning of section 411 and the regulations thereunder) at the time such benefit accrues satisfies the requirements of paragraph (a) of this section if the period of service required by the plan as a condition of participation does not extend beyond the later of—

(1) *Age 25.* The date on which the employee attains the age of 25; or

(2) *Three years of service.* The date on which the employee completes 3 years of service.

(c) *Special rule for employees of certain educational institutions.* A plan maintained exclusively for employees of an educational institution (as defined in section 170(b)(1)(A)(ii)) by an employer exempt from tax under section 501(a) which provides that after 1 year of service each participant's right to his accrued benefit under the plan is completely nonforfeitable (within the meaning of section 411 and the regulations thereunder) at the time such benefit accrues satisfies the requirements of paragraph (a) of this section if the period of service required by the plan as a condition of participation does not extend beyond the later of—

(1) *Age 30.* The date on which the employee attains the age of 30; or

(2) *One year of service.* The date on which the employee completes 1 year of service.

(d) *Other conditions.* Section 410(a), § 1.410(a)–4, and this section relate solely to age and service conditions and do not preclude a plan from establishing conditions, other than conditions relating to age or service, which must be satisfied by plan participants. For example, such provisions would not preclude a qualified plan from requiring, as a condition of participation, that an employee be employed within a specified job classification. See section 410(b) and the regulations thereunder for rules with respect to coverage of employees under qualified plans.

(e) *Age and service requirements*—(1) *General rule.* For purposes of applying the rules of this section, plan provisons may be treated as imposing age or service requirements even though the provisions do not specifically refer to age or service. Plan provisions which have the effect of requiring an age or service requirement with the employer or employers maintaing the plan will be treated as if they imposed an age or service requirement. In general, a plan under which an employee cannot participate unless he retires will impose an age and service requirement. However, a plan may provide benefits which supplement benefits provided for employees covered under a pension plan, as defined in section 3(2) of the Employee Retirement Income Security Act of 1974, satisfying the requirements of section 410(a)(1) without violating the age and service rules.

(2) *Examples.* The rules of this paragraph are illustrated by the following examples:

Example 1. Corporation A is divided into two divisions. In order to work in division 2 an employee must first have been employed in division 1 for 5 years. A plan provision which required division 2 employment for participation will be treated as a service requirement because such a provision has the effect of requiring 5 years of service.

Example 2. Plan B requires as a condition of participation that each employee have had a driver's license for 15 years or more. This provision will be treated as an age requirement because such a provision has the effect of requiring an employee to attain a specified age.

Example 3. A plan which requires 1 year of service as a condition of participation also excludes a part-time or seasonal employee if his customary employment is for not more than 20 hours per week or 5 months in any plan year. The plan does not qualify because the provision could result in the exclusion by reason of a minimum service requirement of an employee who has completed a year of service. The plan would not qualify even though after excluding all such employees, the plan satisfied the coverage requirements of section 410(b).

Example 4. Employer A establishes a plan which covers employees after they retire and does not cover current employees unless they retire. Any employee who works past age 60 is treated as retired. The plan fails to satisfy the requirements of section 410(a) because the plan imposes a minimum age and service requirement in excess of that allowed by this section.

Example 5. Employer B establishes plan X, which provides that employees covered by qualified plan Y will receive benefits supplementing their benefits under plan Y to take into account cost of living increases after retirement. Plan X is not treated as imposing an age of service requirement.

Example 6. Employer C establishes a qualified plan satisfying the minimum age and service requirements. At a later time, entry into the plan is frozen so that employees not covered at that time cannot participate in the plan. The limitation on new participants is not treated as imposing a minimum age and service requirement.

(Sec. 410 (88 Stat. 898; 26 U.S.C. 410))

[T.D. 7508, 42 FR 47194, Sept. 20, 1977]

§ 1.410(a)–3T Minimum age and service conditions (temporary).

(a) [Reserved]

(b) *Special rule for plan with 2-year 100 percent vesting.* A plan which provides that after not more than 2 years of service each participant's right to his or her accrued benefit under the plan is completely nonforeitable (within the meaning of section 411 and the regulations thereunder) at the time such benefit accrues satisfies the requirements of paragraph (a) of this section if the period of service required by the plan as a condition of participation does not extend beyond the later of—

(1) [Reserved]

(2) *Two years of service.* The date on which the employee completes 2 years of service. For employees not described in § 1.411(a)–3T(e)(1), which describes employees with one hour of service in any plan year beginning after December 31, 1988, or later in the case of certain collectively bargained plans, the preceding sentence shall be applied by substituting ''3 years of service'' for ''2 years of service''.

[T.D. 8170, 53 FR 239, Jan. 6, 1988]

§ 1.410(a)–4 Maximum age conditions and time of participation.

(a) *Maximum age conditions*—(1) *General rule.* A plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) if the plan excludes from participation (on the basis of age) an employee who has attained an age specified by the plan unless—

(i) The plan is a defined benefit plan or a target benefit plan, and

(ii) The employee begins employment with the employer after the employee has attained an age specified by the plan, which age is not more than 5 years before normal retirement age (within the meaning of section 411(a)(8) and § 1.411(a)–7.

For purposes of this paragraph, a target benefit plan is a defined contribution plan under which the amount of employer contributions allocated to each participant is determined under a plan formula which does not allow employer discretion and on the basis of the amount necessary to provide a target benefit specified by the plan for such participant. Such target benefit must be the type of benefit which is provided by a defined benefit plan and the targeted benefit must not discriminate in favor of employees who are officers, shareholders, or highly compensated. For purposes of this paragraph, in the determination of the time an employee begins employment, any such time which is included in a period of service which may be disregarded under the break in service rules need not be taken into account.

(2) *Examples.* The rules provided by this paragraph are illustrated by the following examples:

Example 1. A defined benefit plan provides that an employee will become a participant upon completion of 3 years of service if at such time the employee is less than age 60. The normal retirement age under the plan is age 65. The plan also provides full and immediate vesting for each of the plan's participants. Under the plan, an employee hired at age 58 would be denied participation on account of service for the first 3 years and on account of maximum age for the remaining years even though the employee was hired more than 5 years prior to the normal retirement date. The plan therefore does not satisfy section 410(a)(2).

Example 2. A defined benefit plan provides a normal retirement age of the later of age 65 or completion of 10 years of service. Because no employee could ever be hired within 5 years of his normal retirement age, the plan could not exclude employees for being over a specified age.

Example 3. Prior to the effective date of section 410, a defined benefit plan with a normal retirement age of 65 contained a maximum age 55 requirement for participation. Because of the maximum age requirement, and employee hired at age 58 was excluded from the plan. This employee is age 61 at the time that section 410 first applies to the plan. The employee cannot be excluded from participation because of age. The exclusion under section 410(a)(2) is not applicable in this instance because the employee's age at the time of hire, 58, was not within 5 years of the normal retirement age specified in the plan.

Example 4. Employee A was hired at age 50 and participated in a defined benefit plan until separating from service at age 55 with 5 years of service and with no vested benefit. At age 61, employee A was rehired within 5 years of the normal retirement age of 65 after he incurred 6 consecutive breaks in service. Because A's consecutive number of 1-year breaks (6) exceeds his years of service prior to such breaks (5), his service before

the breaks may be disregarded. Consequently, A's initial employment date falling within such period may be disregarded and the plan could exclude A on account of his age because his employment commenced within 5 years of normal retirement age.

(b) *Time of participation*—(1) *General rule*. A plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) unless under the plan any employee who has satisfied the applicable minimum age and service requirements specified in §1.410(a)–3, and who is otherwise entitled to participate in the plan, commences participation in the plan no later than the earlier of—

(i) The first day of the first plan year beginning after the date on which such employee first satisfied such requirements, or

(ii) The date 6 months after the date on which he first satisfied such requirements,

unless such employee was separated from service and has not returned before the date referred to in subdivision (i) or (ii), whichever is applicable. If such separated employee returns to service after either of such dates without incurring a 1-year break in service, the employee must commence participation immediately upon his return. In the case of a plan using the elapsed time method described in §1.410(a)–7, such an employee who has a period of absence commencing before the date referred to in subdivision (i) or (ii) (whichever is applicable) must commence participation as of such applicable date no later than the date such absence ended. However, if an employee's prior service is disregarded on account of the plan's break-in-service rules then, for purposes of this subparagraph, such service is also disregarded for purposes of determining the date on which such employee first satisfied the minimum age and service requirements.

(2) *Examples*. The rules provided by this paragraph are illustrated by the following examples:

Example 1. A calendar year plan provides that an employee may enter the plan only on the first semi-annual entry date, January 1 or July 1, after he has satisfied the applicable minimum age and service requirements specified in section 410(a)(1). The plan satisfies the requirements of this paragraph because an employee is eligible to participate no later than the earlier of (1) the first day of the first plan year beginning after he satisfied the applicable minimum age and service requirements, or (2) the date 6 months after he satisfied such requirements.

Example 2. A plan provides that an employee is not eligible to participate until the first day of the first plan year beginning after he has satisfied the minimum age and service requirements of section 410(a)(1). In this case, an employee who satisfies the ''6 month'' rule described in subparagraph (1) of this paragraph will not be eligible to participate in the plan. Therefore, the plan does not satisfy the requirements of this paragraph.

Example 3. A calendar year plan provides that an employee may enter the plan only on the first semi-annual entry date, January 1 or July 1, after he has satisfied the applicable minimum age and service requirements specified in section 410(a)(1). Employee A after 10 years of service separated from service in 1976 with a vested benefit. On February 1, 1990, A returns to employment covered by the plan. Assuming A completes a year of service after his return, A must participate immediately on his return, February 1. A's prior service cannot be disregarded, because he had a vested benefit when he separated from service. Therefore, the plan may not postpone his participation until July 1.

Example 4. Assume the same facts as in example (3). The plan has the break-in-service rule described in section 410(a)(5)(D) and §1.410(a)–5(c)(4). Employee B, after he had 5 years of service but no vested benefit incurs 5 consecutive 1-year breaks. Because B's prior service can be disregarded, the plan may postpone B's participation in the plan under the rule described in section 410(a)(4) and this paragraph.

(Sec. 410 (88 Stat. 898; 26 U.S.C. 410))

[T.D. 7508, 42 FR 47195, Sept. 20, 1977, as amended by T.D. 7703, 45 FR 40980, June 17, 1980]

§1.410(a)–5 Year of service; break in service.

(a) *Year of service*. For the rules relating to years of service under subparagraphs (A), (C), and (D) of section 410(a)(3), see regulations prescribed by the Secretary of Labor under 29 CFR Part 2530, relating to minimum standards for employee pension benefit plans.

Rules relating to a general rule for a year of service, hours of service, and maritime industries apply for purposes of section 410(a) and the regulations thereunder.

(b) *Seasonal industries*. For rules which relate to seasonal industries under section 410(a)(3)(B), see regulations prescribed by the Secretary of Labor under 29 CFR Part 2530, relating to minimum standards for employee pension benefits plans.

(c) *Breaks in service*—(1) *General rule*. This paragraph provides rules with respect to breaks in service under section 410(a)(5). Except as provided in subparagraphs (2), (3), (4), and (5) of this paragraph, all of an employee's years of service with the employer or employers maintaining a plan are taken into account in computing his period of service under the plan for purposes of section 410(a)(1) and § 1.410(a)–3.

(2) *Employees under 3-year 100 percent vesting schedule—(* i) *General rule*. In the case of an employee who incurs a 1-year break in service under a plan which provides that after not more than 3 years of service, each participant's right to his accrued benefit under the plan is completely nonforfeitable (within the meaning of section 411 and the regulations thereunder) at the time such benefit accrues, the employee's service before the break in service is not required to be taken into account after the break in service in determining the employee's years of service under section 410(a)(1) and § 1.410(a)-3 if such employee has not satisfied such service requirement.

(ii) *Example*. The rules of this subparagraph are illustrated by the following example.

Example. A qualified plan computing service by the actual counting of hours provides full and immediate vesting. The plan can not require as a condition of participation that an employee complete 3 consecutive years of service with the employer because the requirement as to consecutive years is not permitted under section 410(a) (5). However, such a plan can require 3 years without a break in service, i.e., 3 years with no intervening years in which the employee fails to complete more than 500 hours of service. Under a plan containing such a participation requirement, the following example illustrates when employees whould become eligible to participate.

Year	Hours of service completed		
	Employee A	Employee B	Employee C
1	1,000	1,000	1,000
2	1,000	1,000	500
3	1,000	700	1,000
4	1,000	1,000	700
5	1,000	1,000	1,000
6	1,000	1,000	1,000

NOTE. Employee A will have satisfied the plan's service requirement at the end of year 3. Employee B at the end of year 4, and Employee C at the end of year 6.

(3) *One-year break in service*—(i) *In general*. In computing the period of service of an employee who has incurred a 1-year break in service, for purposes of section 410(a)(1) and § 1.410(a)–3, a plan may disregard the employee's service before the break until the employee completes a year of service after such break in service.

(ii) *Examples*. The rules provided by this subparagraph are illustrated by the following examples.

Example 1. Employee A completes a year of service under a plan computing service by the actual counting of hours for the 12-month period ending December 31, 1980, and incurs a 1-year break in service for the 12-month period ending December 31, 1981. The plan does not contain the provisions permitted by section 410(a)(5)(B) (relating to 3-year 100 percent vesting) and section 410(a)(5)(D) (relating to nonvested participants). Thereafter, he does not complete a year of service. As of January 1, 1982, in computing his period of service under the plan his service prior to December 31, 1981, is not required to be taken into account for purposes of section 410(a)(1) and § 1.410 (a)–3.

Example 2. The employee in example (1) completes a year of service for the 12-month period ending December 31, 1982. Prior to December 31, 1982, in computing the employee's period of service as of any date occurring in 1982, the employee's service before December 31, 1981, is not required to be taken into account for purposes of section 410(a)(1) and § 11.410(a)–3. Because the employee completed a year of service for the 12-month period ending December 31, 1982, however, his period of service is redetermined as of January 1, 1982. Upon completion of a year of service for 1982, the employee's period of service, determined as of any date occurring in 1982, includes service prior to December 31, 1981.

(4) *Nonvested participants*—(i) *General rule*. In the case of a participant in a plan who does not have any nonforfeitable right under the plan to his employer-derived accrued benefit and who incurs a 1-year break in service, for

purposes of section 410(a)(1) and §1.410.(a)–3 the plan may disregard his years of service prior to such break if the number of his consecutive 1-year breaks in service equals or exceeds his aggregate number of years of service prior to such break. In the case of a plan using the elapsed time method described in Department of Labor regulations, the plan may disregard such years of service prior to such break if the period of severance is at least 1 year and the period of severance equals or exceeds the prior period of service, whether or not consecutive, completed before such period of severance. The plan may in computing such aggregate number of years of service prior to such break disregard any years of service which could have been disregarded under this subparagraph by reason of any prior break in service.

(ii) *Examples*. The rules of this subparagraph are illustrated by the following example:

Example. In 1980, A, who was hired at age 35, separates from the service of X Corporation after completing 4 years of service. At this time A had no vested benefits. In 1985, after incurring 5 consecutive one-year breaks in service, A was reemployed. Under section 410(a)(5)(D), A's 4 years of service may be disregarded because they are exceeded by the number of years of consecutive one-year breaks (5) after such service.

(d) *Special continuity rule for certain plans*. For special rules for computing years of service in the case of a plan maintained by more than one employer, see regulations prescribed by the Secretary of Labor under 29 CFR Part 2530, relating to minimum standards for employee pension benefit plans.

(Sec. 410 (88 Stat. 898; 26 U.S.C. 410))

[T.D. 7508, 42 FR 47196, Sept. 20, 1977; T.D. 7508, 42 FR 57123, Nov. 1, 1977, as amended by T.D. 7703, 45 FR 40980, June 17, 1980]

§ 1.410(a)–6 Amendment of break in service rules; Transition period.

(a) *In general*. Under section 1017(f) (1) of the Employee retirement Income Security Act of 1974, a plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) if the rules of the plan relating to breaks in service are amended, and—

(1) Such amendment is effective after January 1, 1974, and before the date on which section 410 becomes applicable to the plan, and

(2) Under such amendment, any employee's participation in the plan commences at any date later than the later of—

(i) The date on which his participation would commence under the break in service rules of section 410(a)(5), or

(ii) The earliest date on which his participation would commence under the plan as in effect on or after January 1, 1974.

(b) *Break in service rules*. For purposes of paragraph (a), the term ''break in service rules'' means the rules provided by a plan relating to circumstances under which a period of an employee's service or plan participation is disregarded for purposes of determining his rights to participate in the plan, if under such rules such service is disregarded by reason of the employee's failure to complete a required period of service within a specified period of time.

(Sec. 410 (88 Stat. 898; 26 U.S.C. 410))

[T.D. 7508, 42 FR 47197, Sept. 20, 1977; 43 FR 2721, Jan. 19, 1978]

§ 1.410(a)–7 Elapsed time.

(a) *In general*—(1) *Introduction to elapsed time method of crediting service*. (i) 29 CFR 2530.200b–2 sets forth the general method of crediting service for an employee. The general method is based upon the actual counting of hours of service during the applicable 12-consecutive-month computation period. The equivalencies set forth in 29 CFR 2530.200b–3 are also methods for crediting hours of service during computation periods. Under the general method and the equivalencies an employee receives a year's credit (in units of years of service or years of participation) for a computation period during which the employee is credited with a specified number of hours of service. In general, an employee's statutory entitlement with respect to eligibility to participate, vesting and benefit accrual is determined by totalling the number of years' credit to which an employee is entitled.

(ii) Under the alternative method set forth in this section, by contrast, an employee's statutory entitlement with respect to eligibility to participate, vesting and benefit accrual is not based upon the actual completion of a specified number of hours of service during a 12-consecutive-month period. Instead, such entitlement is determined generally with reference to the total period of time which elapses while the employee is employed (i.e., while the employment relationship exists) with the employer or employers maintaining the plan. The alternative method set forth in this section is designed to enable a plan to lessen the administrative burdens associated with the maintenance of records of an employee's hours of service by permitting each employee to be credited with his or her total period of service with the employer or employers maintaining the plan, irrespective of the actual hours of service completed in any 12-consecutive-month period.

(2) *Overview of the operation of the elapsed time method.* (i) Under the elapsed time method of crediting service, a plan is generally required to take into account the period of time which elapses while the employee is employed (*i.e.,* while the employment relationship exists) with the employer or employers maintaining the plan, regardless of the actual number of hours he or she completes during such period. Under this alternative method of crediting service, an employee's service is required to be taken into account for purposes of eligibility to participate and vesting as of the date he or she first performs an hour of service within the meaning of 29 CFR 2530.200b–2 (a) (1) for the employer or employers maintaining the plan. Service is required to be taken into account for the period of time from the date the employee first performs such an hour of service until the date he or she severs from service with the employer or employers maintaining the plan.

(ii) The date the employee severs from service is the earlier of the date the employee quits, is discharged, retires or dies, or the first anniversary of the date the employee is absent from service for any other reason (e.g., disability, vacation, leave of absence, layoff, etc.). Thus, for example, if an employee quits, the severance from service date is the date the employee quits. On the other hand, if an employee is granted a leave of absence (and if no intervening event occurs), the severance from service date will occur one year after the date the employee was first absent on leave, and this one year of absence is required to be taken into account as service for the employer or employers maintaining the plan. Because the severance from service date occurs on the earlier of two possible dates (*i.e.,* quit, discharge, retirement or death *or* the first anniversary of an absence from service for any other reason), a quit, discharge, retirement or death within the year after the beginning of an absence for any other reason results in an immediate severance from service. Thus, for example, if an employee dies at the end of a four-week absence resulting from illness, the severance from service date is the date of death, rather than the first anniversary date of the first day of absence for illness.

(iii) In addition, for purposes of eligibility to participate and vesting under the elapsed time method of crediting service, an employee who has severed from service by reason of a quit, discharge or retirement may be entitled to have a period of time of 12 months or less taken into account by the employer or employers maintaining the plan if the employee returns to service within a certain period of time and performs an hour of service within the meaning of 29 CFR 2530.200b–2 (a) (1). In general, the period of time during which the employee must return to service begins on the date the employee severs from service as a result of a quit, discharge or retirement and ends on the first anniversary of such date. However, if the employee is absent for any other reason (e.g., layoff) and then quits, is discharged or retires, the period of time during which the employee may return and receive credit begins on the severance from service date and ends one year after the first day of absence (e.g., first day of layoff). As a result of the operation of these rules, a severance from service (e.g., a quit), or an absence (e.g., layoff) followed by a severance from service,

never results in a period of time of more than one year being required to be taken into account after an employee severs from service or is absent from service.

(iv) For purposes of benefit accrual under the elapsed time method of crediting service, an employee is entitled to have his or her service taken into account from the date he or she begins to participate in the plan until the severance from service date. Periods of severance under any circumstances are not required to be taken into account. For example, a participant who is discharged on December 14, 1980 and rehired on October 14, 1981 is not required to be credited with the 10 month period of severance for benefit accrual purposes.

(3) *Overview of certain concepts relating to the elapsed time method*—(i) *In general.* The rules with respect to the elapsed time method of crediting service are based on certain concepts which are defined in paragraph (b) of this section. These concepts are applied in the substantive rules contained in paragraphs (c), (d), (e), (f) and (g) of this section. The purpose of this subparagraph is to summarize these concepts.

(ii) *Employment commencement date.* (A) A concept which is necessary in order to credit service accurately under any service crediting method is the establishment of a starting point for crediting service. The employment commencement date, which is the date on which an employee first performs an hour of service within the meaning of 29 CFR 2530.200b–2 (a) (1) for the employer or employers maintaining the plan, is used to establish the date upon which an employee must begin to receive credit for certain purposes (e.g., eligibility to participate and vesting).

(B) In order to credit accurately an employee's total service with an employer or employers maintaining the plan, a plan also may provide for an ''adjusted'' employment commencement date (*i.e.*, a recalculation of the employment commencement date to reflect noncreditable periods of severance) or a reemployment commencement date as defined in paragraph (b)(3) of this section. Fundamentally, all three concepts rely upon the performance of an hour of service to provide a starting point for crediting service. One purpose of these three concepts is to enable plans to satisfy the requirements of this section in a variety of ways.

(C) The fundamental rule with respect to these concepts is that any plan provision is permissible so long as it satisfies the minimum standards. Thus, for example, although the rules of this section provide that credit must begin on the employment commencement date, a plan is permitted to ''adjust'' the employment commencement date to reflect periods of time for which service is not required to be credited. Similarly, a plan may wish to credit service under the elapsed time method as discrete periods of service and provide for a reemployment commencement date. Certain plans may wish to provide for both concepts, although it is not a requirement of this section that plans so provide.

(iii) *Severance from service date.* Another fundamental concept of the elapsed time method of crediting service is the severance from service date, which is defined as the earlier of the date on which an employee quits, retires, is discharged or dies, or the first anniversary of the first date of absence for any other reason. One purpose of the severance from service date is to provide the endpoint for crediting service under the elapsed time method. As a general proposition, service is credited from the employment commencement date (*i.e.*, the starting point) until the severance from service date (*i.e.*, the endpoint). A complementary purpose of the severance from service date is to establish the starting point for measuring a period of severance from service in order to determine a ''break in service'' (see paragraph (a)(3)(v) of this section). A third purpose of such date is to establish the starting point for measuring the period of time which may be required to be taken into account under the service spanning rules (see paragraph (a)(3)(vi) of this section).

(iv) *Period of service.* A third elapsed time concept is the use of the ''period of service'' rather than the ''year of service'' in determining service to be

taken into account for purposes of eligibility to participate, vesting and benefit accrual. For purposes of eligibility to participate and vesting, the period of service runs from the employment commencement date or reemployment commencement date until the severance from service date. For purposes of benefit accrual, a period of service runs from the date that a participant commences participation under the plan until the severance from service date. Because the endpoint of the period of service is marked by the severance from service date, an employee is credited with the period of time which runs during any absence from service (other than for reason of a quit, retirement, discharge or death) which is 12 months or less. Thus, for example, a three week absence for vacation is taken into account as part of a period of service and does not trigger a severance from service date.

(v) *Period of severance.* A period of severance begins on the severance from service date and ends when an employee returns to service with the employer or employers maintaining the plan. The purpose of the period of severance is to apply the statutory ''break in service'' rules to an elapsed time method of crediting service.

(vi) *Service spanning.* Under the elapsed time method of crediting service, a plan is required to credit periods of service and, under the service spanning rules, certain periods of severance of 12 months or less for purposes of eligibility to participate and vesting. Under the first service spanning rule, if an employee severs from service as a result of quit, discharge or retirement and then returns to service within 12 months, the period of severance is required to be taken into account. Also, a situation may arise in which an employee is absent from service for any reason other than quit, discharge, retirement or death and during the absence a quit, discharge or retirement occurs. The second service spanning rule provides in that set of circumstances that a plan is required to take into account the period of time between the severance from service date (*i.e.*, the date of quit, discharge or retirement) and the first anniversary of the date on which the employee was first absent, if the employee returns to service on or before such first anniversary date.

(4) *Organization and applicability.* (i) The substantive rules for crediting service under the elapsed time method with respect to eligibility to participate are contained in paragraph (c), the rules with respect to vesting are contained in subparagraph (d), and the rules with respect to benefit accrual are contained in paragraph (e). The format of the rules is designed to enable a plan to use the elapsed time method of crediting service either for all purposes or for any one or combination of purposes under sections 410 and 411. Thus, for example, a plan may credit service for eligibility to participate purposes by the use of the general method of crediting service set forth in 29 CFR 2530.200b–2 or by the use of any of the equivalences set forth in 29 CFR 2530.200b–3, while the plan may credit service for vesting and benefit accrual purposes by the use of the elapsed time method of crediting service.

(ii) A plan using the elapsed time method of crediting service for one or more classifications of employees covered under the plan may use the general method of crediting service set forth in 29 CFR 2530.200b–2 or any of the equivalencies set forth in 29 CFR 2530.200b–3 for other classifications of employees, provided that such classifications are reasonable and are consistently applied. Thus, for example, a plan may provide that part-time employees are credited under the general method of crediting service set forth in 29 CFR 2530.200b–2 and full-time employees are credited under the elapsed time method. A classification, however, will not be deemed to be reasonable or consistently applied if such classification is designed with an intent to preclude an employee or employees from attaining his or her statutory entitlement with respect to eligibility to participate, vesting or benefit accrual. For example, a classification applied so that any full-time employee credited with less than 1,000 hours of service during a given 12-consecutive-month period would be considered part-time and subject to the general method of crediting service rather than the

elapsed time method would not be reasonable.

(iii) Notwithstanding paragraph (a)(4)(i) and (ii) of this section, the use of the elapsed time method for some purposes or the use of the elapsed time method for some employees may, under certain circumstances, result in discrimination prohibited under section 401(a)(4), even though the use of the elapsed time method for such purposes, and for such employees, is permitted under this section.

(5) *More than one employer plans.* For special rules for computing years of service in the case of a plan maintained by more than one employer, see 29 CFR Part 2530 (Department of Labor regulations relating to minimum standards for employee pension benefit plans).

(b) *Definitions*—(1) *Employment commencement date.* For purposes of this section, the term ''employment commencement date'' shall mean the date on which the employee first performs an hour of service within the meaning of 29 CFR 2530.200b–2 (a)(1) for the employer or employers maintaining the plan.

(2) *Severance from service date.* For purposes of this section, a ''severance from service'' shall occur on the earlier of—

(i) The date on which an employee quits, retires, is discharged or dies; or

(ii) The first anniversary of the first date of a period in which an employee remains absent from service (with or without pay) with the employer or employers maintaining the plan for any reason other than quit, retirement, discharge or death, such as vacation, holiday, sickness, disability, leave of absence or layoff.

(3) *Reemployment commencement date.* For purposes of this section, the term ''reemployment commencement date'' shall mean the first date, following a period of severance from service which is not required to be taken into account under the service spanning rules in paragraphs (c)(2)(iii) and (d)(1)(iii) of this section, on which the employee performs an hour of service within the meaning of 29 CFR 2530.200b–2(a)(1) for the employer or employers maintaining the plan.

(4) *Participation commencement date.* For purposes of this section, the term ''participation commencement date'' shall mean the date a participant first commences participation under the plan.

(5) *Period of severance.* For purposes of this section, the term ''period of severance'' shall mean the period of time commencing on the severance from service date and ending on the date on which the employee again performs an hour of service within the meaning of 29 CFR 2530.200b–2(a)(1) for an employer or employers maintaining the plan.

(6) *Period of service*—(i) *General rule.* For purposes of this section, the term ''period of service'' shall mean a period of service commencing on the employee's employment commencement date or reemployment commencement date, whichever is applicable, and ending on the severance from service date.

(ii) *Aggregation rule.* Unless a plan provides in some manner for an ''adjusted'' employment commencement date or similar method of consolidating periods of service, periods of service shall be aggregated unless such periods may be disregarded under section 410(a)(5) or 411(a)(4).

(iii) *Other federal law.* Nothing in this section shall be construed to alter, amend, modify, invalidate, impair or supersede any law of the United States or any rule or regulation issued under such law. Thus, for example, nothing in this section shall be construed as denying an employee credit for a ''period of service'' if credit is required by a separate federal law. Furthermore, the nature and extent of such credit shall be determined under such law.

(c) *Eligibility to participate*—(1) *General rule.* For purposes of section 410(a)(1)(A), a plan generally may not require as a condition of participation in the plan that an employee complete a period of service with the employer or employers maintaining the plan extending beyond the later of—

(i) The date on which the employee attains the age of 25; or

(ii) The date on which the employee completes a one-year period of service. See the regulations under section 410(a) (relating to eligibility to participate).

(2) *Determination of one-year period of service.* (i) For purposes of determining

the date on which an employee satisfies the service requirement for initial eligibility to participate under the plan, a plan using the elapsed time method of crediting service shall provide that an employee who completes the 1-year period of service requirement on the first anniversary of his employment commencement date satisfies the minimum service requirement as of such date. In the case of an employee who fails to complete a one-year period of service on the first anniversary of his employment commencement date, a plan which does not contain a provision permitted by section 410(a)(5)(D) (rule of parity) shall provide for the aggregation of periods of service so that a one-year period of service shall be completed as of the date the employee completes 12 months of service (30 days are deemed to be a month in the case of the aggregation of fractional months) or 365 days of service.

(ii) For purposes of section 410(a)(1)(B)(i), a ''3-year period of service'' shall be deemed to be ''3 years of service.''

(iii) *Service spanning rules.* In determining a 1-year period of service for purposes of initial eligibility to participate and a period of service for purposes of retention of eligibility to participate, in addition to taking into account an employee's period of service, a plan shall take into account the following periods of severance—

(A) If an employee severs from service by reason of a quit, discharge or retirement and the employee then performs an hour of service within the meaning of 29 CFR 2530.200b–2(a)(1) within 12 months of the severance from service date, the plan is required to take into account the period of severance; and

(B) Notwithstanding paragraph (c)(2)(iii)(A) of this section, if an employee severs from service by reason of a quit, discharge or retirement during an absence from service of 12 months or less for any reason other than a quit, discharge, retirement or death, and then performs an hour of service within the meaning of 29 CFR 2530.200b–2(a)(1) within 12 months of the date on which the employee was first absent from service, the plan is required to take into account the period of severance.

(iv) For purposes of determining an employee's retention of eligibility to participate in the plan, a plan shall take into account an employee's entire period of service unless certain periods of service may be disregarded under section 410(a)(5) of the Code.

(v) *Example.* Employee W, age 31, completed 6 months of service and was laid off. After 2 months of layoff, W quit. Five months later, W returned to service. For purposes of eligibility to participate, W was required to be credited with 13 months of service (8 months of service and 5 months of severance). If, on the other hand, W had not returned to service within the first 10 months of severance (*i.e.*, within 12 months after the first day of layoff), W would be required to be credited with only 8 months of service.

(3) *Entry date requirements*—(i) *General rule.* For purposes of section 410(a)(4), it is necessary for a plan to provide that any employee who has satisfied the minimum age and service requirements, and who is otherwise entitled to participate in the plan, commences participation in the plan no later than the earlier of—

(A) The first day of the first plan year beginning after the date on which such employee satisfied such requirements, or

(B) The date six months after the date on which he satisfied such requirements, unless such employee was separated from service before the date referred to in subdivision (i) (A) or (B), whichever is applicable. See the regulations under section 410(a) (relating to eligibility to participate).

(ii) *Separation from service*—(A) *Definition.* For purposes of this section, the term ''separated from service'' includes a severance from service or an absence from service for any reason other than a quit, discharge, retirement or death, regardless of the duration of such absence. Accordingly, if an employee is laid off for a period of six weeks, the employee shall be deemed to be ''separated from service'' during such period for purposes of the entry date requirements.

(B) *Application.* A period of severance which is taken into account under the

service spanning rules in paragraph (c)(2)(iii) of this section or an absence of 12 months or less may result in an employee satisfying the plan's minimum service requirement during such period of time. In addition, once an employee satisfies the plan's minimum service requirement, either before or during such period of time, such period of time may contain an entry date applicable to such employee. In the case of an employee whose period of severance is taken into account and such period contains an entry date applicable to the employee, he or she shall be made a participant in the plan (if otherwise eligible) no later than the date on which he or she ended the period of severance. In the case of an employee whose period of absence contains an entry date applicable to such employee, he or she, no later than the date such absence ended, shall be made a participant in the plan (if otherwise eligible) as of the first applicable entry date which occurred during such absence from service.

(iii) *Examples*. For purposes of the following examples, assume that the plan provides for a minimum age requirement of 25 and a minimum service requirement of one year, and provides for semi-annual entry dates.

(A) Employee A, age 35, worked for 10 months in a job classification covered under the plan, became disabled for nine consecutive months and then returned to service. During the period of absence, A completed a 1-year period of service and passed a semi-annual entry date after satisfying the minimum service requirement. Accordingly, the plan is required to make A a participant no later than his return to service effective as of the applicable entry date.

(B) Employee B, after satisfying the minimum age and service requirements, quit work before the next semi-annual entry date, and then returned to service before incurring a 1-year period of severance, but after such semi-annual entry date. Employee B is entitled to become a participant immediately upon his return to service effective as of the date of his return.

(4) *Break in service*. For purposes of applying the break in service rules under section 410(a)(5) (B) and (C), the term ''1-year period of severance'' shall be substituted for the term ''1-year break in service''. A 1-year period of severance shall be determined on the basis of a 12-consecutive-month period beginning on the severance from service date and ending on the first anniversary of such date, provided that the employee during such 12-consecutive-month period does not perform an hour of service within the meaning of 29 CFR 2530.200b–2(a)(1) for the employer or employers maintaining the plan.

(5) *One-year hold-out*—(i) *General rule*. (A) For purposes of section 410(a)(5)(C), in determining the period of service of an employee who has incurred a 1-year period of severance, a plan may disregard the employee's period of service before such period of severance until the employee completes a 1-year period of service after such period of severance.

(B) *Example*. Assume that a plan provides for a minimum service requirement of 1-year and provides for semi-annual entry dates, but does not contain the provisions permitted by section 410(a)(5)(D) (relating to the rule of parity). Employee G, age 40, completed a seven-month period of service, quit and then returned to service 15 months later, thereby incurring a 1-year period of severance. After working four months, G was laid off for nine months and then returned to work again. Although the plan may hold employee G out from participation in the plan until the completion of a 1-year period of service after the 1-year (or greater) period of severance, once the 1-year hold-out is completed, the plan is required to provide the employee with such statutory entitlement as arose during the 1-year hold-out. Accordingly, employee G satisfied the 1-year hold-out requirement as of the eighth month of layoff, and G is entitled to become a participant in the plan immediately upon his return to service after the nine-month layoff effective as of the first applicable entry date occurring after the date on which he satisfied the 1-year of service requirement (*i.e.*, the first applicable entry date after the first month of layoff). See the regulations under section 410 (a) (relating to eligibility to participate).

(6) *Rule of parity*—(i) *General rule*. For purposes of section 410(a)(5)(D), in the case of a participant who does not have any nonforfeitable right under the plan to his accrued benefit derived from employer contributions and who incurs a 1-year period of severance, a plan, in determining an employee's period of service for purposes of section 410(a)(1), may disregard his period of service if his latest period of severance equals or exceeds his prior periods of service, whether or not consecutive, completed before such period of severance. See the regulations under section 410(a) (relating to eligibility to participate).

(ii) In determining whether a completely nonvested employee's service may be disregarded under the rule of parity, a plan is not permitted to apply the rule until the employee incurs a 1-year period of severance. Accordingly, a plan may not disregard a period of service of less than one year until an employee has incurred a period of severance of at least one year.

(iii) *Example*. Assume that a plan provides for a minimum service requirement of one year and provides for the rule of parity. An employee works for three months, quits and then is rehired 10 months later. Such employee is entitled to receive 13 months of credit for purposes of eligibility to participate and vesting (see the service spanning rules). Although the period of severance exceeded the period of service, the three months of service may not be disregarded because no 1-year period of severance occurred.

(d) *Vesting*—(1) *General rule*. (i) For purposes of section 411(a)(2), relating to vesting in accrued benefits derived from employer contributions, a plan which determines service to be taken in account on the basis of elapsed time shall provide that an employee is credited with a number of years of service equal to at least the number of whole years of the employee's period of service, whether or not such periods of service were completed consecutively.

(ii) In order to determine the number of whole years of an employee's period of service, a plan shall provide that non-successive periods of service must be aggregated and that less than whole year periods of service (whether or not consecutive) must be aggregated on the basis that 12 months of service (30 days are deemed to be a month in the case of the aggregation of fractional months) or 365 days of service equal a whole year of service.

(iii) *Service spanning rules*. In determining a participant's period of service for vesting purposes, a plan shall take into account the following periods of severance—

(A) If an employee severs from service by reason of a quit, discharge or retirement and the employee then performs an hour of service within the meaning of 29 CFR 2530.200b–2(a)(1) within 12 months of the severance from service date, the plan is required to take into account the period of severance; and

(B) Nothwithstanding paragraph (d)(1)(iii)(A) of this section, if an employee severs from service by reason of a quit, discharge or retirement during an absence from service of 12 months or less for any reason other than a quit, discharge, retirement or death, and then performs an hour of service within the meaning of 29 CFR 2530.200b–2(a)(1) within 12 months of the date on which the employee was first absent from service, the plan is required to take into account the period of severance.

(iv) For purposes of determining an employee's nonforfeitable percentage of accrued benefits derived from employer contributions, a plan, after calculating an employee's period of service in the manner prescribed in this paragraph, may disregard any remaining less than whole year, 12-month or 365-day period of service. Thus, for example, if a plan provides for the statutory five to fifteen year graded vesting, an employee with a period (or periods) of service which yield 5 whole year periods of service and an additional 321-day period of service is twenty-five percent vested in his or her employer-derived accrued benefits (based solely on the 5 whole year periods of service).

(2) *Service which may be disregarded*. (i) For purposes of section 411(a)(4), in determining the nonforfeitable percentage of an employee's right to his or her accrued benefits derived from employer contributions, all of an employee's period or periods of service with an employer or employers maintaining the plan shall be taken into account

unless such service may be disregarded under paragraph (d)(2)(ii) of this section.

(ii) For purposes of paragraph (d)(2)(i) of this section, the following periods of service may be disregarded—

(A) The period of service completed by an employee before the date on which he attains age 22;

(B) In the case of a plan which requires mandatory employee contributions, the period of service which falls within the period of time to which a particular employee contribution relates, if the employee had the opportunity to make a contribution for such period of time and failed to do so;

(C) The period of service during any period for which the employer did not maintain the plan or a predecessor plan;

(D) The period of service which is not required to be taken into account by reason of a period of severance which constitutes a break in service within the meaning of paragraph (d)(4) of this section;

(E) The period of service completed by an employee prior to January 1, 1971, unless the employee completes a period of service of at least 3 years at any time after December 31, 1970; and

(F) The period of service completed before the first plan year for which this section applies to the plan, if such service would have been disregarded under the plan rules relating to breaks in service in effect at that time. See the regulations under section 411(a) (relating to vesting).

(3) *Seasonal industry*. [Reserved]

(4) *Break in service*. For purposes of applying the break in service rules, the term ''1-year period of severance'' shall be substituted for the term ''1-year break in service''. A 1-year period of severance shall be a 12-consecutive-month period beginning on the severance from service date and ending on the first anniversary of such date, provided that the employee during such 12-consecutive-month period fails to perform an hour of service within the meaning of 29 CFR 2530.200b–2(a)(1) for an employer or employers maintaining the plan.

(5) *One-year hold-out*. For purposes of section 411(a)(6)(B), in determining the nonforfeitable percentage of the right to accrued benefits derived from employer contributions of an employee who has incurred a 1-year period of severance, the period of service completed before such period of severance is not required to be taken into account until the employee has completed a 1-year period of service after his return to service. See the regulations under section 411(a) (relating to vesting).

(6) *Vesting in pre-break accruals*. For purposes of section 411(a)(6)(C), a ''1-year period of severance'' shall be deemed to constitute a ''1-year break in service.'' See the regulations under section 411(a) (relating to vesting).

(7) *Rule of partity*—(i) *General rule*. For purposes of section 411(a)(6)(D), in the case of an employee who is a nonvested participant in employer-derived benefits at the time he incurs a 1-year period of severance, the period of service completed by such participant before such period of severance is not required to be taken into account for purposes of determining the vested percentage of his or her right to employer-derived benefits if at such time the consecutive period of severance equals or exceeds his prior periods of service, whether or not consecutive, completed before such period of severance. See the regulations under section 411(a) (relating to vesting).

(e) *Benefit accrual*. (1) For purposes of section 411(b), a plan may provide that a participant's service with an employer or employers maintaining the plan shall be determined on the basis of the participant's total period of service beginning on the participation commencement date and ending on the severance from service date.

(2) Under section 411(b)(3)(A), a defined benefit pension plan may determine an employee's service for purposes of benefit accrual on any basis which is reasonable and consistent and which takes into account all service during the employee's participation in the plan which is included in a period of service required to be taken into account under section 410(a)(5) (relating to service which must be taken into account for purposes of determining an employee's eligibility to participate). A plan which provides for the determination of an employee's service with an employer or employers maintaining

the plan on the basis permitted under paragraph (e)(1) of this section will be deemed to meet the requirements of section 411(b)(3)(A), provided that the plan meets the requirements of 29 CFR 2530.204–3, relating to plans which determine an employee's service for purposes of benefit accrual on a basis other than computation periods. Specifically, under 29 CFR 2530.204–3, it must be possible to prove that, despite the fact that benefit accrual under such a plan is not based on computation periods, the plan's provisions meet at least one of the three benefit accrual rules of section 411(b)(1) under all circumstances. Further, 29 CFR 2530.204–3 prohibits such a plan from disregarding service under section 411(b)(3)(C) (which would otherwise permit a plan to disregard service performed by an employee during a computation period in which the employee is credited with less than 1,000 hours). See the regulations under section 411(b) (relating to benefit accrual).

(f) *Transfers between methods of crediting service*—(1) *Single plan.* A plan may provide that an employee's service for purposes of eligibility to participate, vesting or benefit accrual shall be determined on the basis of computation periods under the general method set forth in 29 CFR 2530.200b–2 for certain classes of employees but under the alternative method permitted under this section for other classes of employees if the plan provides as follows—

(i) In the case of an employee who transfers from a class of employees whose service is determined on the basis of computation periods to a class of employees whose service is determined on the alternative basis permitted under this section, the employee shall receive credit for a period of service consisting of—

(A) A number of years equal to the number of years of service credited to the employee before the computation period during which the transfer occurs; and

(B) The greater of (*1*) the period of service that would be credited to the employee under the elapsed time method for his service during the entire computation period in which the transfer occurs or (*2*) the service taken into account under the computation periods method as of the date of the transfer.

In addition, the employee shall receive credit for service subsequent to the transfer commencing on the day after the last day of the computation period in which the transfer occurs.

(ii) In the case of an employee who transfers from a class of employees whose service is determined on the alternative basis permitted under this section to a class of employees whose service is determined on the basis of computation periods—

(A) The employee shall receive credit, as of the date of the transfer, for a number of years of service equal to the number of 1-year periods of service credited to the employee as of the date of the transfer, and

(B) The employee shall receive credit, in the computation period which includes the date of the transfer, for a number of hours of service determined by applying one of the equivalencies set forth in 29 CFR 2530.200b–3 (e) (1) to any fractional part of a year credited to the employee under this section as of the date of the transfer. Such equivalency shall be set forth in the plan and shall apply to all similarly situated employees.

(2) *More than one plan.* In the case of an employee who transfers from a plan using either the general method of determining service on the basis of computation periods set forth in 29 CFR 2530.200b–2 or the method of determining service permitted under this section to a plan using the other method of determining service, all service required to be credited under the plan to which the employee transfers shall be determined by applying the rules of paragraph (f)(1) of this section.

(g) *Amendments to change method of crediting service.* A plan may be amended to change the method of crediting service for any purpose or for any class of employees between the general method set forth in 29 CFR 2530.200–2 and the method permitted under this section, if such amendment contains provisions under which each employee with respect to whom the method of crediting service is changed is treated in the same manner as an employee

who transfers from one class of employees to another under paragraph (f)(1) of this section.

(h) *Transitional rule.* For plans in existence on [insert the date of the publication of this document], the provisions of paragraph (f) of this section are effective for plan years beginning after December 31, 1983.

[T.D. 7703, 45 FR 40980, June 17, 1980]

§ 1.410(a)–8 Five consecutive 1-year breaks in service, transitional rules under the Retirement Equity Act of 1984.

Sections 410(a)(5)(D) and 411(a)(6)(D), as amended by the Retirement Equity Act of 1984 (REA 1984), permit a plan to disregard years of service that were disregarded under the plan provisions satisfying those sections (as in effect on August 22, 1984) as of the day before the REA amendments apply to the plan. Under section 302(a) of REA 1984, the new break-in-service rules generally apply to plan years beginning after December 31, 1984. Thus, for example, assume a plan has a calendar plan year and disregarded years of service as permitted by sections 410(a)(5)(D) and 411(a)(6)(D) as in effect on August 22, 1984. An employee completed two years of service in 1981 and 1982, and then incurred two consecutive 1-year breaks in service in 1983 and 1984. The plans may disregard the prior years of service even though the employee did not incur five consecutive 1-year breaks in service. On the other hand, assume the employee completed three consecutive years of service beginning in 1980, and incurred two 1-year breaks in service in 1983 and 1984. Because, as of December 31, 1984, the years of service credited before 1983 could not be disregarded, whether the plan may subsequently disregard those years of service would be governed by the rules enacted by REA 1984.

[T.D. 8219, 53 FR 31851, Aug. 22, 1988; 53 FR 48534, Dec. 1, 1988]

§ 1.410(a)–8T Year of service; break in service (temporary).

(a)–(b) [Reserved]

(c) *Breaks in service.* (1) [Reserved]

(2) *Employees under 2-year 100 percent vesting schedule*—(i) *General rule.* In the case of an employee who incurs a 1-year break in service under a plan which provides that after not more than 2 years of service each participant's right to his accrued benefit under the plan is completely nonforfeitable (within the meaning of section 411 and the regulations thereunder) at the time such benefit accrues, the employee's service before the break in service is not required to be taken into account after the break in service in determining the employee's years of service under section 410(a)(1) and § 1.410(a)–3 if such employee has not satisfied such service requirement.

(ii) *Example.* The rules of this subparagraph are illustrated by the following example:

Example. A qualified plan computing service by the actual counting of hours provides full and immediate vesting. The plan can not require as a condition of participation that an employee complete 2 consecutive years of service with the employer because the requirement as to consecutive years is not permitted under section 410(a)(5). However, such a plan can require 2 years without a break in service, i.e., 2 years with no intervening years in which the employee fails to complete more than 500 hours of service. Under a plan containing such a participation requirement, the following example illustrates when employees would become eligible to participate.

Year	Hours of service completed		
	Employee A	Employee B	Employee C
1	1,000	1,000	1,000
2	1,000	700	500
3	1,000	1,000	1,000
4	1,000	1,000	700
5	1,000	1,000	1,000

NOTE: Employee A will have satisfied the plan's service requirement at the end of year 2, Employee B at the end of year 3, and Employee C at the end of year 5.

(3) *One-year break in service*—

(i) [Reserved]

(ii) *Examples.* The rules provided by this subparagraph are illustrated by the following examples:

Example 1. Employee A completes a year of service under a plan computing service by the actual counting of hours for the 12-month period ending December 31, 1989, and incurs a 1-year break in service for the 12-month period ending December 31, 1990. The plan does not contain the provisions permitted by section 410(a)(5)(B) (relating to 2-

year 100 percent vesting) and section 410(a)(5)(D) (relating to nonvested participants). Thereafter, he does not complete a year of service. As of January 1, 1991, in computing his period of service under the plan his service prior to December 31, 1990, is not required to be taken into account for purposes of section 410(a)(1) and § 1.410(a)–3.

[T.D. 8170, 53 FR 239, Jan. 6, 1988]

§ 1.410(a)–9 Maternity and paternity absence.

(a) *Elapsed time*—(1) *Rule*. For purposes of applying the rules of § 1.410(a)–7 (relating to the elapsed time method of crediting service) to absences described in sections 410(a)(5)(E) and 411(a)(6)(E) (relating to maternity or paternity absence), the severance from service date of an employee who is absent from service beyond the first anniversary of the first day of absence by reason of a maternity or paternity absence described in section 410(a)(5)(E)(i) or 411(a)(6)(E)(i) is the second anniversary of the first day of such absence. The period between the first and second anniversaries of the first day of absence from work is neither a period of service nor a period of severance. This rule applies to maternity and paternity absences beginning on or after the first day of the first plan year in which the plan is required to credit service under sections 410(a)(5)(E) and 411(a)(6)(E).

(2) *Example*. The rules of this section are illustrated by the following example:

Assume an individual works until June 30, 1986; is first absent from employment on July 1, 1986, on account of maternity or paternity absence; and on July 1, 1989, performs an hour of service. The period of service must include the period from employment commencement date until June 30, 1987 (one year after the date of separation for any reason other than a quit, discharge, retirement, or death). The period from July 1, 1987, to June 30, 1988, is neither a period of service nor a period of severance. The period of severance would be from July 1, 1988, to June 30, 1989.

(b) *Other methods*. This paragraph provides a safe harbor for plans that compute years of service under the hours of service methods or permitted equivalencies. Such a plan will be treated as satisfying the requirements of sections 410(a)(5)(E) and 411(a)(6)(E) if the plan increases the minimum period of consecutive 1-year breaks required to disregard any service (or deprive any employee of any right) by one. Thus, a plan will satisfy sections 410(a)(5)(E) and 411(a)(6)(E) without having to compute service for maternity or paternity and sections 410(a)(5)(D) and 411 (a)(4)(D) and (a)(6)(C), by increasing the period of consecutive breaks-in-service from 5 to 6.

[T.D. 8219, 53 FR 31852, Aug. 22, 1988; 53 FR 48534, Dec. 1, 1988]

§ 1.410(a)–9T Elapsed time (temporary).

(a)–(b) [Reserved]

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(i) [Reserved]

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(i)–(iii) [Reserved]

(iv) For purposes of determining an employee's nonforfeitable percentage of accrued benefits derived from employer contributions, a plan, after calculating an employee's period of service in the manner prescribed in this paragraph, may disregard any remaining less than whole year, 12-month or 365-day period of service. Thus, for example, if a plan provides for the statutory three to seven year graded vesting, an employee with a period (or periods) of service which yields 3 whole year periods of service and an additional 321-day period of service is twenty percent vested in his or her employer-derived accrued benefits (based solely on the 3 whole year periods of service).

[T.D. 8170, 53 FR 239, Jan. 6, 1988]

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[T.D. 8363, 56 FR 47641, Sept. 19, 1991; 57 FR 10954, Mar. 31, 1992, as amended by T.D. 8487, 58 FR 46838, Sept. 3, 1993; T.D. 8548, 59 FR 32914, June 27, 1994; T.D. 9275, 71 FR 41359, July 21, 2006]

§ 1.410(b)–1 Minimum coverage requirements (before 1994).

(a) *In general.* A plan is not a qualified plan (and a trust forming a part of the plan is not a qualified trust) unless the plan satisfies section 410(b)(1). For plan years prior to the applicable effective date set forth in § 1.410(b)–10, a plan satisfies section 410(b)(1) if it satisfies the requirements of paragraph (b)(1) or (b)(2) of this section. See also § 1.410(b)–2 for plan years beginning on or after the applicable effective date set forth in § 1.410(b)–10.

(b) *Coverage tests*—(1) *Percentage test.* A plan satisfies the requirements of this subparagraph if it benefits—

(i) Seventy percent or more of all employees, or

(ii) Eighty percent or more of all employees who are eligible to benefit under the plan if 70 percent or more of all the employees are eligible to benefit under the plan,

excluding in each case employees who have not satisfied the minimum age and service requirements (if any) prescribed by the plan, as of the date coverage is tested, as a condition of participation and employees permitted to be excluded under paragraph (c) of this section. The percentage requirements of this subparagraph refer to a percentage of active employees, including employees temporarily on leave, such as those in the Armed Forces of the United States, if such employees are eligible under the plan.

(2) *Classification test.* A plan satisfies the requirements of section 410(b)(1) and this subparagraph if it benefits such employees as qualify under a classification of employees set up by the employer, which classification is found by the Internal Revenue Service not to be discriminatory in favor of employees who are officers, shareholders, or highly compensated. For purposes of this subparagraph, except as provided by paragraph (c) of this section, all active employees (including employees who do not satisfy the minimum age or service requirements of the plan) are taken into account.

(c) *Exclusion of certain employees.* Under section 410(b)(2), for purposes of section 410(b)(1) and paragraph (b) of this section, there shall be excluded from consideration employees described in subparagraphs (1), (2), and (3) of this paragraph.

(1) *Bargaining unit.* Under section 410(b)(2)(A) and this paragraph, there may be excluded from consideration employees not included in the plan who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if the Internal Revenue Service finds that retirement benefits were the subject of good faith bargaining between such employee representatives and such employer or employers. For purposes of determining whether such bargaining occurred, it is not material that such employees are not covered by another plan or that the plan was not considered in such bargaining.

(2) *Air pilots.* Under section 410(b)(2)(B) and this paragraph there may be excluded from consideration, in the case of a plan established or maintained pursuant to an agreement which the Secretary of Labor finds to be a collective bargaining agreement between air pilots represented in accordance with title II of the Railway Labor Act and one or more employers all employees not covered by such agreement. Section 410(b)(2)(B) and this subparagraph do not apply to a plan if the plan provides contributions or benefits for employees whose principal duties are not customarily performed aboard aircraft in flight.

(3) *Nonresident aliens.* Under section 410(b)(2)(C) and this paragraph, there may be excluded from consideration employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(b) and the regulations thereunder) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3) and the regulations thereunder).

(d) *Special rules*—(1) *Highly compensated*. The classification of an employee as highly compensated for purposes of section 410(b)(1)(B) and §1.410(b)–1(b)(2) is made on the basis of the facts and circumstances of each case, taking into account the level of the employee's compensation and the level of compensation paid by the employer to other employees, whether or not covered by the plan. Average compensation levels determined on a local, regional, or national basis, are not relevant for this purpose. Further, the classification of an employee as highly compensated is not made solely on the basis of the number or percentage of employees whose compensation exceeds, or is exceeded by, the employee's.

(2) *Discrimination*. The determination as to whether a plan discriminates in favor of employees who are officers, shareholders, or highly compensated is made on the basis of the facts and circumstances of each case, allowing a reasonable difference between the ratio of such employees benefited by the plan to all such employees of the employer and the ratio of the employees (other than officers, shareholders, or highly compensated) of the employer benefited by the plan to all employees (other than officers, shareholders, or highly compensated). A showing that a specified percentage of employees covered by a plan are not officers, shareholders, or highly compensated, is not in itself sufficient to establish that the plan does not discriminate in favor of employees who are officers, shareholders, or highly compensated.

(3) *Multiple plans*—(i) An employer may designate two or more plans as constituting a single plan which is intended to qualify for purposes of section 410(b)(1) and this section, in which case all plans so designated shall be considered as a single plan in determining whether the requirements of such section are satisfied by each of the separate plans. A determination that the combination of plans so designated does not satisfy such requirements does not preclude a determination that one or more of such plans, considered separately, satisfies such requirements.

(ii) Notwithstanding subdivision (i) of this subparagraph, a plan which is subject to the limitations of section 401(a)(17) of the Code or section 301(d)(3) of the Tax Reduction Act of 1975 cannot be considered with any other plan which covers any employee covered by such plan.

(4) *Profit-sharing plans*. Employees under a profit-sharing plan who receive the amounts allocated to their accounts before the expiration of a period of time or the occurrence of a contingency specified in the plan shall not be considered covered by the plan. Thus, in case a plan permits employees to receive immediately the amounts allocated to their accounts, or to have such amounts paid to a profit-sharing plan for them, the employees who receive the shares immediately shall not be considered covered by the plan.

(5) *Certain classifications*. See section 401(a)(5) and the regulations thereunder for rules relating to classifications of employees which are not considered to be discriminatory per se for purposes of section 410(b)(1)(B) and §1.410(b)–1(b)(2).

(6) *Integration with Social Security Act*. See section 401(a)(5) and the regulations thereunder for rules relating to integration of plans with the Social Security Act.

(7) *Different age and service requirements*—(i) *Application*. The rules of this subparagraph (7) apply to a plan which must satisfy the minimum age and service requirements of section 410(a)(1)(A) in order to be a qualified plan. Accordingly, the rules are inapplicable to plans described in section 410(c)(1) (see §1.410(a)–1(c)(1)); plans satisfying the alternative minimum age and service requirements of section 410(a)(1)(B) but not satisfying the requirements of section 410(a)(1)(A); and plans which provide contributions or benefits for employees, some or all of whom are owner-employees (see section 401(a)(10)).

(ii) *General rules*. A provision for different age and service requirements for present and future employees either upon establishment or subsequent amendment is not, of itself, discriminatory under section 410(b)(1)(B) even

though present employees who are officers, shareholders, or highly compensated cannot meet the age and service requirements for future employees at the time the plan is established or amended and even though present participants who are officers, shareholders, or highly compensated would not have satisfied the age and service requirements for future employees at the time they became participants in the plan. Furthermore, prohibited discrimination will be deemed not to arise in operation, solely because of such different requirements, when future employees are added to the employer's work force.

(8) *Certain controlled groups.* In applying the percentage test and classification test described in paragraph (b) (1) and (2) of this section for a year, all the employees of corporations or trades and businesses whose employees are treated as employed by a single employer by reason of section 414 (b) or (c) must be taken into account. The preceding sentence shall apply for a plan year if, on 1 day in each quarter of such plan year, such corporations are members of a controlled group of corporations (within the meaning of section 414(b)) of such trades or businesses are under common control (within the meaning of section 414(c)).

(9) *Transitional rule.* In the case of a cash and deferred profit-sharing plan, in existence on June 27, 1974, the requirements of paragraph (b)(2) of this section are satisfied if over one-half of the participants in the plan are among the lowest paid two-thirds of all eligible employees. This subparagraph shall not apply after December 31, 1977.

(e) *Example.* The rules provided by this section are illustrated by the following example:

Example. An employer established a noncontributory defined benefit plan covering all employees of its ABC Division who are hired prior to age 60 and who are at least 25 years old. The normal retirement age under the plan is age 65. The employer has 100 employees including 20 employees who are under age 25 and 10 employees who were hired over age 60. The plan does not cover 15 employees who are over age 25 and were hired before age 60 because they are not in the ABC Division. Of these 15 excluded employees, 3 have less than 1 year of service. In addition, 12 of the 55 employees covered have less than one year of service. The plan can be shown not to satisfy the requirements of IRC section 410(b)(1)(A) as follows:

(i) Number of employees	100
(ii) Number of employees excluded on account of minimum age and service	20
(iii) (i)–(ii)	80
(iv) Number of employees who must be covered if plan is to satisfy IRC section 410(b)(1)(A), 70% of (iii)	56
(v) Number of employees actually covered	55

Because the number of employees covered is less than the number of employees who must be covered, the plan does not satisfy the percentage coverage requirements of IRC section 410(b)(1)(A).

(Sec. 410 (88 Stat. 898; 26 U.S.C. 410))

[T.D. 7508, 42 FR 47197, Sept. 20, 1977, as amended by T.D. 7735, 45 FR 74722, Nov. 12, 1980; T.D. 8363, 56 FR 47643, Sept. 19, 1991; T.D. 8487, 58 FR 46839, Sept. 3, 1993]

§ 1.410(b)–2 Minimum coverage requirements (after 1993).

(a) *In general.* A plan is a qualified plan for a plan year only if the plan satisfies section 410(b) for the plan year. A plan satisfies section 410(b) for a plan year if and only if it satisfies paragraph (b) of this section with respect to employees for the plan year and paragraph (c) of this section with respect to former employees for the plan year. The rules in paragraphs (a), (b), and (c) of this section apply to all plans as a condition of qualification, including plans under which no employee is able to accrue any additional benefits (for example, frozen plans). Paragraphs (d), (e), and (f) of this section provide special rules for nonelective section 403(b) plans subject to section 403(b)(12)(A)(i), for governmental and church plans subject to section 410(c), and for certain acquisitions or dispositions, respectively. See § 1.410(b)–7 for rules for determining the ''plan'' subject to section 410(b).

(b) *Requirements with respect to employees*—(1) *In general.* A plan satisfies this paragraph (b) for a plan year if and only if it satisfies at least one of the tests in paragraphs (b)(2) through (b)(7) of this section for the plan year.

(2) *Ratio percentage test*—(i) *In general.* A plan satisfies this paragraph (b)(2) for a plan year if and only if the plan's ratio percentage for the plan year is at least 70 percent. This test incorporates both the percentage test of section 410(b)(1)(A) and the ratio test of section

410(b)(1)(B). See §1.410(b)–9 for the definition of ratio percentage.

(ii) *Examples.* The following examples illustrate the ratio percentage test of this paragraph (b)(2).

Example 1. For a plan year, Plan A benefits 70 percent of an employer's nonhighly compensated employees and 100 percent of the employer's highly compensated employees. The plan's ratio percentage for the year is 70 percent (70 percent/100 percent), and thus the plan satisfies the ratio percentage test.

Example 2. For a plan year, Plan B benefits 40 percent of the employer's nonhighly compensated employees and 60 percent of the employer's highly compensated employees. Plan B fails to satisfy the ratio percentage test because the plan's ratio percentage is only 66.67 percent (40 percent/60 percent).

(3) *Average benefit test.* A plan satisfies this paragraph (b)(3) for a plan year if and only if the plan satisfies both the nondiscriminatory classification test of §1.410(b)–4 and the average benefit percentage test of §1.410(b)–5 for the plan year.

(4) *Certain tax credit employee stock ownership plans.* A plan satisfies this paragraph (b)(4) for a plan year if and only if the plan—

(i) Is a tax credit employee stock ownership plan (as defined in section 409(a)),

(ii) Is the only plan of the employer that is intended to qualify under section 401(a), and

(iii) Is a plan that satisfies the rule set forth in section 410(b)(6)(D).

This paragraph (b)(4) is available only for plan years for which the tax credit employee stock ownership plan receives contributions for which the employer is allowed a tax credit under section 41 (as in effect prior to its repeal by the Tax Reform Act of 1986) or section 48(n) (as in effect prior to its amendment by the Tax Reform Act of 1984). The requirement of this paragraph (b)(4) that the plan be the only plan of the employer that is intended to qualify under section 401(a) is not satisfied if the employer has only one plan, but that plan is treated as two or more separate plans under the mandatory disaggregation rules of §1.410(b)–7(c).

(5) *Employers with no nonhighly compensated employees.* A plan satisfies this paragraph (b)(5) for a plan year if and only if the plan is maintained by an employer that has no nonhighly compensated employees at any time during the plan year.

(6) *Plans benefiting no highly compensated employees.* A plan satisfies this paragraph (b)(6) for a plan year if and only if the plan benefits no highly compensated employees for the plan year.

(7) *Plans benefiting collectively bargained employees.* A plan that benefits solely collectively bargained employees for a plan year satisfies this paragraph (b)(7) for the plan year. If a plan (within the meaning of §1.410(b)–7(b)) benefits both collectively bargained employees and noncollectively bargained employees for a plan year, §1.410(b)–7(c)(4) provides that the portion of the plan that benefits collectively bargained employees is treated as a separate plan from the portion of the plan that benefits noncollectively bargained employees. Thus, the mandatorily disaggregated portion of the plan that benefits the collectively bargained employees automatically satisfies this paragraph (b)(7) for the plan year and hence section 410(b). See §1.410(b)–9 for the definitions of collectively bargained employee and noncollectively bargained employee.

(c) *Requirements with respect to former employees*—(1) *Former employees tested separately.* Former employees are tested separately from employees for purposes of section 410(b). Thus, former employees are disregarded in applying the ratio percentage test, the nondiscriminatory classification test, and the average benefit percentage test with respect to the coverage of employees under a plan, and employees are disregarded in applying this section with respect to the coverage of former employees under a plan.

(2) *Testing former employees.* A plan satisfies section 410(b) with respect to former employees if and only if, under all of the relevant facts and circumstances (including the group of nonexcludable former employees not benefiting under the plan), the group of former employees benefiting under the plan does not discriminate significantly in favor of highly compensated former employees.

(d) *Nonelective contributions under section 403(b) plans.* For plan years beginning on or after January 1, 1989, a plan

subject to section 403(b)(12)(A)(i) with respect to nonelective contributions (i.e., contributions not made pursuant to a salary reduction agreement) is treated as a plan subject to the requirements of this section. For this purpose, a plan described in the preceding sentence must satisfy the requirements of this section without regard to section 410(c) and paragraph (e) of this section. For plan years beginning before the effective date set forth in §1.410(b)–10(d), any plan described in section 410(c)(1)(A) (regarding governmental plans) satisfies the requirements of this section.

(e) *Certain governmental and church plans.* The requirements of section 410(b) do not apply to a plan described in section 410(c)(1) (other than a plan subject to section 403(b)(12)(A)(i) or a plan with respect to which an election has been made under section 410(d)). Such a plan must satisfy section 401(a)(3) as in effect on September 1, 1974. For this purpose, a plan that satisfies section 410(b) (without regard to this paragraph (e)) is treated as satisfying section 401(a)(3) as in effect on September 1, 1974. For plan years beginning before the effective date set forth in §1.410(b)–10(d), any plan described in section 410(c)(1)(A) (regarding governmental plans) satisfies the requirements of this section and is thus treated as satisfying the requirements of section 401(a)(3) as in effect on September 1, 1974. See §1.410(b)–10(b)(2) for a special rule for plans of tax-exempt organizations.

(f) *Certain acquisitions or dispositions.* Section 410(b)(6)(C) (relating to certain acquisitions or dispositions) provides a special rule whereby a plan may be treated as satisfying section 410(b) for a limited period of time after an acquisition or disposition if it satisfies section 410(b) (without regard to the special rule) immediately before the acquisition or disposition and there is no significant change in the plan or in the coverage of the plan other than the acquisition or disposition. For purposes of section 410(b)(6)(C) and this paragraph (f), the terms ''acquisition'' and ''disposition'' refer to an asset or stock acquisition, merger, or other similar transaction involving a change in employer of the employees of a trade or business.

(g) *Additional rules.* The Commissioner may, in revenue rulings, notices, and other guidance of general applicability, provide any additional rules that may be necessary or appropriate in applying the minimum coverage requirements of section 410(b), including (without limitation) additional rules limiting or expanding the methods in §1.410(b)–5(d) and (e) for determining employee benefit percentages.

[T.D. 8363, 56 FR 47643, Sept. 19, 1991; 57 FR 10817, Mar. 31, 1992, as amended by T.D. 8487, 58 FR 46839, Sept. 3, 1993; T.D. 8548, 59 FR 32914, June 27, 1994]

§1.410(b)–3 Employees and former employees who benefit under a plan.

(a) *Employees benefiting under a plan*—(1) *In general.* Except as provided in paragraph (a)(2) of this section, an employee is treated as benefiting under a plan for a plan year if and only if for that plan year, in the case of a defined contribution plan, the employer receives an allocation taken into account under §1.401(a)(4)–2(c)(2)(ii), or in the case of a defined benefit plan, the employee has an increase in a benefit accrued or treated as an accrued benefit under section 411(d)(6).

(2) *Exceptions to allocation or accrual requirement*—(i) *Section 401(k) and 401(m) plans.* Notwithstanding paragraph (a)(1) of this section, an employee is treated as benefiting under a section 401(k) plan for a plan year if and only if the employee is an eligible employee as defined in §1.401(k)–6 under the plan. Similarly, an employee is treated as benefiting under a section 401(m) plan for a plan year if and only if the employee is an eligible employee as defined in §1.401(m)–5 under the plan for the plan year.

(ii) *Section 415 limits*—(A) *General rule for defined benefit plans.* In determining whether an employee is treated as benefiting under a defined benefit plan for a plan year, plan provisions that implement the limits of section 415 are disregarded. Any plan provision that provides for increases in an employee's accrued benefit under the plan due solely to adjustments under section 415(d)(1), additional years of participation or service under section 415(b)(5), or

changes in the defined contribution fraction under section 415(e) is also disregarded, but only if such provision applies uniformly to all employees in the plan.

(B) *Defined benefit plans taking section 415 limits into account under section 401(a)(4) testing.* Paragraph (a)(2)(ii)(A) of this section does not apply in the case of a defined benefit plan that uses the option in §1.401(a)(4)–3(d)(2)(ii)(B) to take into account plan provisions implementing the provisions of section 415 in determining accrual rates under the section 401(a)(4) general test.

(C) *Defined contribution plans.* A defined contribution plan is permitted to apply the rule in the first sentence of paragraph (a)(2)(ii)(A) of this section in determining whether an employee is treated as benefiting under the plan, provided it applies the rule on a consistent basis for all employees in the plan.

(iii) *Certain employees treated as benefiting*—(A) *In general.* An employee is treated as benefiting under a plan for a plan year if the employee satisfies all of the applicable conditions for accruing a benefit or receiving an allocation for the plan year but fails to have an increase in accrued benefit or to receive an allocation solely because of one or more of the conditions set forth in paragraphs (a)(2)(iii) (B) through (F) of this section.

(B) *Certain plan limits.* The employee's benefit would otherwise exceed a limit that is applicable on a uniform basis to all employees in the plan. Thus, for example, if the formula under a defined benefit plan takes into account only the first 30 years of service for accrual purposes, an employee who has completed more than 30 years of service is still treated as benefiting under the plan.

(C) *Benefits previously accrued.* The benefit previously accrued by the employee is greater than the benefit that would be determined under the plan if the benefit previously accrued were disregarded. This could happen, for example, when the plan is applying the wear-away formula of §1.401(a)(4)–13(c)(4)(ii) and the employee's frozen accrued benefit exceeds the benefit determined under the current formula.

(D) *Benefit offset arrangements.* The plan offsets the employee's current benefit accrual under an offset arrangement described in §1.401(a)(4)–3(f)(9) (without regard to whether the offset is attributable to pre-participation service or past service).

(E) *Target benefit plans.* In the case of a target benefit plan that satisfies the nondiscriminatory amount requirement of §1.401(a)(4)–1(b)(2) by satisfying the safe harbor in §1.401(a)(4)–8(b)(3), the employee's theoretical reserve is greater than or equal to the actuarial present value of the fractional rule benefit.

(F) *Post-normal retirement age adjustments.* The employee has attained normal retirement age under a defined benefit plan and fails to accrue a benefit because of the provisions of section 411(b)(1)(H)(iii) regarding adjustments for delayed retirement.

(iv) *Section 412(i) plans*—(A) *General rule.* Notwithstanding paragraph (a)(1) of this section, an employee is treated as benefiting under an insurance contract plan within the meaning of section 412(i) for a plan year if and only if a premium is paid on behalf of the employee for the plan year.

(B) *Exceptions.* Notwithstanding paragraph (a)(2)(iv)(A) of this section, an employee is treated as benefiting under an insurance contract plan within the meaning of section 412(i) for a plan year if the sole reason that a premium is not paid on behalf of the employee is one of the reasons described in paragraph (a)(2)(iii) of this section. In addition, an employee is treated as benefiting under an insurance contract plan, within the meaning of section 412(i), that is a defined benefit plan if a premium is not paid on behalf of the employee solely because the insurance contracts that have previously been purchased on behalf of the employee guarantee to provide for the employee's projected normal retirement benefit without regard to future premium payments.

(3) *Examples.* The following examples illustrate the determination of whether an employee is benefiting under a plan for purposes of section 410(b).

Example 1. An employer has 35 employees who are eligible under a defined benefit plan.

The plan requires 1,000 hours of service to accrue a benefit. Only 30 employees satisfy the 1,000-hour requirement and accrue a benefit. The five employees who do not satisfy the 1,000-hour requirement during the plan year are taken into account in testing the plan under section 410(b) but are treated as not benefiting under the plan.

Example 2. An employer maintains a section 401(k) plan. Only employees who are at least age 21 and who complete one year of service are eligible employees under the plan within the meaning of §1.401(k)–6. Under the rule of paragraph (a)(2)(i) of this section, only employees who have satisfied these age and service conditions are treated as benefiting under the plan.

Example 3. The facts are the same as in *Example 2,* except that the employer also maintains a section 401(m) plan that provides matching contributions contingent on elective contributions under the section 401(k) plan. The matching contributions are contingent on employment on the last day of the plan year. Under §1.401(m)–5, because matching contributions are contingent on employment on the last day of the plan year, not all employees who are eligible employees under the section 401(k) plan are eligible employees under the section 401(m) plan. Thus, employees who have satisfied the age and service conditions but who do not receive a matching contribution because they are not employed on the last day of the plan year are treated as not benefiting under the section 401(m) portion of the plan.

(b) *Former employees benefiting under a plan*—(1) *In general.* A former employee is treated as benefiting for a plan year if and only if the plan provides an allocation or benefit increase described in paragraph (a)(1) of this section to the former employee for the plan year. Thus, for example, a former employee benefits under a defined benefit plan for a plan year if the plan is amended to provide an ad hoc cost-of-living adjustment in the former employee's benefits. In contrast, because an increase in benefits payable under a plan pursuant to an automatic cost-of-living provision adopted and effective before the beginning of the plan year is previously accrued, a former employee is not treated as benefiting in a subsequent plan year merely because the former employee receives an increase pursuant to such an automatic cost-of-living provision. Any accrual or allocation for an individual during the plan year that arises from the individual's status as an employee is treated as an accrual or allocation of an employee. Similarly, any accrual or allocation for an individual during the plan year that arises from the individual's status as a former employee is treated as an accrual or allocation of a former employee. It is possible for an individual to accrue a benefit both as an employee and as a former employee in a given plan year. During the plan year in which an individual ceases performing services for the employer, the individual is treated as an employee in applying section 410(b) with respect to employees and is treated as a former employee in applying section 410(b) with respect to former employees.

(2) *Examples.* The following examples illustrate the determination of whether a former employee benefits under a plan for purposes of section 410(b).

Example 1. Employer A amends its defined benefit plan in the 1995 plan year to provide an ad hoc cost-of-living increase of 5 percent for all retirees. Former employees who receive this increase are treated as benefiting under the plan for the 1995 plan year.

Example 2. Employer B maintains a defined benefit plan with a calendar plan year. In the 1995 plan year, Employer B amends the plan to provide that an employee who has reached early retirement age under the plan and who retires before July 31 of the 1995 plan year will receive an unreduced benefit, even though the employee has not yet reached normal retirement age. This early retirement window benefit is provided to employees based on their status as employees. Thus, although individuals who take advantage of the benefit become former employees, the window benefit is treated as provided to employees and is not treated as a benefit for former employees.

Example 3. The facts are the same as *Example 2,* except that on September 1, 1995, Employer B also amends the defined benefit plan to provide an ad hoc cost-of-living increase effective for all former employees. An individual who ceases performing services for the employer before July 31, 1995, under the early retirement window, and then receives the ad hoc cost-of-living increase, is treated as benefiting for the 1995 plan year both as an employee with respect to the early retirement window, and as a former employee with respect to the ad hoc COLA.

[T.D. 8363, 56 FR 47644, Sept. 19, 1991; 57 FR 10954, Mar. 31, 1992, as amended by T.D. 8487, 58 FR 46839, Sept. 3, 1993; T.D. 9169, 69 FR 78153, 78154, Dec. 29, 2004]

§ 1.410(b)–4 Nondiscriminatory classification test.

(a) *In general.* A plan satisfies the nondiscriminatory classification test of this section for a plan year if and only if, for the plan year, the plan benefits the employees who qualify under a classification established by the employer in accordance with paragraph (b) of this section, and the classification of employees is nondiscriminatory under paragraph (c) of this section.

(b) *Reasonable classification established by the employer.* A classification is established by the employer in accordance with this paragraph (b) if and only if, based on all the facts and circumstances, the classification is reasonable and is established under objective business criteria that identify the category of employees who benefit under the plan. Reasonable classifications generally include specified job categories, nature of compensation (i.e., salaried or hourly), geographic location, and similar bona fide business criteria. An enumeration of employees by name or other specific criteria having substantially the same effect as an enumeration by name is not considered a reasonable classification.

(c) *Nondiscriminatory classification*—(1) *General rule.* A classification is nondiscriminatory under this paragraph (c) for a plan year if and only if the group of employees included in the classification benefiting under the plan satisfies the requirements of either paragraph (c)(2) or (c)(3) of this section for the plan year.

(2) *Safe harbor.* A plan satisfies the requirement of this paragraph (c)(2) for a plan year if and only if the plan's ratio percentage is greater than or equal to the employer's safe harbor percentage, as defined in paragraph (c)(4)(i) of this section. See § 1.410(b)-9 for the definition of a plan's ratio percentage.

(3) *Facts and circumstances*—(i) *General rule.* A plan satisfies the requirements of this paragraph (c)(3) if and only if—

(A) The plan's ratio percentage is greater than or equal to the unsafe harbor percentage, as defined in paragraph (c)(4)(ii) of this section, and

(B) The classification satisfies the factual determination of paragraph (c)(3)(ii) of this section.

(ii) *Factual determination.* A classification satisfies this paragraph (c)(3)(ii) if and only if, based on all the relevant facts and circumstances, the Commissioner finds that the classification is nondiscriminatory. No one particular fact is determinative. Included among the facts and circumstances relevant in determining whether a classification is nondiscriminatory are the following—

(A) The underlying business reason for the classification. The greater the business reason for the classification, the more likely the classification is to be nondiscriminatory. Reducing the employer's cost of providing retirement benefits is not a relevant business reason.

(B) The percentage of the employer's employees benefiting under the plan. The higher the percentage, the more likely the classification is to be nondiscriminatory.

(C) Whether the number of employees benefiting under the plan in each salary range is representative of the number of employees in each salary range of the employer's workforce. In general, the more representative the percentages of employees benefiting under the plan in each salary range, the more likely the classification is to be nondiscriminatory.

(D) The difference between the plan's ratio percentage and the employer's safe harbor percentage. The smaller the difference, the more likely the classification is to be nondiscriminatory.

(E) The extent to which the plan's average benefit percentage (determined under § 1.410(b)-5) exceeds 70 percent.

(4) *Definitions*—(i) *Safe harbor percentage.* The safe harbor percentage of an employer is 50 percent, reduced by ¾ of a percentage point for each whole percentage point by which the nonhighly compensated employee concentration percentage exceeds 60 percent. See paragraph (c)(4)(iv) for a table that illustrates the safe harbor percentage and unsafe harbor percentage.

(ii) *Unsafe harbor percentage.* The unsafe harbor percentage of an employer

is 40 percent, reduced by ¾ of a percentage point for each whole percentage point by which the nonhighly compensated employee concentration percentage exceeds 60 percent. However, in no case is the unsafe harbor percentage less than 20 percent.

(iii) *Nonhighly compensated employee concentration percentage*. The nonhighly compensated employee concentration percentage of an employer is the percentage of all the employees of the employer who are nonhighly compensated employees. Employees who are excludable employees for purposes of the average benefit test are not taken into account.

(iv) *Table*. The following table sets forth the safe harbor and unsafe harbor percentages at each nonhighly compensated employee concentration percentage:

Nonhighly compensated employee concentration percentage	Safe harbor percentage	Unsafe harbor percentage
0–60	50.00	40.00
61	49.25	39.25
62	48.50	38.50
63	47.75	37.75
64	47.00	37.00
65	46.25	36.25
66	45.50	35.50
67	44.75	34.75
68	44.00	34.00
69	43.25	33.25
70	42.50	32.50
71	41.75	31.75
72	41.00	31.00
73	40.25	30.25
74	39.50	29.50
75	38.75	28.75
76	38.00	28.00
77	37.25	27.25
78	36.50	26.50
79	35.75	25.75
80	35.00	25.00
81	34.25	24.25
82	33.50	23.50
83	32.75	22.75
84	32.00	22.00
85	31.25	21.25
86	30.50	20.50
87	29.75	20.00
88	29.00	20.00
89	28.25	20.00
90	27.50	20.00
91	26.75	20.00
92	26.00	20.00
93	25.25	20.00
94	24.50	20.00
95	23.75	20.00
96	23.00	20.00
97	22.25	20.00
98	21.50	20.00
99	20.75	20.00

(5) *Examples*. The following examples illustrate the rules in this paragraph (c).

Example 1. Employer A has 200 nonexcludable employees, of whom 120 are nonhighly compensated employees and 80 are highly compensated employees. Employer A maintains a plan that benefits 60 nonhighly compensated employees and 72 highly compensated employees. Thus, the plan's ratio percentage is 55.56 percent ([60/120]/[72/80] = 50%/90% = 0.5556), which is below the percentage necessary to satisfy the ratio percentage test of §1.410(b)–2(b)(2). The employer's nonhighly compensated employee concentration percentage is 60 percent (120/200); thus, Employer A's safe harbor percentage is 50 percent and its unsafe harbor percentage is 40 percent. Because the plan's ratio percentage is greater than the safe harbor percentage, the plan's classification satisfies the safe harbor of paragraph (c)(2) of this section.

Example 2. The facts are the same as in *Example 1*, except that the plan benefits only 40 nonhighly compensated employees. The plan's ratio percentage is thus 37.03 percent ([40/120]/[72/80] = 33.33%/90% = 0.3703). Under these facts, the plan's classification is below the unsafe harbor percentage and is thus considered discriminatory.

Example 3. The facts are the same as in *Example 1*, except that the plan benefits 45 nonhighly compensated employees. The plan's ratio percentage is thus 41.67 percent ([45/120]/[72/80] = 37.50%/90% = 0.4167), above the unsafe harbor percentage (40 percent) and below the safe harbor percentage (50 percent). The Commissioner may determine that the classification is nondiscriminatory after considering all the relevant facts and circumstances.

Example 4. Employer B has 10,000 nonexcludable employees, of whom 9,600 are nonhighly compensated employees and 400 are highly compensated employees. Employer B maintains a plan that benefits 600 nonhighly compensated employees and 100 highly compensated employees. Thus, the plan's ratio percentage is 25.00 percent ([600/9,600]/[100/400] = 6.25%/25% = 0.2500), which is below the percentage necessary to satisfy the ratio percentage test of §1.410(b)–2(b)(2). Employer B's nonhighly compensated employee concentration percentage is 96 percent (9,600/10,000); thus, Employer B's safe harbor percentage is 23 percent, and its unsafe harbor percentage is 20 percent. Because the plan's ratio percentage (25.00 percent) is greater than the safe harbor percentage (23.00 percent), the plan's classification satisfies the safe harbor of paragraph (c)(2) of this section.

Example 5. The facts are the same as in *Example 4*, except that the plan benefits only 400 nonhighly compensated employees. The plan's ratio percentage is thus 16.67 percent ([400/9,600]/[100/400] = 4.17%/25% = 0.1667). The

plan's ratio percentage is below the unsafe harbor percentage and thus the classification is considered discriminatory.

Example 6. The facts are the same as in *Example 4*, except that the plan benefits 500 nonhighly compensated employees. The plan's ratio percentage is thus 20.83 percent ([500/9,600]/[100/400] = 5.21%/25% = 0.2083), above the unsafe harbor percentage (20 percent) and below the safe harbor percentage (23 percent). The Commissioner may determine that the classification is nondiscriminatory after considering all the facts and circumstances.

[T.D. 8363, 56 FR 47645, Sept. 19, 1991; 57 FR 10954, Mar. 31, 1992]

§ 1.410(b)–5 Average benefit percentage test.

(a) *General rule*. A plan satisfies the average benefit percentage test of this section for a plan year if and only if the average benefit percentage of the plan for the plan year is at least 70 percent. A plan is deemed to satisfy this requirement if it satisfies paragraph (f) of this section for the plan year.

(b) *Determination of average benefit percentage*. The average benefit percentage of a plan for a plan year is the percentage determined by dividing the actual benefit percentage of the nonhighly compensated employees in plans in the testing group for the testing period that includes the plan year by the actual benefit percentage of the highly compensated employees in plans in the testing group for that testing period. See paragraph (d)(3)(ii) of this section for the definition of testing period.

(c) *Determination of actual benefit percentage*. The actual benefit percentage of a group of employees for a testing period is the average of the employee benefit percentages, calculated separately with respect to each of the employees in the group for the testing period. All nonexcludable employees of the employer are taken into account for this purpose, even if they are not benefiting under any plan that is taken into account.

(d) *Determination of employee benefit percentages*—(1) *Overview*. This paragraph (d) provides rules for determining employee benefit percentages. See paragraph (e) of this section for alternative methods for determining employee benefit percentages.

(2) *Employee contributions and employee-provided benefits disregarded*. Only employer-provided contributions and benefits are taken into account in determining employee benefit percentages. Therefore, employee contributions (including both employee contributions allocated to separate accounts and employee contributions not allocated to separate accounts), and benefits derived from such contributions, are not taken into account in determining employee benefit percentages.

(3) *Plans and plan years taken into account*—(i) *Testing group*. All plans included in the testing group under § 1.410(b)–7(e)(1), and only those plans, are taken into account in determining an employee's employee benefit percentage.

(ii) *Testing period*. An employee's employee benefit percentage is determined on the basis of plan years ending with or within the same calendar year. These plan years are referred to in this section as the relevant plan years or, in the aggregate, as the testing period.

(4) *Contributions or benefits basis*. Employee benefit percentages may be determined on either a contributions or a benefits basis. Employee benefit percentages for any testing period must be determined on the same basis (contributions or benefits) for all plans in the testing group.

(5) *Determination of employee benefit percentage*—(i) *General rule*. The employee benefit percentage for an employee for a testing period is the rate that would be determined for that employee for purposes of applying the general test for nondiscrimination in §§ 1.401(a)(4)–2, 1.401(a)(4)–3, 1.401(a)(4)–8 or 1.401(a)(4)–9, if all the plans in the testing group were aggregated for purposes of section 410(b). Thus, if employee benefit percentages are determined on a contributions basis, each employee's employee benefit percentage is the aggregate normal allocation rate that would be determined for the employee under § 1.401(a)(4)–9(b)(2)(ii)(A) (if the plans in the testing group include both defined benefit and defined contribution plans), the allocation rate that would be determined for the employee under § 1.401(a)(4)–2(c)(2) (if the plans in the testing group include only defined contribution plans), or the equivalent normal allocation

rate that would be determined for the employee under §1.401(a)(4)–8(c)(2) (if the plans in the testing group include only defined benefit plans). Similarly, if employee benefit percentages are determined on a benefits basis, each employee's employee benefit percentage is the aggregate normal accrual rate that would be determined for the employee under §1.401(a)(4)–9(b)(2)(ii)(B), the normal accrual rate that would be determined for the employee under §1.401(a)(4)–3(d), or the equivalent accrual rate that would be determined for the employee under §1.401(a)(4)–8(b)(2), depending on whether the plans in the testing group include both defined benefit and defined contribution plans, only defined benefit plans, or only defined contribution plans.

(ii) *Plans with differing plan years.* If not all the plans in the testing group share the same plan year, §1.410(b)–7(d)(5) would ordinarily prohibit them from being aggregated for purposes of section 410(b). In such a case, employee benefit percentages are determined by applying the rules of paragraph (d)(5)(i) of this section separately to each subset of plans in the testing group that share the same plan year (or the same accrual computation period) and aggregating the results for all plans in the testing group. Thus, an employee's employee benefit percentage is determined as the sum of these separate employee benefit percentages that are determined consistently for all the plans in the testing group (except for differences attributable solely to the differences in plan years).

(iii) *Options and consistency requirements.* In determining employee benefit percentages under this paragraph (d)(5), any optional or alternative methods or rules available for determining rates in §§1.401(a)(4)–2, 1.401(a)(4)–3, 1.401(a)(4)–8, or 1.401(a)(4)–9, whichever is applicable, may be applied. Thus, for example, employee benefit percentages may generally be calculated using any of the alternative methods of determining average annual compensation or plan year compensation under §1.401(a)(4)–12, and using any underlying definition of compensation that satisfies section 414(s). Except as otherwise specifically permitted, the determination of employee benefit percentages must be made on a consistent basis for all employees and for all plans in the testing group as required by §§1.401(a)(4)–2(c)(2)(vi), 1.401(a)(4)–3(d)(2)(i), 1.401(a)(4)–8(b)(2)(iv), 1.401(a)(4)–8(c)(2)(iv) or 1.401(a)(4)–9(b)(2)(iv).

(6) *Permitted disparity*—(i) *In general.* Permitted disparity may be imputed in determining employee benefit percentages as provided in §§1.401(a)(4)–2, 1.401(a)(4)–3, 1.401(a)(4)–8, or 1.401(a)(4)–9, whichever is applicable. When separate employee benefit percentages are determined for individual plans under paragraph (e)(2) of this section (or for subsets of plans that have the same plan year as described in paragraph (d)(5)(ii) of this section), permitted disparity may be imputed for an employee only in one individual plan (or subset of plans) and may not be imputed for the same employee in another individual plan (or subset of plans). However, if the same average annual compensation or plan year compensation is used to determine employee benefit percentages in more than one plan, the employee's employee benefit percentages for those plans may be summed prior to imputing permitted disparity.

(ii) *Plans which may not use permitted disparity.* Permitted disparity may be reflected in the determination of rates only to the extent that the plans for which rates are being determined are plans for which the permitted disparity of section 401(l) is available. Thus, for example, if a section 401(k) plan is included in the testing group and permitted disparity is imputed under §1.401(a)(4)–2(c)(iv), then employee benefit percentages are determined by first calculating an adjusted allocation rate (within the meaning of §1.401(a)(4)–7(b)(1)) without regard to the amount of allocations under the section 401(k) plan and adding to it the allocation rate for the section 401(k) plan. See §1.401(l)–1(a)(4) for a list of types of plans for which permitted disparity is not available.

(7) *Requirements for certain plans providing early retirement benefits*—(i) *General rule.* If any defined benefit plan in the testing group provides for early retirement benefits in addition to normal

retirement benefits to any highly compensated employee, and the average actuarial reduction for any one of these benefits commencing in the five years prior to the plan's normal retirement age is less than four percent per year, then the aggregate most valuable allocation rate, equivalent most valuable allocation rate, aggregate most valuable accrual rate, or most valuable accrual rate must be substituted for the related normal rates in paragraph (d)(5) of this section.

(ii) *Exception*. Paragraph (d)(7)(i) of this section does not apply if early retirement benefits with average actuarial reductions described in that paragraph are currently available, within the meaning of §1.401(a)(4)–4(b), under plans in the testing group to a percentage of nonhighly compensated employees that is at least 70 percent of the percentage of highly compensated employees to whom these benefits are currently available.

(e) *Additional optional rules*—(1) *Overview*. This paragraph (e) contains various alternative methods for determining employee benefit percentages for a testing period.

(2) *Determination of employee benefit percentages as the sum of separately determined rates*—(i) *In general*. Employee benefit percentages may be determined as the sum of separately determined employee benefit percentages for each of the plans in the testing group that are aggregated under paragraphs (d)(5)(i) or (ii) of this section, provided that these employee benefit percentages are determined on a consistent basis for all of these plans pursuant to paragraph (d)(5)(iii) of this section.

(ii) *Exception from consistency requirement*. The consistency requirement of paragraph (e)(2)(i) of this section is not violated merely because employee benefit percentages are not determined in a consistent manner for all of the plans in the testing group and the inconsistencies in determination of rates among plans are described in paragraph (e)(2)(iii) of this section. The exception in this paragraph (e)(2)(ii) applies only if it is reasonable to believe that the inconsistencies do not result in an average benefit percentage that is significantly higher than the average benefit percentage that would be determined had employee benefit percentages been determined on a consistent basis pursuant to paragraph (d)(5)(iii) of this section.

(iii) *Permitted inconsistencies*. The following inconsistencies between plans are permitted under this paragraph (e)(2)—

(A) Use of different underlying definitions of section 414(s) compensation in the determination of rates;

(B) Use of different definitions of average annual compensation;

(C) Use of different testing ages;

(D) Use of different fresh-start dates;

(E) Use of different actuarial assumptions for normalization; or

(F) Disregard of actuarial increases after normal retirement age and QPSA charges without regard to any requirement for uniformity in the actuarial increases or QPSA charges.

(3) *Determination of employee benefit percentages without regard to plans of another type*—(i) *General rule*. Employee benefit percentages may be determined under plans of one type (i.e., defined benefit plans or defined contribution plans) by treating all plans of the other type (i.e., defined contribution plans or defined benefit plans, respectively) as if they were not part of the testing group, using the method provided in this paragraph (e)(3). If this method is used to determine whether a defined contribution plan satisfies the average benefit percentage test, employee benefit percentages under all defined contribution plans in the testing group must be determined on a contributions basis, and benefits under any defined benefit plans may not be included in the employee benefit percentage. Similarly, if this method is used to determine whether a defined benefit plan satisfies the average benefit percentage test, employee benefit percentages under all defined benefit plans in the testing group must be determined on a benefits basis, and allocations under any defined contribution plans may not be included in the employee benefit percentage.

(ii) *Restriction on use of separate testing group determination method*. A plan does not satisfy the average benefit percentage test using the method provided in this paragraph (e)(3) unless each of the plans in the testing group

of the other type (i.e., defined benefit plan or defined contribution plan) than the plan being tested satisfies the average benefit test of §1.410(b)–2(b)(3) using the method in this paragraph (e)(3) or satisfies the ratio percentage test of §1.410(b)–2(b)(2).

(iii) *Treatment of permitted disparity.* Although under the general rule of this paragraph (e)(3) plans of another type are disregarded in determining employee benefit percentages, the permitted disparity used by those plans (including any permitted disparity that is used by those plans to satisfy §1.401(a)(4)–1(b)(2)) is nonetheless taken into account in determining the extent to which permitted disparity may be used in determining employee benefit percentages.

(iv) *Example.* The following example illustrates the rules of this paragraph (e)(3):

Example. Employer A maintains two defined benefit plans, neither of which covers a group of employees that satisfies the ratio percentage test of §1.410(b)–2(b)(2), and a profit-sharing plan and a section 401(k) plan, each of which benefits a group of employees that satisfies the ratio percentage test of §1.410(b)–2(b)(2). The defined benefit plans will satisfy the average benefit percentage test if the actual benefit percentage of all nonexcludable nonhighly compensated employees, computed on a benefits basis without regard to contributions under the profit-sharing plan or the section 401(k) plan, is at least 70 percent of the actual benefit percentage of all nonexcludable highly compensated employees, computed on a benefits basis without regard to contributions under the profit-sharing plan or the section 401(k) plan.

(4) *Simplified method for determining employee benefit percentages for certain defined benefit plans*—(i) *In general.* An employee's employee benefit percentage with respect to a plan may be determined under the simplified method of paragraph (e)(4)(ii) of this section, provided the following conditions are satisfied:

(A) The only plans included in the testing group are defined benefit plans, and employee benefit percentages under these plans are determined on a benefits basis.

(B) Employee benefit percentages under the plans in the testing group are not required to be determined by taking into account early retirement benefits under paragraph (d)(7) of this section.

(C) The plan is a safe harbor defined benefit plan described in §1.401(a)(4)–3(b).

(ii) *Simplified method*—(A) *Section 401(l) plans.* Under the simplified method of this paragraph (e)(4)(ii), an employee's employee benefit percentage with respect to a section 401(l) plan described in §1.401(a)(4)–3(b)(3) (i.e., a unit credit plan) may be deemed equal to the employee's excess benefit percentage or gross benefit percentage (as defined in §1.401(*l*)–1(c) (14) or (18), respectively), whichever is applicable under the plan's benefit formula in the plan year. In the case of a section 401(l) plan described in §1.401(a)(4)–3(b)(4) (i.e., a fractional accrual plan), an employee's employee benefit percentage with respect to that plan may be deemed equal to the rate at which the excess or gross benefit, whichever is applicable, accrues for the employee in the plan year, taking into account the plan's benefit formula and the employee's projected service at normal retirement age. The use of this simplified method will be treated as an imputation of permitted disparity. See paragraph (d)(6) of this section for a restriction on multiple use of permitted disparity.

(B) *Other plans.* Under the simplified method of this paragraph (e)(4)(ii), an employee's employee benefit percentage with respect to a plan described in §1.401(a)(4)–3(b)(3) that is not a section 401(*l*) plan and that is not imputing permitted disparity may be deemed equal to the employee's benefit rate in the plan year under the plan's benefit formula. In the case of a plan described in §1.401(a)(4)–3(b)(4) that is not a section 401(*l*) plan and that is not imputing permitted disparity, an employee's employee benefit percentage with respect to that plan may be deemed equal to the rate at which the benefit accrues for the employee in the plan year, taking into account the plan's benefit formula and an employee's projected service at normal retirement age.

(5) *Three-year averaging period.* An employee's employee benefit percentage may be determined for a testing period as the average of the employee's

employee benefit percentages determined separately for the testing period and for the immediately preceding one or two testing periods (referred to in this section as an averaging period). Employee benefit percentages of a particular employee that are averaged together within an averaging period must be determined on a consistent basis for all testing periods within the averaging period.

(6) *Alternative methods of determining compensation.* Employee benefit percentages may be determined on the basis of any definition of compensation that satisfies §1.414(s)–1(d) (without regard to whether the definition satisfies §1.414(s)–1(d)(3)), provided that the same definition is used for all employees and it is reasonable to believe that the definition does not result in an average benefit percentage that is significantly higher than the average benefit percentage that would be determined had employee benefit percentages been determined using a definition of compensation that also satisfies §1.414(s)–1(d)(3).

(f) *Special rule for certain collectively bargained plans.* A plan (as determined without regard to the mandatory disaggregation rule of §1.410(b)–7(c)(5)) that benefits both collectively bargained employees and noncollectively bargained employees is deemed to satisfy the average benefit percentage test of this section if—

(1) The provisions of the plan applicable to each employee in the plan are identical to the provisions of the plan applicable to every other employee in the plan, including the plan benefit or allocation formula, any optional forms of benefit, any ancillary benefit, and any other right or feature under the plan, and

(2) The plan would satisfy the ratio percentage test of §1.410(b)–2(b)(2), if §§1.410(b)–6(d) and 1.410(b)–7(c)(5) (the excludable employee and mandatory disaggregation rules for collectively bargained and noncollectively bargained employees) did not apply.

[T.D. 8363, 56 FR 47646, Sept. 19, 1991; 57 FR 10817, 10954, Mar. 31, 1992, as amended by T.D. 8487, 58 FR 46840, Sept. 3, 1993]

§ 1.410(b)–6 Excludable employees.

(a) *Employees*—(1) *In general.* For purposes of applying section 410(b) with respect to employees, all employees of the employer, other than the excludable employees described in paragraphs (b) through (i) of this section, are taken into account. Excludable employees are not taken into account with respect to a plan even if they are benefiting under the plan, except as otherwise provided in paragraph (b) of this section.

(2) *Rules of application.* Except as specifically provided otherwise, excludable employees are determined separately with respect to each plan for purposes of testing that plan under section 410(b). Thus, in determining whether a particular plan satisfies the ratio percentage test of §1.410(b)–2(b)(2), paragraphs (b) through (i) of this section are applied solely with reference to that plan. Similarly, in determining whether two or more plans that are permissively aggregated and treated as a single plan under §1.410(b)–7(d) satisfy the ratio percentage test of §1.410(b)–2(b)(2), paragraphs (b) through (i) of this section are applied solely with reference to the deemed single plan. In determining whether a plan satisfies the average benefit percentage test of §1.410(b)–5, the rules of this section are applied by treating all plans in the testing group as a single plan.

(b) *Minimum age and service exclusions*—(1) *In general.* If a plan applies minimum age and service eligibility conditions permissible under section 410(a)(1) and excludes all employees who do not meet those conditions from benefiting under the plan, then all employees who fail to satisfy those conditions are excludable employees with respect to that plan. An employee is treated as meeting the age and service requirements on the date that any employee with the same age and service (including service permitted to be taken into account for purposes of nondiscrimination testing under §1.401(a)(4)–11(d)(3)) would be eligible to commence participation in the plan, as provided in section 410(b)(4)(C).

(2) *Multiple age and service conditions.* If a plan, including a plan for which an employer chooses the treatment under paragraph (b)(3) of this section, has two

or more different sets of minimum age and service eligibility conditions, those employees who fail to satisfy all of the different sets of age and service conditions are excludable employees with respect to the plan. Except as provided in paragraph (b)(3) of this section, an employee who satisfies any one of the different sets of conditions is not an excludable employee with respect to the plan. Differences in the manner in which service is credited (e.g., hours of service calculated in accordance with 29 CFR 2530.200b–2 for hourly employees and elapsed time calculated in accordance with §1.410(a)–7 for salaried employees) for purposes of applying a service condition are not taken into account in determining whether multiple age and service eligibility conditions exist.

(3) *Plans benefiting certain otherwise excludable employees*—(i) *In general.* An employer may treat a plan benefiting otherwise excludable employees as two separate plans, one for the otherwise excludable employees and one for the other employees benefiting under the plan. See §1.410(b)–7(c)(3) regarding permissive disaggregation of plans benefiting otherwise excludable employees. The effect of this rule is that employees who would be excludable under paragraph (b)(1) of this section (applied without regard to section 410(a)(1)(B)) but for the fact that the plan does not apply the greatest permissible minimum age and service conditions may be treated as excludable employees with respect to the plan. This treatment is available only if the plan satisfies section 410(b) and §1.410(b)–2 with respect to these otherwise excludable employees in the manner described in paragraph (b)(3)(ii) of this section.

(ii) *Testing portion of plan benefiting otherwise excludable employees.* In determining whether the plan that benefits employees who would otherwise be excludable under paragraph (b)(1) of this section (applied without regard to section 410(a)(1)(B)) satisfies section 410(b) and §1.410(b)–2, employees who have satisfied the greatest permissible minimum age and service conditions with respect to the plan are excludable employees. In addition, if the plan being tested applies minimum age and service conditions and those conditions are less than the maximum permissible minimum age and service conditions, employees who have not satisfied the lower minimum age and service conditions actually provided for in the plan are excludable employees. Thus, for example, if the plan requires attainment of age 18 and 3 months of service, employees who have not attained age 18 or 3 months of service with the employer are excludable employees.

(4) *Examples.* The following examples illustrate the minimum age and service condition rules of this paragraph (b). In each example, the employer is not treated as operating qualified separate lines of business under section 414(r).

Example 1. An employer maintains Plan A for hourly employees and Plan B for salaried employees. Plan A has no minimum age or service condition. Plan B has no minimum age condition and requires 1 year of service. The employer treats Plans A and B as a single plan for purposes of section 410(b). Because Plan A imposes no minimum age or service condition, all employees of the employer automatically satisfy the minimum age and service conditions of Plan A. Therefore, no employees are excludable under this paragraph (b) in testing Plans A and B for purposes of section 410(b).

Example 2. An employer maintains three plans. Plan C benefits employees in Division C who satisfy the plan's minimum age and service condition of age 21 and 1 year of service. Plan D benefits employees in Division D who satisfy the plan's minimum age and service condition of age 18 and 1 year of service. Plan E benefits employees in Division E who satisfy the plan's minimum age and service condition of age 21 and 6 months of service. The employer treats Plans D and E as a single plan for purposes of section 410(b). In testing Plan C under the ratio percentage test or the nondiscriminatory classification test of section 410(b), employees who are not at least age 21 or who do not have at least 1 year of service are excludable employees under paragraph (b)(1) of this section. In testing Plans D and E, employees who do not satisfy the age and service requirements of either of the two plans are excludable employees under paragraph (b)(2) of this section. Thus, an employee is excludable with respect to Plans D and E only if the employee is not at least age 18 with at least 1 year of service or is not at least age 21 with at least 6 months of service. Thus, an employee who is 19 years old and has 11 months of service is excludable. Similarly, an employee who is 17 years old and has performed 2 years of service is also excludable.

Example 3. An employer maintains three plans. Plan F benefits all employees in Division F (the plan does not apply any minimum age or service condition). Plan G benefits employees in Division G who satisfy the plan's minimum age and service condition of age 18 and 1 year of service. Plan H benefits employees in Division H who satisfy the plan's minimum age and service condition of age 21 and 6 months of service. In testing the employer's plans under the average benefit percentage test provided in §1.410(b)–5, Plans F, G, and H are treated as a single plan and, as such, use the lowest minimum age and service condition under the rule of paragraph (b)(2) of this section. Therefore, because Plan F does not apply any minimum age or service condition, no employee is excludable under this paragraph (b).

Example 4. An employer maintains Plan J, which does not apply any minimum age or service conditions. Plan J benefits all employees in Division 1 but does not benefit employees in Division 2. Although Plan J has no minimum age or service condition, the employer wants to exclude employees whose age and service is below the permissible minimums provided in section 410(b)(1)(A). The employer has 110 employees who either do not have 1 year of service or are not at least age 21. Of these 110 employees, 10 are highly compensated employees and 100 are nonhighly compensated employees. Five of these highly compensated employees, or 50 percent, work in Division 1 and thus benefit under Plan J. Thirty-five of these nonhighly compensated employees, or 35 percent, work in Division 1 and thus benefit under Plan J. Plan J satisfies the ratio percentage test of section 410(b) with respect to employees who do not satisfy the greatest permissible minimum age and service requirement because the ratio percentage of that group of employees is 70 percent. Thus, in determining whether or not Plan J satisfies section 410(b), the 110 employees may be treated as excludable employees in accordance with paragraph (b)(3)(i) of this section.

(c) *Certain nonresident aliens*—(1) *General rule.* An employee who is a nonresident alien (within the meaning of section 7701(b)(1)(B)) and who receives no earned income (within the meaning of section 911(d)(2)) from the employer that constitutes income from sources within the United States (within the meaning of section 861(a)(3)) is treated as an excludable employee.

(2) *Special treaty rule.* In addition, an employee who is a nonresident alien (within the meaning of section 7701(b)(1)(B)) and who does receive earned income (within the meaning of section 911(d)(2)) from the employer that constitutes income from sources within the United States (within the meaning of section 861(a)(3)) is permitted to be excluded, if all of the employee's earned income from the employer from sources within the United States is exempt from United States income tax under an applicable income tax convention. This paragraph (c)(2) applies only if all employees described in the preceding sentence are so excluded.

(d) *Collectively bargained employees*—(1) *General rule.* A collectively bargained employee is an excludable employee with respect to a plan that benefits solely noncollectively bargained employees. If a plan (within the meaning of §1.410(b)–7(b)) benefits both collectively bargained employees and noncollectively bargained employees for a plan year, §1.410(b)–7(c)(4) provides that the portion of the plan that benefits the collectively bargained employees is treated as a separate plan from the portion of the plan that benefits the noncollectively bargained employees. Thus, a collectively bargained employee is always an excludable employee with respect to the mandatorily disaggregated portion of any plan that benefits noncollectively bargained employees.

(2) *Definition of collectively bargained employee*—(i) *In general.* A collectively bargained employee is an employee who is included in a unit of employees covered by an agreement that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, provided that there is evidence that retirement benefits were the subject of good faith bargaining between employee representatives and the employer or employers. An employee is a collectively bargained employee regardless of whether the employee benefits under any plan of the employer. See section 7701(a)(46) and §301.7701–17T of this chapter for additional requirements applicable to the collective bargaining agreement. An employee who performs hours of service during the plan year as both a collectively bargained employee and a noncollectively bargained employee is treated as a collectively bargained employee with respect to the hours of

service performed as a collectively bargained employee and a noncollectively bargained employee with respect to the hours of service performed as a noncollectively bargained employee. See §1.410(b)–7(c) for disaggregation rules for plans benefiting collectively bargained and noncollectively bargained employees.

(ii) *Special rules for certain employees in multiemployer plans*—(A) *In general.* For purposes of this paragraph (d), in testing the disaggregated portion of a multiemployer plan benefiting noncollectively bargained employees, a noncollectively bargained employee who benefits under the plan may be treated as a collectively bargained employee with respect to all of the employee's hours of service under the rules of paragraphs (d)(2)(ii) (B) through (E) of this section, if the employee is or was a member of a unit of employees covered by a collective bargaining agreement and that agreement or a successor agreement provides for the employee to benefit under the plan in the current plan year. For this purpose, provisions of a participation agreement or similar document are taken into account in determining whether a collective bargaining agreement provides for an employee to benefit under a multiemployer plan.

(B) *Employees who were collectively bargained employees during a portion of the current plan year.* An employee described in paragraph (d)(2)(ii)(A) of this section who performs services for one or more employers that are parties to the collective bargaining agreement, for the plan, or for the employee representative both as a collectively bargained employee and as a noncollectively bargained employee during a plan year may be treated as a collectively bargained employee for the plan year, provided that at least half of the employee's hours of service during the plan year are performed as a collectively bargained employee.

(C) *Employees who were collectively bargained employees during the collective bargaining agreement.* An employee described in paragraph (d)(2)(ii)(A) of this section who was a collectively bargained employee with respect to all of the employee's hours of service during a plan year (including employees who are treated as collectively bargained employees with respect to all of their hours of service during a plan year under paragraph (d)(2)(ii) (B) or (E) of this section) may be treated as a collectively bargained employee with respect to all of the employee's hours of service for the duration of the collective bargaining agreement applicable for such plan year or, if later, until the end of the following plan year. For this purpose, a collective bargaining agreement is applicable for a plan year if it provided for the employee to benefit in the plan and was effective for any portion of that plan year. This paragraph (d)(2)(ii)(C) does not apply unless the terms of the plan providing for benefit accruals treat the employee in a manner that is generally no more favorable than similarly-situated employees who are collectively bargained employees.

(D) *Employees who previously were collectively bargained employees.* An employee who was treated as a collectively bargained employee pursuant to paragraph (d)(2)(ii)(C) of this section may be treated as a collectively bargained employee with respect to all of the employee's hours of service after the end of the period described in paragraph (d)(2)(ii)(C) of this section, provided that the employee is performing services for one or more employers that are parties to the collective bargaining agreement, for the plan, or for the employee representative. This paragraph (d)(2)(ii)(D) does not apply unless the terms of the plan providing for benefit accruals treat the employee in a manner that is generally no more favorable than similarly-situated employees who are collectively bargained employees, and no more than five percent of the employees covered under the multiemployer plan are noncollectively bargained employees (determined without regard to this paragraph (d)(2)(ii)(D)). In determining whether more than five percent of the employees covered under the multiemployer plan are noncollectively bargained employees, those employees who are described in paragraphs (d)(2)(ii) (B) and (C) of this section are treated as collectively bargained employees.

(E) *Transition rule.* For a plan year beginning before the applicable effective date of these regulations as set forth in §1.410(b)–10 (b) or (d), any employee described in paragraph (d)(2)(ii)(A) of this section may be treated as a collectively bargained employee with respect to all of the employee's hours of service for that plan year.

(F) *Consistency requirement.* The rules in paragraphs (d)(2) (i) and (ii) of this section must be applied to all employees on a reasonable and consistent basis for the plan year.

(iii) *Covered by a collective bargaining agreement*—(A) *General rule.* For purposes of paragraph (d)(2)(i) of this section, an employee is included in a unit of employees covered by a collective bargaining agreement if and only if the employee is represented by a bona fide employee representative that is a party to the collective bargaining agreement under which the plan is maintained. Thus, for example, an employee of either a plan or the employee representative that is a party to the collective bargaining agreement under which the plan is maintained is not included in a unit of employees covered by the collective bargaining agreement under which the plan is maintained merely because the employee is covered under the plan pursuant to an agreement entered into by the plan or employee representative on behalf of the employee (other than in the capacity of an employee representative with respect to the employee). This is the case even if all of such employees benefiting under the plan constitute only a de minimis percentage of the total employees benefiting under the plan.

(B) *Plans covering professional employees*—(*1*) *In general.* An employee is not considered included in a unit of employees covered by a collective bargaining agreement for a plan year for purposes of paragraph (d)(2)(iii)(A) of this section if, for the plan year, more than 2 percent of the employees who are covered pursuant to the agreement are professionals. This rule applies to all employees under the agreement, nonprofessionals as well as professionals. Thus, no employees covered by such an agreement are excludable employees with respect to employees who are not covered by a collective bargaining agreement.

(*2*) *Multiple collective bargaining agreements.* This paragraph (d)(2)(iii)(B) is applied separately with respect to each collective bargaining agreement. Thus, for example, if a plan benefits two groups of employees, one included in a unit of employees covered by collective bargaining agreement X, more than 2 percent of whom are professionals, and another included in a unit of employees covered by collective bargaining agreement Y, none of whom are professionals, the group covered by agreement X is not considered covered by a collective bargaining agreement and the group covered by agreement Y is considered covered by a collective bargaining agreement.

(*3*) *Application of minimum coverage tests.* If a plan covers more than 2 percent professional employees, no employees in the plan are treated as covered by a collective bargaining agreement. A plan that covers more than 2 percent professional employees must satisfy section 410(b) without regard to section 413(b) and the special rule in §1.410(b)–2(b)(7) of this section (regarding collectively bargained plans). In such cases, all nonexcludable employees must be taken into account. For this purpose, employees included in other collective bargaining units are excludable employees. However, the employees who are not covered by a collective bargaining agreement and the employees who are covered by an agreement that has more than 2 percent professionals are not excludable employees.

(iv) *Examples.* The following examples illustrate the collective bargaining unit rules of this section.

Example 1. An employer has 700 collectively bargained employees (none of whom is a professional employee) and 300 noncollectively bargained employees (200 of whom are highly compensated employees). For purposes of applying the ratio percentage test of §1.410(b)–2(b)(2) to Plan X, which benefits only the 300 noncollectively bargained employees, the 700 collectively bargained employees are treated as excludable employees pursuant to paragraph (d) of this section.

Example 2. (i) An employer has 1,500 employees in the following categories:

	Noncollectively bargained employees	Collectively bargained employees	Total
Highly compensated employees	100	100	200
Nonhighly compensated employees	900	400	1,300
Total	1,000	500	1,500

The employer maintains Plan Y, which benefits 1,100 employees, including all of the noncollectively bargained employees (except for 100 nonhighly compensated employees who are noncollectively bargained employees), and 200 of the collectively bargained employees (including the 100 highly compensated employees who are collectively bargained employees). There are no professional employees covered by the collective bargaining agreement. In accordance with §1.410(b)–7(c)(4), the employer must apply the ratio percentage test of §1.410(b)–2(b)(2) to Plan Y as if the plan were two separate plans, one benefiting the noncollectively bargained employees and the other benefiting the collectively bargained employees.

(ii) In testing the portion of Plan Y that benefits the noncollectively bargained employees, the collectively bargained employees are excludable employees. That portion's ratio percentage is 88.89 percent ([800/900] /[100/100] = 88.89%/100% = 0.8889), and thus it satisfies the ratio percentage test. The portion of Plan Y that benefits collectively bargained employees automatically satisfies section 410(b) under the special rule in §1.410(b)–2(b)(7).

(e) *Employees of qualified separate lines of business.* If an employer is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with §1.414(r)–1 (b), in testing a plan that benefits employees of one qualified separate line of business, the employees of the other qualified separate lines of business of the employer are treated as excludable employees. The rule in this paragraph (e) does not apply for purposes of satisfying the nondiscriminatory classification requirement of section 410(b)(5)(B). See §§1.414(r)–1(c)(2) and 1.414(r)–8 (separate application of section 410(b) to the employees of a qualified separate line of business). In addition, the rule in this paragraph (e) does not apply to a plan that is tested under the special rule for employer-wide plans in §1.414(r)–1(c) (2) (ii) for a plan year.

(f) *Certain terminating employees*—(1) *In general.* An employee may be treated as an excludable employee for a plan year with respect to a particular plan if—

(i) The employee does not benefit under the plan for the plan year,

(ii) The employee is eligible to participate in the plan,

(iii) The plan has a minimum period of service requirement or a requirement that an employee be employed on the last day of the plan year (last-day requirement) in order for an employee to accrue a benefit or receive an allocation for the plan year,

(iv) The employee fails to accrue a benefit or receive an allocation under the plan solely because of the failure to satisfy the minimum period of service or last-day requirement,

(v) The employee terminates employment during the plan year with no more than 500 hours of service, and the employee is not an employee as of the last day of the plan year (for purposes of this paragraph (f)(1)(v), a plan that uses the elapsed time method of determining years of service may use either 91 consecutive calendar days or 3 consecutive calendar months instead of 500 hours of service, provided it uses the same convention for all employees during a plan year), and

(vi) If this paragraph (f) is applied with respect to any employee with respect to a plan for a plan year, it is applied with respect to all employees with respect to the plan for the plan year.

(2) *Hours of service.* For purposes of this paragraph (f), the term ''hours of service'' has the same meaning as provided for such term by 29 CFR 2530.200b–2 under the general method of crediting service for the employee. If one of the equivalencies set forth in 29 CFR 2530.200b–3 is used for crediting service under the plan, the 500-hour requirement must be adjusted accordingly.

(3) *Examples.* The following examples illustrate the provision of this paragraph (f).

Example 1. An employer has 35 employees who are eligible to participate under a defined contribution plan. The plan provides that an employee will not receive an allocation of contributions for a plan year unless the employee is employed by the employer on the last day of the plan year. Only 30 employees are employed by the employer on the

last day of the plan year. Two of the five employees who terminated employment before the last day of the plan year had 500 or fewer hours of service during the plan year, and the remaining three had more than 500 hours of service during the year. Of the five employees who were no longer employed on the last day of the plan year, the two with 500 hours of service or less during the plan year are treated as excludable employees for purposes of section 410(b), and the remaining three who had over 500 hours of service during the plan year are taken into account in testing the plan under section 410(b) but are treated as not benefiting under the plan.

Example 2. An employer has 30 employees who are eligible to participate under a defined contribution plan. The plan requires 1,000 hours of service to receive an allocation of contributions or forfeitures. Ten employees do not receive an allocation because of their failure to complete 1,000 hours of service. Three of the 10 employees who failed to satisfy the minimum service requirement completed 500 or fewer hours of service and terminated their employment. Two of the employees completed more than 500, but fewer than 1,000 hours of service and terminated their employment. The remaining five employees did not terminate employment. Under the rule in paragraph (f) of this section, the three terminated employees who completed 500 or fewer hours of service are treated as excludable employees for the portion of the plan year they are employed. The other seven employees who do not receive an allocation are taken into account in testing the plan under section 410(b) but are treated as not benefiting under the plan.

Example 3. An employer maintains two plans, Plan A for salaried employees and Plan B for hourly employees. Of the 100 salaried employees, two do not receive an allocation under Plan A for the plan year because they terminate employment before completing 500 hours of service. Of the 300 hourly employees, 50 do not receive an allocation under Plan B for the plan year because they terminate employment before completing 500 hours. In applying section 410(b) to Plan A, the two employees who did not receive an allocation under Plan A are excludable employees, but the 50 who did not receive an allocation under Plan B are not excludable employees, because they were not eligible to participate under Plan A.

(g) *Employees of certain governmental or tax-exempt entities*—(1) *Plans covered.* For purposes of testing either a section 401(k) plan, or a section 401(m) plan that is provided under the same general arrangement as a section 401(k) plan, an employer may treat as excludable those employees described in paragraphs (g)(2) and (3) of this section.

(2) *Employees of governmental entities.* Employees of governmental entities who are precluded from being eligible employees under a section 401(k) plan by reason of section 401(k)(4)(B)(ii) may be treated as excludable employees if more than 95 percent of the employees of the employer who are not precluded from being eligible employees by reason of section 401(k)(4)(B)(ii) benefit under the plan for the year.

(3) *Employees of tax-exempt entities.* Employees of an organization described in section 403(b)(1)(A)(i) who are eligible to make salary reduction contributions under section 403(b) may be treated as excludable with respect to a section 401(k) plan, or a section 401(m) plan that is provided under the same general arrangement as a section 401(k) plan, if—

(i) No employee of an organization described in section 403(b)(1)(A)(i) is eligible to participate in such section 401(k) plan or section 401(m) plan; and

(ii) At least 95 percent of the employees who are neither employees of an organization described in section 403(b)(1)(A)(i) nor employees of a governmental entity who are precluded from being eligible employees under a section 401(k) plan by reason of section 401(k)(4)(B)(ii) are eligible to participate in such section 401(k) plan or section 401(m) plan.

(h) *Former employees*—(1) *In general.* For purposes of applying section 410(b) with respect to former employees, all former employees of the employer are taken into account, except that the employer may treat a former employee described in paragraph (h)(2) or (h)(3) of this section as an excludable former employee. If either (or both) of the former employee exclusion rules under paragraphs (h)(2) and (h)(3) of this section is applied, it must be applied to all former employees for the plan year on a consistent basis.

(2) *Employees terminated before a specified date.* The employer may treat a former employee as excludable if—

(i) The former employee became a former employee either prior to January 1, 1984, or prior to the tenth calendar year preceding the calendar year in which the current plan year begins, and

(ii) The former employee became a former employee in a calendar year that precedes the earliest calendar year in which any former employee who benefits under the plan in the current plan year became a former employee.

(3) *Previously excludable employees.* The employer may treat a former employee as excludable if the former employee was an excludable employee (or would have been an excludable employee if these regulations had been in effect) under the rules of paragraphs (b) through (g) of this section during the plan year in which the former employee became a former employee. If the employer treats a former employee as excludable pursuant to this paragraph (h)(3), the former employee is not taken into account with respect to a plan even if the former employee is benefiting under the plan.

(i) *Former employees treated as employees.* An employer may treat as excludable employees all formerly nonhighly compensated employees who are treated as employees of the employer under § 1.410(b)–9 solely because they have increases in accrued benefits under a defined benefit plan that are based on ongoing service or compensation credits (including imputed service or compensation) after they cease to perform services for the employer.

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§ 1.410(b)–7 Definition of plan and rules governing plan disaggregation and aggregation.

(a) *In general.* This section provides a definition of ''plan.'' First, this section sets forth a definition of plan within the meaning of section 401(a) or 403(a). Then certain mandatory disaggregation and permissive aggregation rules are applied. The result is the definition of plan that applies for purposes of sections 410(b) and 401(a)(4). Thus, in general, the term ''plan'' as used in this section initially refers to a plan described in section 414(l) and to an annuity plan described in section 403(a), and the term ''plan'' as used in other sections under these regulations means the plan determined after application of this section. Paragraph (b) of this section provides that each single plan under section 414(l) is treated as a single plan for purposes of section 410(b). Paragraph (c) of this section describes the rules for certain plans that must be treated as comprising two or more separate plans, each of which is a single plan subject to section 410(b). Paragraph (d) of this section provides a rule permitting an employer to aggregate certain separate plans to form a single plan for purposes of section 410(b). Paragraph (e) of this section provides rules for determining the testing group of plans taken into account in determining whether a plan satisfies the average benefit percentage test of § 1.410(b)–5.

(b) *Separate asset pools are separate plans.* Each single plan within the meaning of section 414(l) is a separate plan for purposes of section 410(b). See § 1.414(l)–1(b). For example, if only a portion of the assets under a defined benefit plan is available, on an ongoing basis, to provide the benefits of certain employees, and the remaining assets are available only in certain limited cases to provide such benefits (but are available in all cases for the benefit of other employees), there are two separate plans. Similarly, the defined contribution portion of a plan described in section 414(k) is a separate plan from the defined benefit portion of that same plan. A single plan under section 414(l) is a single plan for purposes of section 410(b), even though the plan comprises separate written documents and separate trusts, each of which receives a separate determination letter from the Internal Revenue Service. A defined contribution plan does not comprise separate plans merely because it includes more than one trust, or merely because it provides for separate accounts and permits employees to direct the investment of the amounts allocated to their accounts. Further, a plan does not comprise separate plans merely because assets are separately invested in individual insurance or annuity contracts for employees.

(c) *Mandatory disaggregation of certain plans*—(1) *Section 401(k) and 401(m)*

plans. The portion of a plan that is a section 401(k) plan and the portion that is not a section 401(k) plan are treated as separate plans for purposes of section 410(b). Similarly, the portion of a plan that is a section 401(m) plan and the portion that is not a section 401(m) plan are treated as separate plans for purposes of section 410(b). Thus, a plan that consists of elective contributions under a section 401(k) plan, employee and matching contributions under a section 401(m) plan, and contributions other than elective, employee, or matching contributions is treated as three separate plans for purposes of section 410(b). In addition, the portion of a plan that consists of contributions described in §1.401(k)–2(a)(5) (i.e., contributions that fail to satisfy the allocation or compensation requirements applicable to elective contributions and are therefore required to be tested separately) and the portion of the plan that does not consist of such contributions are treated as separate plans for purposes of section 410(b). Similarly, the portion of a plan that consists of contributions described in §1.410(m)–1(b)(4)(ii) (i.e., matching contributions that fail to satisfy the allocation and other requirements applicable to matching contributions and are therefore required to be tested separately) and the portion of the plan that does not consist of such contributions are treated as separate plans for purposes of section 410(b).

(2) *ESOPs and non-ESOPs*. The portion of a plan that is an ESOP and the portion of the plan that is not an ESOP are treated as separate plans for purposes of section 410(b), except as otherwise permitted under §54.4975–11(e) of this Chapter.

(3) *Plans benefiting otherwise excludable employees*. If an employer applies section 410(b) separately to the portion of a plan that benefits only employees who satisfy age and service conditions under the plan that are lower than the greatest minimum age and service conditions permissible under section 410(a), the plan is treated as comprising separate plans, one benefiting the employees who have satisfied the lower minimum age and service conditions but not the greatest minimum age and service conditions permitted under section 410(a) and one benefiting employees who have satisfied the greatest minimum age and service conditions permitted under section 410(a). See §410(b)–6(b)(3)(ii) for rules about testing otherwise excludable employees.

(4) *Plans benefiting certain disaggregation populations of employees*—(i) *In general*—(A) *Single plan must be treated as separate plans*. If a plan (*i.e.*, a single plan within the meaning of section 414(l)) benefits employees of more than one disaggregation population, the plan must be disaggregated and treated as separate plans, each separate plan consisting of the portion of the plan benefiting the employees of each disaggregation population. See paragraph (c)(4)(ii) of this section for the definition of disaggregation population.

(B) *Benefit accruals or allocations attributable to current status*. Except as otherwise provided in paragraph (c)(4)(i)(C) of this section, in applying the rule of paragraph (c)(4)(i)(A) of this section, the portion of the plan benefiting employees of a disaggregation population consists of all benefits accrued by, or all allocations made to, employees while they were members of the disaggregation population.

(C) *Exceptions for certain benefit accruals*—(*1*) *Attribution of benefits to first disaggregation population*. If employees benefiting under a plan change from one disaggregation population to a second disaggregation population, benefits they accrue while members of the second disaggregation population that are attributable to years of service previously credited while the employees were members of the first disaggregation population may be treated as provided to them in their status as members of the first disaggregation population and thus included in the portion of the plan benefiting employees of the first disaggregation population. This special treatment is available only if it is applied on a consistent basis, if it does not result in significant discrimination in favor of highly compensated employees, and if the plan provision providing the additional benefits applies on the same terms to all similarly-situated employees. For example, if all formerly

collectively bargained employees accrue additional benefits under a plan after becoming noncollectively bargained employees, then those benefit increases may be treated as included in the portion of the plan benefiting collectively bargained employees if they are attributable to years of service credited while the employees were collectively bargained (e.g., where the additional benefits result from compensation increases that occur while the employees are noncollectively bargained or from plan amendments affecting benefits earned while collectively bargained that are adopted while the employees are noncollectively bargained) and if such treatment does not result in significant discrimination in favor of highly compensated employees.

(*2*) *Attribution of benefits to current disaggregation population*. If employees benefiting under a plan change from one disaggregation population to another disaggregation population, benefits they accrue while members of the first disaggregation population may be treated as provided to them in their current status and thus included in the portion of the plan benefiting employees of the disaggregation population of which they are currently members. This special treatment is available only if it is applied on a consistent basis and if it does not result in significant discrimination in favor of highly compensated employees.

(D) *Change in disaggregation populations*—(*1*) *Reasonable treatment*. If, in previous years, the configuration of a plan's disaggregation populations differed from their configuration for the current year, for purposes of the benefits accrued by, or allocations made to, an employee for those years, the employee's status as a member of a current disaggregation population for those years must be determined on a reasonable basis. A different configuration occurs, for example, if disaggregation populations exist for the first time, such as when an employer is first treated as operating qualified separate lines of business, or if the existing disaggregation populations change, such as when an employer redesignates its qualified separate lines of business.

(*2*) *Example*. The following example illustrates the application of this paragraph (c)(4)(i)(D).

Example. (a) Employer X operates Divisions M and N, which are treated as qualified separate lines of business for the first time in 1998. Thus, the disaggregation populations of employees of Division M and employees of Division N exist for the first time. Since 1981 Employer X has maintained a defined benefit plan, Plan P, for employees of Division M. Plan P provides a normal retirement benefit of one percent of average annual compensation for each year of service up to 25. Employee A has worked for Division M since 1981 and has never worked for Division N. Employee B has worked for Division N since 1989 and worked for Division M from 1981 to 1988. Employee C has worked in the headquarters of Employer X since 1981. For the period 1981 to 1988 Employee C was credited with years of service under Plan P.

(b) For purposes of the benefits accrued by Employee A under Plan P during years 1981 through 1997, Employee A is reasonably treated as having been a member of the Division M disaggregation population for those years. For purposes of the benefits accrued by Employee B under Plan P during years 1981 through 1988, Employee B is reasonably treated as having been a member of the Division M disaggregation population for 1981 through 1988 and as having changed to the Division N disaggregation population for 1989 through 1997. For purposes of the benefits accrued by Employee C under Plan P during years 1981 through 1988, Employee C is reasonably treated as having been a member of the Division M disaggregation population for those years. Moreover, any benefit accruals for Employee B and Employee C in years after 1988, that result from increases in average annual compensation after 1988 and that are attributable to years of service credited for 1981 through 1988, may be treated as provided to Employee B and Employee C in their status as members of the Division M disaggregation population if the requirements of paragraph (c)(4)(i)(C)(*1*) of this section are otherwise met.

(ii) *Definition of disaggregation population*—(A) *Plan benefiting employees of qualified separate lines of business*. If an employer is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with § 1.414(r)–1(b), and a plan benefits employees of more than one qualified separate line of business, the employees of each qualified separate line of business are separate disaggregation populations. In this case, the portion of the plan benefiting the employees of

each qualified separate line of business is treated as a separate plan maintained by that qualified separate line of business. However, employees of different qualified separate lines of business who are benefiting under a plan that is tested under the special rule for employer-wide plans in §1.414(r)–1(c)(2)(ii) for a plan year are not separate disaggregation populations merely because they are employees of different qualified separate lines of business.

(B) *Plan benefiting collectively bargained employees*. If a plan benefits both collectively bargained employees and noncollectively bargained employees, the collectively bargained employees are one disaggregation population and the noncollectively bargained employees are another disaggregation population. If the population of collectively bargained employees includes employees covered under different collective bargaining agreements, the population of employees covered under each collective bargaining agreement is also a separate disaggregation population.

(C) *Plan maintained by more than one employer*. If a plan benefits employees of more than one employer, the employees of each employer are separate disaggregation populations. In this case, the portion of the plan benefiting the employees of each employer is treated as a separate plan maintained by that employer, which must satisfy section 410(b) by reference only to that employer's employees. However, for purposes of this paragraph (c)(4)(ii)(C), if the plan of one employer (or, in the case of a plan maintained by more than one employer, the plan provisions applicable to the employees of one employer) treats compensation or service with another employer as compensation or service with the first employer, then the current accruals attributable to that compensation or service are treated as provided to an employee of the first employer under the plan of the first employer (or the portion of a plan maintained by more than one employer benefiting employees of the first employer), and the provisions of paragraph (c)(4)(i)(C) of this section do not apply to those accruals. Thus, for example, if Plan A maintained by Employer X imputes service or compensation for an employee of Employer Y, then Plan A is not treated as benefiting the employees of more than one employer merely because of this imputation.

(5) *Additional rule for plans benefiting employees of more than one qualified separate line of business*. If a plan benefiting employees of more than one qualified separate line of business satisfies the reasonable classification requirement of §1.410(b)–4(b) before the application of paragraph (c)(4) of this section, then any portion of the plan that is treated as a separate plan as a result of the application of paragraphs (c)(4)(i)(A) and (ii)(A) of this section is deemed to satisfy that requirement.

(d) *Permissive aggregation for ratio percentage and nondiscriminatory classification tests*—(1) *In general*. Except as provided in paragraphs (d)(2) and (d)(3) of this section, for purposes of applying the ratio percentage test of §1.410(b)–2(b)(2) or the nondiscriminatory classification test of §1.410(b)–4, an employer may designate two or more separate plans (determined after application of paragraph (b) of this section) as a single plan. If an employer treats two or more separate plans as a single plan under this paragraph, the plans must be treated as a single plan for all purposes under sections 401(a)(4) and 410(b).

(2) *Rules of disaggregation*. An employer may not aggregate portions of a plan that are disaggregated under the rules of paragraph (c) of this section. Similarly, an employer may not aggregate two or more separate plans that would be disaggregated under the rules of paragraph (c) of this section if they were portions of the same plan. In addition, an employer may not aggregate an ESOP with another ESOP, except as permitted under §54.4975–11(e) of this Chapter.

(3) *Duplicative aggregation*. A plan may not be combined with two or more plans to form more than one single plan. Thus, for example, an employer that maintains plans A, B, and C may not aggregate plans A and B and plans A and C to form two single plans. However, the employer may apply the permissive aggregation rules of this paragraph (d) to form any one (and only one) of the following combinations:

plan ABC, plans AB and C, plans AC and B, or plans A and BC.

(4) *Special rule for plans benefiting employees of a qualified separate line of business.* For purposes of paragraph (d)(1) of this section, an employer that is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with §1.414(r)–1(b) is permitted to aggregate the portions of two or more plans that benefit employees of the same qualified separate line of business (regardless of whether the employer elects to aggregate the portions of the same plans that benefit employees of the other qualified separate lines of business of the employer), provided that none of the plans is tested under the special rule for employer-wide plans in §1.414(r)–1 (c)(2)(ii). Thus, the employer is permitted to apply paragraph (d)(1) of this section with respect to two or more separate plans determined after the application of paragraphs (b) and (c)(4) of this section, but may not aggregate a plan that is tested under the special rule for employer-wide plans in §1.414(r)–1(c)(2)(ii) for a plan year with any portion of a plan that does not rely on that special rule for the plan year. In all other respects, the provisions of this paragraph (d) regarding permissive aggregation apply, including (but not limited to) the disaggregation rules under paragraph (d)(2) of this section (including the mandatory disaggregation rule of paragraph (c)(4) of this section), and the prohibition on duplicative aggregation under paragraph (d)(3) of this section. This paragraph (d)(4) applies only in the case of an employer that is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with §1.414(r)–1(b). See §§1.414(r)–1(c)(2) and 1.414(r)–8 (separate application of section 410(b) to the employees of a qualified separate line of business).

(5) *Same plan year requirement.* Two or more plans may not be aggregated and treated as a single plan under this paragraph (d) unless they have the same plan year.

(e) *Determination of plans in testing group for average benefit percentage test*—(1) *In general.* For purposes of applying the average benefit percentage test of §1.410(b)–5 with respect to a plan, all plans in the testing group must be taken into account. For this purpose, the plans in the testing group are the plan being tested and all other plans of the employer that could be permissively aggregated with that plan under paragraph (d) of this section. Whether two or more plans could be permissively aggregated under paragraph (d) of this section is determined (i) without regard to the rule in paragraph (d)(4) of this section that portions of two or more plans benefiting employees of the same line of business may not be aggregated if any of the plans is tested under the special rule for employer-wide plans in §1.414(r)–1(c)(2)(ii), (ii) without regard to paragraph (d)(5) of this section, and (iii) by applying paragraph (d)(2) of this section without regard to paragraphs (c)(1) and (c)(2) of this section.

(2) *Examples.* The following example illustrates the rules of this paragraph (e).

Example 1. Employer X is treated as operating two qualified separate lines of business for purposes of section 410(b) in accordance with section 414(r), QSLOB1 and QSLOB2. Employer X must apply the rules in §1.414(r)–8 to determine whether its plans satisfy section 410(b) on a qualified-separate-line-of-business basis. Employer X maintains the following plans:

(a) Plan A, the portion of Employer X' s employer-wide section 401(k) plan that benefits all noncollectively bargained employees of QSLOB1,

(b) Plan B, the portion of Employer X' s employer-wide section 401(k) plan that benefits all noncollectively bargained employees of QSLOB2,

(c) Plan C, a defined benefit plan that benefits all hourly noncollectively bargained employees of QSLOB1,

(d) Plan D, a defined benefit plan that benefits all collectively bargained employees of QSLOB1,

(e) Plan E, an ESOP that benefits all noncollectively bargained employees of QSLOB1,

(f) Plan F, a profit-sharing plan that benefits all salaried noncollectively bargained employees of QSLOB1.

Assume that Plan F does not satisfy the ratio percentage test of §1.410(b)–2(b)(2) on a qualified-separate-line-of-business basis, but does satisfy the nondiscriminatory classification test of §1.410(b)–4 on both an employer-wide and a qualified-separate-line-of-business basis. Therefore, to satisfy section

410(b), Plan F must satisfy the average benefit percentage test of §1.410(b)–5 on a qualifiedseparatelineofbu5ine55 basis. The plans in the testing group used to determine whether Plan F satisfies the average benefit percentage test of §1.4 10(b)–5 are Plans A, C, E, and F.

Example 2. The facts are the same as in *Example 1*, except that Employer X applies the special rule for employer-wide plans in §1.414(r)–1(c)(2)(ii) to its employer-wide section 401(k) plan. To satisfy section 410(b), Plan F must satisfy the average benefit percentage test of §1.4 10(b)–5. Since paragraph (c)(4) of this section no longer applies to Plans A and B, they are treated as a single plan (Plan AB). The plans in the testing group used to determine whether Plan F satisfies the average benefit percentage test of §1.4 10(b)–5 are therefore Plans A, B, C, E, and F. However, the employees of QSLOB 2 continue to be excludable employees for purposes of determining whether Plan F satisfies the average benefit percentage test. See §1.410(b)–6(e).

(f) *Section 403(b) plans*. In determining whether a plan satisfies section 410(b), a plan subject to section 403(b)(12)(A)(i) is disregarded. However, in determining whether a plan subject to section 403(b)(12)(A)(i) satisfied section 410(b), plans that are not subject to section 403(b)(12)(A)(i) may be taken into account.

[T.D. 8363, 56 FR 47655, Sept. 19, 1991, as amended by T.D. 8376, 56 FR 63433, Dec. 4, 1991; T.D. 8363, 57 FR 10819, 10954, Mar. 31, 1992; T.D. 8487, 58 FR 46843, Sept. 3, 1993; T.D. 8548, 59 FR 32914, June 27, 1994; T.D. 9169, 69 FR 78153, Dec. 29, 2004]

§1.410(b)–8 Additional rules.

(a) *Testing methods*—(1) *In general*. A plan must satisfy section 410(b) for a plan year using one of the testing options in paragraphs (a)(2) through (a)(4) of this section. Whichever testing option is used for the plan year must also be used for purposes of applying section 401(a)(4) to the plan for the plan year. The annual testing option in paragraph (a)(4) of this section must be used in applying section 410(b) to a section 401(k) plan or a section 401(m) plan, and in applying the average benefit percentage test of §1.410(b)–5. For purposes of this paragraph (a), the plan provisions and other relevant facts as of the last day of the plan year regarding which employees benefit under the plan for the plan year are applied to the employees taken into account under the testing option used for the plan year. For this purpose, amendments retroactively correcting a plan in accordance with §1.401(a)(4)–11(g) are taken into account as plan provisions in effect as of the last day of the plan year.

(2) *Daily testing option*. A plan satisfies section 410(b) for a plan year if it satisfies §1.410(b)–2 on each day of the plan year, taking into account only those employees (or former employees) who are employees (or former employees) on that day.

(3) *Quarterly testing option*. A plan is deemed to satisfy section 410(b) for a plan year if the plan satisfies §1.410(b)–2 on at least one day in each quarter of the plan year, taking into account for each of those days only those employees (or former employees) who are employees (or former employees) on that day. The preceding sentence does not apply if the plan's eligibility rules or benefit formula operate to cause the four quarterly testing days selected by the employer not to be reasonably representative of the coverage of the plan over the entire plan year.

(4) *Annual testing option*. A plan satisfies section 410(b) for a plan year if it satisfies §1.410(b)–2 as of the last day of the plan year, taking into account all employees (or former employees) who were employees (or former employees) on any day during the plan year.

(5) *Example*. The following example illustrates this paragraph (a).

Example. Plan A is a defined contribution plan that is not a section 401(k) plan or a section 401(m) plan, and that conditions allocations on an employee's employment on the last day of the plan year. Plan A is being tested for the 1995 calendar plan year using the daily testing option in paragraph (a)(2) of this section. In testing the plan for compliance with section 410(b) on March 11, 1995, Employee X is taken into account because he was an employee on that day and was not an excludable employee with respect to Plan A on that day. Employee X was a participant in Plan A on March 11, 1995, was employed on December 31, 1995, and received an allocation under Plan A for the 1995 plan year. Under these facts, Employee X is treated as benefiting under Plan A on March 11, 1995, even though Employee X had not satisfied all of the conditions for receiving an allocation on that day, because Employee X satisfied all of those conditions as of the last day of the plan year.

(b) *Family member aggregation rule.* For purposes of section 410(b), and in accordance with section 414(q)(6), a highly compensated employee who is a 5-percent owner or one of the ten most highly compensated employees and any family member (or members) of such a highly compensated employee who is also an employee of the employer are to be treated as a single highly compensated employee. If any member of that group is benefiting under a plan, the deemed single employee is treated as benefiting under the plan. If no member of that group is benefiting under a plan, the deemed single employee is treated as not benefiting under the plan.

[T.D. 8363, 56 FR 47656, Sept. 19, 1991]

§ 1.410(b)–9 Definitions.

In applying this section and §§ 1.410(b)–2 through 1.410(b)–10, the definitions in this section govern unless otherwise provided.

Collectively bargained employee. Collectively bargained employee means a collectively bargained employee within the meaning of § 1.410(b)–6(d)(2).

Defined benefit plan. Defined benefit plan means a defined benefit plan within the meaning of section 414(j). The portion of a plan described in section 414(k) that does not consist of separate accounts is treated as a defined benefit plan.

Defined contribution plan. Defined contribution plan means a defined contribution plan within the meaning of section 414(i). The portion of a plan described in section 414(k) that consists of separate accounts is treated as a defined contribution plan.

Employee. Employee means an individual who performs services for the employer who is either a common law employee of the employer, a self-employed individual who is treated as an employee pursuant to section 401(c)(1), or a leased employee (not excluded under section 414(n)(5)) who is treated as an employee of the employer-recipient under section 414(n)(2) or 414(o)(2). Individuals that an employer treats as employees under section 414(n) pursuant to the requirements of section 414(o) are considered to be leased employees for purposes of this rule. In addition, an individual must be treated as an employee with respect to allocations under a defined contribution plan taken into account under § 1.401(a)(4)–2(c)(ii) and with respect to increases in accrued benefits (within the meaning of 411(a)(7)) under a defined benefit plan that are based on ongoing service or compensation (including imputed service or compensation) credits.

Employer. Employer means the employer maintaining the plan and those employers required to be aggregated with the employer under sections 414(b), (c), (m), or (o). An individual who owns the entire interest of an unincorporated trade or business is treated as an employer. Also, a partnership is treated as the employer of each partner and each employee of the partnership.

ESOP. ESOP or *employee stock ownership plan* means an employee stock ownership plan within the meaning of section 4975(e)(7) or a tax credit employee stock ownership plan within the meaning of section 409(a).

Former employee. Former employee means an individual who was, but has ceased to be, an employee of the employer (i.e., the individual has ceased performing services as an employee for the employer). An individual is treated as a former employee beginning on the day after the day on which the individual ceases performing services as an employee for the employer. Thus, an individual who ceases performing services as an employee for an employer during a plan year is both an employee and a former employee for the plan year. Notwithstanding the foregoing, an individual is an employee (and not a former employee) to the extent that the individual is treated as an employee with respect to the plan for the plan year under the definition of employee in this section.

Highly compensated employee. Highly compensated employee means an employee who is a highly compensated employee within the meaning of section 414(q) or a former employee treated as an employee under the definition of employee in this section who is a highly compensated former employee within the meaning of section 414(q).

Highly compensated former employee. Highly compensated former employee means a former employee who is a

highly compensated former employee within the meaning of section 414(q).

Multiemployer plan. Multiemployer plan means a multiemployer plan within the meaning of section 414(f).

Noncollectively bargained employee. Noncollectively bargained employee means an employee who is not a collectively bargained employee.

Nonhighly compensated employee. Nonhighly compensated employee means an employee who is not a highly compensated employee.

Nonhighly compensated former employee. Nonhighly compensated former employee means a former employee who is not a highly compensated former employee.

Plan year. Plan year means the plan year of the plan as defined in the written plan document. In the absence of a specifically designated plan year, the plan year is deemed to be the calendar year.

Plan year compensation. Plan year compensation means plan year compensation within the meaning of §1.401(a)(4)–12.

Professional employee. Professional employee means any highly compensated employee who, on any day of the plan year, performs professional services for the employer as an actuary, architect, attorney, chiropodist, chiropractor, dentist, executive, investment banker, medical doctor, optometrist, osteopath, podiatrist, psychologist, certified or other public accountant, stockbroker, or veterinarian, or in any other professional capacity determined by the Commissioner in a notice or other document of general applicability to constitute the performance of services as a professional.

Ratio percentage. With respect to a plan for a plan year, a plan's *ratio percentage* means the percentage (rounded to the nearest hundredth of a percentage point) determined by dividing the percentage of the nonhighly compensated employees who benefit under the plan by the percentage of the highly compensated employees who benefit under the plan. The percentage of the nonhighly compensated employees who benefit under the plan is determined by dividing the number of nonhighly compensated employees benefiting under the plan by the total number of nonhighly compensated employees of the employer. The percentage of the highly compensated employees who benefit under the plan is determined by dividing the number of highly compensated employees benefiting under the plan by the total number of highly compensated employees of the employer.

Section 401(k) plan. Section 401(k) plan means a plan consisting of elective contributions described in §1.40(k)–1(g)(3) under a qualified cash or deferred arrangement described in §1.401(k)–1(a)(4)(i). Thus, a section 401(k) plan does not include a plan (or portion of a plan) that consists of contributions under a nonqualified cash or deferred arrangement, or qualified nonelective or qualified matching contributions treated as elective contributions under §1.401(k)–1(a)(6).

Section 401(l) plan. Section 401(l) plan means a plan that—

(1) Provides for a disparity in employer-provided benefits or contributions that satisfies section 401(l) in form, and

(2) Relies on one of the safe harbors of §1.401(a)(4)–2(b)(2), 1.401(a)(4)–3(b), 1.401(a)(4)–8(b)(3), or 1.401(a)(4)–8(c)(3)(iii)(B) to satisfy section 401(a)(4).

Section 401(m) plan. Section 401(m) plan means a plan consisting of employee contributions described in §1.401(m)–1(f)(6) or matching contributions described in §1.40(m)–1(f)(12), or both. Thus, a section 401(m) plan does not include a plan (or portion of a plan) that consists of elective contributions or qualified nonelective contributions treated as matching contributions under §1.401(m)–1(b)(5).

[T.D. 8363, 56 FR 47657, Sept. 19, 1991; 57 FR 10817, 10954, Mar. 31, 1992, as amended by T.D. 8487, 58 FR 46843, Sept. 3, 1993; T.D. 9169, 69 FR 78153, Dec. 29, 2004]

EDITORIAL NOTE: By T.D. 9169, 69 FR 78153, Dec. 29, 2004, the Internal Revenue Service published a document in the FEDERAL REGISTER, attempting to amend §1.410(b)–9 by removing ''1.401(k)–1(g)(3) and 1.401(m)–1(f)(12)'' and inserting ''1.401(k)–6 and 1.401(m)–1(f)(12)''. However, because of inaccurate language, this amendment could not be incorporated.

§ 1.410(b)–10 Effective dates and transition rules.

(a) *Statutory effective dates*—(1) *In general*. Except as set forth in paragraph (a)(2) of this section, the minimum coverage rules of section 410(b) as amended by section 1112 of the Tax Reform Act of 1986 apply to plan years beginning on or after January 1, 1989.

(2) *Special statutory effective date for collective bargaining agreements*—(i) *In general*. As provided for by section 1112(e)(2) of the Tax Reform Act of 1986, in the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before March 1, 1986, the minimum coverage rules of section 410(b) as amended by section 1112 of the Tax Reform Act of 1986 do not apply to employees covered by any such agreement in plan years beginning before the earlier of—

(A) January 1, 1991; or

(B) The later of January 1, 1989, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986). For purposes of this paragraph (a)(2), any extension or renegotiation of a collective bargaining agreement, which extension or renegotiation is ratified after February 28, 1986, is to be disregarded in determining the date on which the agreement terminates.

(ii) *Example*. The following example illustrates this paragraph (a)(2).

Example. Employer A maintains Plan 1 pursuant to a collective bargaining agreement. Plan 1 covers 100 of Employer A's noncollectively bargained employees and 900 of Employer A's collectively bargained employees. Employer A also maintains Plan 2, which covers Employer A's other 400 noncollectively bargained employees. The collective bargaining agreement under which Plan 1 is maintained was entered into on January 1, 1986, and expires December 31, 1992. Because Plan 1 is a plan maintained pursuant to a collective bargaining agreement, section 410(b) applies to the first plan year beginning on or after January 1, 1991. In applying section 410(b) to Plan 2, the 100 noncollectively bargained employees in Plan 1 must be taken into account. The deferred effective date for plans maintained pursuant to a collective bargaining agreement is not applicable in determining how section 410(b) is applied to a plan that is not maintained pursuant to a collective bargaining agreement.

(iii) *Plan maintained pursuant to a collective bargaining agreement*. For purposes of this paragraph (a)(2), a plan is maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers, if one or more of the agreements were ratified before March 1, 1986. Only plans maintained pursuant to agreements that the Secretary of Labor finds to be collective bargaining agreements and that satisfy section 7701(a)(46) are eligible for the deferred effective date under this paragraph (a)(2). A plan will not be treated as a plan maintained pursuant to one or more collective bargaining agreements eligible for the deferred effective date under this paragraph (a)(2) unless the plan would be a plan maintained pursuant to one or more collective bargaining agreements under the principles applied under section 1017(c) of the Employee Retirement Income Security Act of 1974. See H.R. Rep. No. 1280, 93rd Cong. 2d Sess. 266 (1974).

(b) *Regulatory effective dates*—(1) *In general*. Except as otherwise provided in this section, §§1.410(b)–2 through 1.410(b)–9 apply to plan years beginning on or after January 1, 1994.

(2) *Plans of tax-exempt organizations*. In the case of plans maintained by organizations exempt from income taxation under section 501(a), including plans subject to section 403(b)(12)(A)(i) (nonelective plans), §§1.410(b)–2 through 1.410(b)–9 apply to plan years beginning on or after January 1, 1996, to the extent such plans are subject to section 410(b).

(c) *Compliance during transition period*. For plan years beginning before the effective date of these regulations, as set forth in paragraph (b) of this section, and on or after the statutory effective date as set forth in paragraph (a) of this section, a plan must be operated in accordance with a reasonable, good faith interpretation of section 410(b). Whether a plan is operated in accordance with a reasonable, good faith interpretation of section 410(b) will generally be determined based on all of the relevant facts and circumstances, including the extent to which an employer has resolved unclear issues in

its favor. If a plan's classification has been determined by the Commissioner to be nondiscriminatory and there have been no significant changes in or omissions of a material fact, the classification will be treated as nondiscriminatory for the relevant plan year. A plan will be deemed to be operated in accordance with a reasonable, good faith interpretation of section 410(b) if it is operated in accordance with the terms of §§1.410(b)–2 through 1.410(b)–9.

(d) *Effective date for governmental plans.* In the case of governmental plans described in section 414(d), including plans subject to section 403(b)(12)(A)(i) (nonelective plans) §1.410(b)–2 through §1.410(b)–10 apply to plan years beginning on or after January 1, 1996, or 90 days after the opening of the first legislative session beginning on or after January 1, 1996, of the governing body with authority to amend the plan, if that body does not meet continuously. Such plans are deemed to satisfy section 410(b) (and in the case of such plans that are not subject to section 403(b)(12)(A)(i), section 401(a)(3) as in effect on September 1, 1974) for plan years before that effective date. For purposes of this section, the governing body with authority to amend the plan is the legislature, board, commission, council, or other governing body with authority to amend the plan. See §1.410(b)–2(d) and (e).

(e) *Effective date for provisions relating to exclusion of employees of certain tax-exempt entities.* The provisions in §1.410(b)–6(g) apply to plan years beginning after December 31, 1996. For plan years to which §1.410(b)–6 applies that begin before January 1, 1997, §1.410(b)–6(g) (as it appeared in the April 1, 2005 edition of 26 CFR part 1) applies.

[T.D. 8487, 58 FR 46844, Sept. 3, 1993, as amended by T.D. 9275, 71 FR 41359, July 21, 2006]

§1.410(d)–1 Election by church to have participation, vesting, funding, etc. provisions apply.

(a) *In general.* If a church or convention or association of churches which maintains any church plan, as defined in section 414(e), makes an election under this section, certain provisions of the Code and title I of the Employee Retirement Income Security Act of 1974 (the ''Act'') shall apply to such church plan as if such plan were not a church plan. The provisions of the Code referred to are section 410 (relating to minimum participation standards), section 411 (relating to minimum vesting standards), section 412 (relating to minimum funding standards), section 4975 (relating to prohibited transactions), and paragraphs (11), (12), (13), (14), (15), and (19) of section 401(a) (relating to joint and survivor annuities, mergers and consolidations, assignment or alienation of benefits, time of benefit commencement, certain social security increases, and withdrawals of employee contributions, respectively).

(b) *Election is irrevocable.* An election under this section with respect to any church plan shall be binding with respect to such plan and, once made, shall be irrevocable.

(c) *Procedure for making election*—(1) *Time of election.* An election under this section may be made for plan years for which the provisions of section 410(d) of the Code apply to the church plan. By reason of section 1017(b) of the Act section 410(d) does not apply to a plan in existence on January 1, 1974, for plan years beginning before January 1, 1976. Section 1017(d) of the Act permits a plan administrator to elect to have certain provisions of the Code (including section 410(d)) apply to a plan before the otherwise applicable effective dates of such provisions. See §1.410(a)–2(d). Therefore, for a plan in existence on Janurary 1, 1974, an election under section 410(d) of the Code may be made for a plan year beginning before January 1, 1976, only if an election has been made under section 1017(d) of the Act with respect to that plan year.

(2) *By whom election is to be made.* The election provided by this section may be made only by the plan administrator of the church plan.

(3) *Manner of making election.* The plan administrator may elect to have the provisions of the Code described in paragraph (a) of this section apply to the church plan as it is were not a church plan by attaching the statement described in subparagraph (5) of this paragraph to either (i) the annual return required under section 6058(a) (or an amended return) with respect to

the plan which is filed for the first plan year for which the election is effective or (ii) a written request for a determination letter relating to the qualification of the plan under section 401(a), 403(a), or 405(a) of the Code and if trusteed, the exempt status under section 501(a) of the Code of a trust constituting a part of the plan.

(4) *Conditional election*. If an election is made with a written request for a determination letter, the election may be conditioned upon issuance of a favorable determination letter and will become irrevocable upon issuance of such letter.

(5) *Statement*. The statement described in subparagraph (3) of this paragraph shall indicate (i) that the election is made under section 410(d) of the Code and (ii) the first plan year for which it is effective.

(Sec. 410 (88 Stat. 898; 26 U.S.C. 410))

[T.D. 7508, 42 FR 47198, Sept. 20, 1977]

§ 1.411(a)–1 Minimum vesting standards; general rules.

(a) *In general*. A plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) unless—

(1) The plan provides that an employee's right to his normal retirement benefit (see § 1.411(a)–7(c)) is nonforfeitable (see § 1.411(a)–4) upon and after the attainment of normal retirement age (see § 1.411(a)–7(b)),

(2) The plan provides that an employee's rights in his accrued benefit derived from his own contributions (see § 1.411(c)–1) are nonforfeitable at all times, and

(3) The plan satisfies the requirements of—

(A) Section 411(a)(2) and § 1.411(a)–3 (relating to vesting in accrued benefit derived from employer contributions), and

(B) In the case of a defined benefit plan, section 411(b)(1) and § 1.411(b)–1 (relating to accrued benefit).

(b) *Organization of regulations relating to minimum vesting standards*—(1) *General rules*. This section prescribes general rules relating to the minimum vesting standards provided by section 411.

(2) *Effective dates*. Section 1.411(a)–2 provides rules under section 1017 of the Employee Retirement Income Security Act of 1974 relating to effective dates under section 411.

(3) *Employer contributions*. Section 1.411(a)–3 provides rules under section 411(a)(2) relating to vesting in employer-derived accrued benefits.

(4) *Certain forfeitures*. Section 1.411(a)–4 provides rules under section 411(a)(3) relating to certain permitted forfeitures, suspensions, etc. under qualified plans.

(5) *Nonforfeitable percentage*. Section 1.411(a)–5 provides rules under section 411(a)(4) relating to service included in the determination of an employee's nonforfeitable percentage under section 411(a)(2) and § 1.411(a)–3.

(6) *Years of service; break in service*. Section 1.411(a)–6 provides rules under section 411(a) (5) and (6) of the Internal Revenue Code of 1954 relating to years of service and breaks in service. Rules prescribed by the Secretary of Labor, relating to years of service and breaks in service under part 2 of subtitle B of title I of the Employee Retirement Income Security Act of 1974 are provided under 29 CFR Part 2530 (Department of Labor regulations relating to minimum standards for employee pension benefit plans).

(7) *Definitions and special rules*. Section 1.411(a)–7 provides definitions and special rules under section 411(a) (7), (8), and (9), for purposes of section 411 and the regulations thereunder.

(8) *Changes in vesting schedule*. Section 1.411(a)–8 provides rules under section 411(a)(10) relating to changes in the vesting schedule of a plan.

(9) *Breaks in service*. Section 1.411(a)–9 provides special rules relating to breaks in service.

(10) *Accrued benefits*. See § 1.411(b)–1 for rules under section 411(b) relating to accrued benefit requirements under defined benefit plans.

(11) *Allocation of accrued benefits*. See § 1.411(c)–1 for rules under section 411(c) relating to allocation of accrued benefits between employer and employee contributions.

(12) *Discrimination, etc*. See § 1.411(d)–1 for rules relating to the coordination of section 411 with section 401(a)(4) (relating to discrimination) and other rules under section 411(d).

(c) *Application of standards to certain plans*—(1) *General rule*. Except as provided in subparagraph (2) of this paragraph, section 411 does not apply to—

(i) A governmental plan (within the meaning of section 414(d) and the regulations thereunder),

(ii) A church plan (within the meaning of section 414(e) and the regulations thereunder) which has not made the election provided by section 410(d) and the regulations thereunder,

(iii) A plan which has not provided for employer contributions at any time after September 2, 1974, and

(iv) A plan established and maintained by a society, order, or association described in section 501(c) (8) or (9), if no part of the contributions to or under such plan are made by employers of participants in such plan.

(2) *Vesting requirements*. A plan described in subparagraph (1) of this paragraph shall, for purposes of section 401(a), be treated as meeting the requirements of section 411 if such plan meets the vesting requirements resulting from the application of section 401(a)(4) and section 401(a)(7) as in effect on September 1, 1974.

(d) *Supersession*. Sections 11.411(a)–1 through 11.411(d)–3, inclusive, of the Temporary Income Tax Regulations under the Employee Retirement Income Security Act of 1974 are superseded by this section and §§1.411(a)–2 through 1.411(d)–3.

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42324, Aug. 23, 1977]

§ 1.411(a)–2 Effective dates.

(a) *Plan not in existence on January 1, 1974*. Under section 1017(a) of the Employee Retirement Income Security Act of 1974, in the case of a plan which was not in existence on January 1, 1974, section 411 and the regulations thereunder apply for plan years beginning after September 2, 1974. See paragraph (c) of this section for time plan is considered in existence.

(b) *Plans in existence on January 1, 1974*. Under section 1017(b) of the Employee Retirement Income Security Act of 1974, in the case of a plan which was in existence on January 1, 1974, section 411 and the regulations thereunder apply for plan years beginning after December 31, 1975. See paragraph (c) of this section for time plan is considered to be in existence.

(c) *Time of plan existence*—(1) *General rule*. For purposes of this section, a plan is considered to be in existence on a particular day if—

(i) The plan on or before that day was reduced to writing and adopted by the employer (including, in the case of a corporate employer, formal approval by the employer's board of directors and, if required, shareholders), even though no amounts had been contributed under the plan as of such day, and

(ii) The plan was not terminated on or before that day.

For example, if a plan was adopted on January 2, 1974, effective as of January 1, 1974, the plan is not considered to have been in existence on January 1, 1974, because it was not both adopted and in writing on January 1, 1974.

(2) *Collectively-bargained plan*. Notwithstanding paragraph (c) (1) of this section, a plan described in section 413 (a), relating to a plan maintained pursuant to a collective-bargaining agreement, is considered to be in existence on a particular day if—

(i) On or before that day there is a legally enforceable agreement to establish such a plan signed by the employer, and

(ii) The employer contributions to be made to the plan are set forth in the agreement.

(3) *Special rule*. If a plan is considered to be in existence under subparagraph (1) of this paragraph, any other plan with which such existing plan is merged or consolidated shall also be considered to be in existence on such date.

(d) *Existing plans under collective-bargaining agreements*. For a special effective date rule for certain plans maintained pursuant to a collective bargaining agreement, see section 1017(c)(1) of the Employee Retirement Income Security Act of 1974 (88 Stat. 932).

(e) *Certain existing plans may elect new provisions*. The plan administrator may elect to have the provisions of the Code relating to participation, vesting, funding, and form of benefit apply to a selected plan year. See §1.410(a)–2(d) for rules relating to such an election.

(f) *Application of rules.* The requirements of section 411 do not apply to employees who separate from service with the employer prior to the first plan year to which such requirements apply and who never return to service with the employer in a plan year to which section 411 applies.

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42325, Aug. 23, 1977]

§ 1.411(a)–3 Vesting in employer-derived benefits.

(a) *In general*—(1) *Alternative requirements.* A plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) unless the plan satisfies the requirements of section 411(a)(2) and this section. A plan satisfies the requirements of this section if is satisfies the requirements of paragraph (b), (c), or (d) of this section.

(2) *Composite arrangements.* A plan will not be considered to satisfy the requirements of paragraph (b), (c), or (d) of this section unless it satisfies all requirements of a particular one of such paragraphs with respect to all of an employee's years of service. A plan which, for example, satisfies the requirements of paragraph (b) (but not (c) or (d)) for an employee's first 9 years of service and satisfies the requirements of paragraph (c) (but not (b)) for all of his remaining years of service, does not satisfy the requirements of this section. A plan is not precluded from satisfying the requirement of one such paragraph with respect to one group of employees and another such paragraph with respect to another group provided that the groups are not so structured as to evade the requirements of this paragraph. For example, if plan A provides that employees who commence participation before age 30 are subject to the ''rule of 45'' vesting schedule and employees who commence participation after age 30 are subject to the full vesting after 10 years schedule, plan A would be so structured as to evade the requirements of this paragraph.

(3) *Plan amendments.* A plan which satisfies the requirements of a particular one of such paragraphs for each of an employee's years of service and which is amended so that, as amended, it satisfies the requirements of another such paragraph for all such years of service, satisfies the requirements of this section even though, as amended, it does not satisfy the requirements of the paragraph which were satisfied prior to the amendment. See § 1.411(a)–8 for rules relating to employee election where the vesting schedule is amended.

(b) *10-year vesting.* A plan satisfies the requirements of section 411(a)(2) (A) and this paragraph if an employee who has completed 10 years of service has a nonforfeitable right to 100 percent of his accrued benefit derived from employer contributions.

(c) *5- to 15-year vesting.* A plan satisfies the requirements of section 411(a)(2) (B) and this paragraph if an employee who has completed at least 5 years of service has a nonforfeitable right to a percentage of his accrued benefit derived from employer contribution which percentage is not less than the nonforfeitable percentage determined under the following table:

Completed years of service	Nonforfeitable percentage
5	25
6	30
7	35
8	40
9	45
10	50
11	60
12	70
13	80
14	90
15 or more	100

(d) *Rule of 45.* A plan satisfies the requirements of section 411(a)(2)(C) and this paragraph if an employee is entitled to the greater of the two percentages determined under paragraph (d) (1) or (2) of this section.

(1) *Age and service test.* An employee who is not separated from the service, who has completed at least 5 years of service, and with respect to whom the sum of his age and years of service equals of exceeds 45, has a nonforfeitable right to a percentage of his accrued benefit derived from employer contributions which is not less than the nonforfeitable percentage corresponding to his number of completed years of service to the sum of his age

and completed years of service (whichever percentage is the lesser) determined under the following table:

Completed years of service	Sum of age and service	Nonforfeitable percentage
5	45 or 46	50
6	47 or 48	60
7	49 or 50	70
8	51 or 52	80
9	53 or 54	90
10 or more	55 or more	100

(2) *Service test*. An employee who has completed at least 10 years of service has a nonforfeitable right to a percentage of his accrued benefit derived from employer contributions determined under the following table:

Completed years of service	Nonforfeitable percentage
10	50
11	60
12	70
13	80
14	90
15	100

(3) *Computation of age*. For purposes of subparagraph (1) of this paragraph, the age of an employee is his age on his last birthday.

(e) *Examples*. The rules provided by this section are illustrated by the following examples:

Example 1. Plan B provides that each employee's rights to his employer-derived accrued benefit are nonforfeitable as follows:

Completed years of service	Nonforfeitable percentage
2 or less	0
3	30
4	35
5	40
6	45
7	50
8	55
9	60
10	65
11	70
12	75
13	80
14	85
15	100

Plan B does not satisfy the requirements of paragraph (c) of this section (relating to 5–15-year vesting) because the nonforfeitable percentage provided by the plan after completion of 14 years of service (85 percent) is less than the percentage required by paragraph (c) of this section at that time (90 percent). The fact that the nonforfeitable percentage provided by the plan for years prior to the 13th year of service is greater than the percentage required under paragraph (c) of this section is immaterial. The plan fails to satisfy the requirements of paragraph (c) of this section even if it is demonstrated that the value of the vesting provided by the plan to the employee is at least equal to the value of the vesting rate required by that paragraph.

Example 2. Plan C provides for plan participation after the completion of 1 year of service. The plan provides that each employee's rights to his employer-derived accrued benefit are 100 percent nonforfeitable after 10 years of plan participation rather than service. The plan does not satisfy the requirements of paragraph (b) of this section because, under the plan, an employee obtains a 100 percent nonforfeitable right to his employer-derived accrued benefit only after completion of more than 10 years of service.

Example 3. Plan D provides that each employee's rights to his employer-derived accrued benefit are nonforfeitable in accordance with the following schedule:

Completed years of service	Nonforfeitable percentage
0–9	0
10	50
11	60
12	70
13	80
14	90
15	100

The plan does not satisfy the requirements of paragraph (b) of this section after the 9th year of service. It does not satisfy the requirements of paragraph (c) of this section for years prior to the 10th year of service. It does not satisfy the requirements of paragraph (d)(1) of this section for any year of service prior to the 10th year. The plan does not satisfy the requirements of this section because it does not satisfy the requirements of a particular one of the three paragraphs for each of an employee's years of service.

Example 4. Plan G provides that each employee's rights to his employer-derived accrued benefit are 100 percent nonforfeitable upon completion of 5 years of service. The plan satisfies the requirements of paragraphs (b), (c), and (d) of this section and, because it satisfies the requirements of at least one of such paragraphs for all of an employee's years of service, it satisfies the requirements of this section.

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42325, Aug. 23, 1977]

§ 1.411(a)–3T Vesting in employer-derived benefits (temporary).

(a) *In general*—(1) [Reserved]

(2) *Composite arrangements.* A plan will not be considered to satisfy the requirements of paragraph (b), (c), or (d) of this section unless it satisfies all requirements of a particular one of such paragraphs with respect to all of an employee's years of service. A plan which, for example, satisfies the requirements of paragraph (b) (but not (c) or (d)) for an employee's first 4 years of service and satisfies the requirements of paragraph (c) (but not (b)) for all of his remaining years of service does not satisfy the requirements of this section. A plan is not precluded from satisfying the requirements of one such paragraph with respect to one group of employees and another such paragraph with respect to another group provided that the groups are not so structured as to evade the requirements of this paragraph.

(b) *5-year vesting.* A plan satisfies the requirements of section 411(a)(2)(A) and this paragraph if an employee who has completed 5 years of service has a nonforfeitable right to 100 percent of his or her accrued benefits derived from employer contributions.

(c) *3- to 7-year vesting.* A plan satisfies the requirements of section 411(a)(2)(B) and this paragraph if an employee who has completed at least 3 years of service has a nonforfeitable right to a percentage of his accrued benefit derived from employer contributions, which percentage is not less than the nonforfeitable percentage determined under the following table:

Completed years of service	Nonforfeitable percentage
3	20
4	40
5	60
6	80
7 or more	100

(d) *Multiemployer plans.* A plan satisfies the requirements of section 411(a)(2)(C) and this paragraph if—

(1) The plan is a multiemployer plan (within the meaning of section 414(f)), and

(2) Under the plan—

(i) An employee who is covered pursuant to a collective bargaining agreement described in section 414(f)(1)(B) has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions not later than upon completion of 10 years of service, and

(ii) The requirements of paragraph (b) or (c) of this section are met with respect to employees who are not covered pursuant to a collective bargaining agreement described in section 414(f)(1)(B).

(iii) For purposes of this provision, an employee is not covered pursuant to a collective bargaining agreement unless the employee is represented by a bona fide employee representative that is a party to the collective bargaining agreement pursuant to which the multiemployer plan is maintained. Thus, for example, an employee of either the multiemployer plan or the employee representative is not covered pursuant to the collective bargaining agreement under which the plan is maintained even if the employee is covered pursuant to an agreement entered into by the multiemployer plan or employee representative on behalf of the employee and even if all such employees covered under the plan constitute only a de minimis percentage of the total employees covered under the plan.

(e) *Effective date.* (1) The provisions of this section apply to all employees who have one hour of service in any plan year beginning after—

(i) December 31, 1988, or

(ii) In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before March 1, 1986, for employees covered by any such agreement, the earlier of—

(A) The later of—

(*1*) January 1, 1989, or

(*2*) The date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986), or

(B) January 1, 1991.

(2) For employees not described in paragraph (e)(1), above, the regulations in effect prior to January 1, 1989, shall be applied to determine the requirements of this section.

(f) *Examples*. The rules provided by this section are illustrated by the following examples:

Example 1. Plan B provides that each employee's rights to his employer-derived accrued benefit are nonforfeitable as follows:

Completed years of service	Nonforfeitable percentage
1	0
2	10
3	25
4	45
5	65
6	75
7	100

Plan B does not satisfy the requirements of paragraph (c) of this section (relating to 3- to 7-year vesting) because the nonforfeitable percentage provided by the plan after completion of 6 years of service (75 percent) is less than the percentage required by paragraph (c) of this section at that time (80 percent). The fact that the nonforfeitable percentage provided by the plan for years prior to the 6th year of service is greater than the percentage required under paragraph (c) of this section is immaterial. The plan fails to satisfy the requirements of paragraph (c) of this section even if it is demonstrated that the value of the vesting provided by the plan to the employees is at least equal to the value of the vesting rate required by this paragraph.

Example 2. Plan C provides for plan participation after the completion of 1 year of service. The plan provides that each employee's rights to his employer-derived accrued benefits are 100 percent nonforfeitable after 5 years of plan participation rather than service. The plan does not satisfy the requirements of paragraph (b) of this section because, under the plan, an employee obtains a 100 percent nonforfeitable right to his or her employer-derived accrued benefit only after completion of more than 5 years of service.

Example 3. Plan D provides that each employee's rights to his employer-derived accrued benefits are nonforfeitable in accordance with the following schedule:

Completed years of service	Nonforfeitable percentage
0 to 4	0
5	60
6	80
7	100

The plan does not satisfy the requirements of paragraph (b) of this section after the 4th year of service. It does not satisfy the requirements of paragraph (c) of this section for years prior to the 5th year of service. The plan does not satisfy the requirements of this section because it does not satisfy the requirements of a particular one of the two paragraphs for each of an employee's years of service.

Example 4. Plan G provides that each employee's rights to his employer-derived accrued benefit are 100 percent nonforfeitable upon completion of 3 years of service. The plan satisfies the requirements of paragraphs (b) and (c) of this section and, because it satisfies the requirements of at least one of such paragraphs for all of an employee's years of service, it satisfies the requirements of this section.

[T.D. 8170, 53 FR 240, Jan. 6, 1988]

§ 1.411(a)–4 Forfeitures, suspensions, etc.

(a) *Nonforfeitability*. Certain rights in an accrued benefit must be nonforfeitable to satisfy the requirements of section 411(a). This section defines the term ''nonforfeitable'' for purposes of these requirements. For purposes of section 411 and the regulations thereunder, a right to an accrued benefit is considered to be nonforfeitable at a particular time if, at that time and thereafter, it is an unconditional right. Except as provided by paragraph (b) of this section, a right which, at a particular time, is conditioned under the plan upon a subsequent event, subsequent performance, or subsequent forbearance which will cause the loss of such right is a forfeitable right at that time. Certain adjustments to plan benefits such as adjustments in excess of reasonable actuarial reductions, can result in rights being forfeitable. Rights which are conditioned upon a sufficiency of plan assets in the event of a termination or partial termination are considered to be forfeitable because of such condition. However, a plan does not violate the nonforfeitability requirements merely because in the event of a termination an employee does not have any recourse toward satisfaction of his nonforfeitable benefits from other than the plan assets or the Pension Benefit Guaranty Corporation. Furthermore, nonforfeitable rights are not considered to be forfeitable by reason of the fact that they may be reduced to take into account benefits which are provided under the Social Security Act or under any other Federal or State law and which are taken

into account in determining plan benefits. To the extent that rights are not required to be nonforfeitable to satisfy the minimum vesting standards, or the nondiscrimination requirements of section 401(a)(4), they may be forfeited without regard to the limitations on forfeitability required by this section. The right of an employee to repurchase his accrued benefit for example under section 411(a)(3)(D), is an example of a right which is required to satisfy such standards. Accordingly, such a right is subject to the limitations on forfeitability. Rights which are required to be prospectively nonforfeitable under the vesting standards are nonforfeitable and may not be forfeited until it is determined that such rights are, in fact, in excess of the vesting standards. Thus, employees have a right to vest in the accrued benefits if they continue in employment of employers maintaining the plan unless a forfeitable event recognized by section 411 occurs. For example, if a plan covered employees in Division A of Corporation X under a plan utilizing a 10-year 100 percent vesting schedule, the plan could not forfeit employees' rights on account of their moving to service in Division B of Corporation X prior to completion of 10 years of service even though employees are not vested at that time.

(b) *Special rules.* For purposes of paragraph (a) of this section a right is not treated as forfeitable—

(1) *Death*—(i) *General rule.* In the case of a participant's right to his employer-derived accrued benefit, merely because such accrued benefit is forfeitable by the participant to the extent it has not been paid or distributed to him prior to his death. This subparagraph shall not apply to a benefit which must be paid to a survivor in order to satisfy the requirements of section 401(a)(11).

(ii) *Employee contributions.* A participant's right in his accrued benefit derived from his own contributions must be nonforfeitable at all times. Such a right is not treated as forfeitable merely because, after commencement of annuity or pension payments in a benefit form provided under the plan, the participant dies without receiving payments equal in amount to his nonforfeitable accrued benefit derived from his contributions determined at the time of commencement.

(2) *Suspension of benefits upon reemployment of retiree.* In the case of certain suspensions of benefits under section 411(a)(3)(B), see regulations prescribed by the Secretary of Labor under 29 CFR Part 2530 (Department of Labor regulations relating to minimum standards for employee pension benefit plans).

(3) *Retroactive plan amendment.* In the case of a participant's right to his employer-derived accrued benefit, merely because such benefit is subject to reduction to the extent provided by a plan amendment described in section 412(c)(8) and the regulations thereunder, which amendment is given retroactive effect in accordance with such section.

(4) *Other forfeiture rules*—(i) *Withdrawal of mandatory contributions.* For rules allowing forfeitures on account of the withdrawal of mandatory contributions, see § 1.411(a)–7(d) (2) and (3).

(ii) *Additional requirements.* For additional requirements relating to nonforfeitability of benefits in the event of a withdrawal by the employee, see section 401(a)(19) and § 1.401(a)–19.

(5) *Multiemployer plan.* In the case of a multiemployer plan described in section 414(f), merely because an employee's accrued benefit which results from service with an employer before such employer was required to contribute to the plan is forfeitable on account of the cessation of contributions by the employer of the employee. This subparagraph shall not apply to an employee's accrued benefit with respect to an employer which accrued under a plan maintained by that employer prior to the adoption by that employer of the multiemployer plan.

(6) *Lost beneficiary; escheat.* In the case of a benefit which is payable, merely because the benefit is forfeitable on account of the inability to find the participant or beneficiary to whom payment is due, provided that the plan provides for reinstatement of the benefit if a claim is made by the participant or beneficiary for the forfeited benefit. In addition, a benefit which is lost by reason of escheat under applicable state law is not treated as a forfeiture.

(7) *Certain matching contributions.* A matching contribution (within the meaning of section 401(m)(4)(A) and §1.401(m)–1(a)(2)) is not treated as forfeitable even if under the plan it may be forfeited under §1.401(m)–2(b)(1) because the contribution to which it relates is treated as an excess contribution (within the meaning of §§1.401(k)–2(b)(2)(ii) and 1.401(k)–6), excess deferral (within the meaning of §1.402(g)–1(e)(1)(iii)), excess aggregate contribution (within the meaning of §1.401(m)–5), or a default elective contribution (within the meaning of §1.414(w)–1(e)) that is withdrawn in accordance with the requirements of §1.414(w)–1(c).

(c) *Examples.* The rules of this section are illustrated by the following examples:

Example 1. Corporation A's plan provides that an employee is fully vested in his employer-derived accrued benefit after completion of 5 years of service. The plan also provides that, if an employee works for a competitor he forfeits his rights in the plan. Such provision could result in the forfeiture of an employee's rights which are required to be nonforfeitable under section 411 and therefore the plan would not satisfy the requirements of section 411. If the plan limited the forfeiture to employees who completed less than 10 years of service, the plan would not fail to satisfy the requirements of section 411 because the forfeitures under this provision are limited to rights which are in excess of the minimum required to be nonforfeitable under section 411(a)(2)(A).

Example 2. Plan B provides that if an employee does not apply for benefits within 5 years after the attainment of normal retirement age, the employee loses his plan benefits. Such a plan provision could result in forfeiture of an employee's rights which are required to be nonforfeitable under section 411 and, therefore, the plan would not satisfy the requirements of section 411.

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42326, Aug. 23, 1977, as amended by T.D. 8357, 56 FR 40549, Aug. 15, 1991; T.D. 9169, 69 FR 78153, Dec. 29, 2004; T.D. 9219, 70 FR 47126, Aug. 12, 2005; T.D. 9447, 74 FR 8211, Feb. 24, 2009]

EDITORIAL NOTE: By T.D. 9169, 69 FR 78153, Dec. 29, 2004, §1.411(a)–(b)(7) was amended by removing the reference to §1.401(k)–1(f)(2) and (g)(7). However, the reference does not appear in the paragraph.

§1.411(a)–4T Forfeitures, suspensions, etc. (temporary).

(a) *Nonforfeitability.* Certain rights in an accrued benefit must be nonforfeitable to satisfy the requirements of section 411(a). This section defines the term ''nonforfeitable'' for purposes of these requirements. For purposes of section 411 and the regulations thereunder, a right to an accrued benefit is considered to be nonforfeitable at a particular time if, at that time and thereafter, it is an unconditional right. Except as provided by paragraph (b) of this section, a right which, at a particular time, is conditioned under the plan upon a subsequent event, subsequent performance, or subsequent forbearance which will cause the loss of such right is a forfeitable right at that time. Certain adjustments to plan benefits, such as adjustments in excess of reasonable actuarial reductions, can result in rights being forfeitable. Rights which are conditioned upon a sufficiency of plan assets in the event of a termination or partial termination are considered to be forfeitable because of such condition. However, a plan does not violate the nonforfeitability requirements merely because in the event of a termination an employee does not have any recourse toward satisfaction of his nonforfeitable benefits from other than the plan assets, the Pension Benefit Guaranty Corporation, or a trust established and maintained pursuant to sections 4041(c)(3)(B) (ii) or (iii) and section 4049 of ERISA with respect to the plan. Furthermore, nonforfeitable rights are not considered to be forfeitable by reason of the fact that they may be reduced as allowed under sections 401(a)(5) and 401(l). To the extent that rights are not required to be nonforfeitable to satisfy the minimum vesting standards, or the nondiscrimination requirements of section 401(a)(4), they may be forfeited without regard to the limitations on forfeitability required by this section. The right of an employee to repurchase his accrued benefit for example under section 411(a)(3)(D), is an example of a right which is required to satisfy such standards. Accordingly, such a right is subject to the limitations on forfeitability. Rights which are required to be prospectively nonforfeitable under the

vesting standards are nonforfeitable and may not be forfeited until it is determined that such rights are, in fact, in excess of the vesting standards. Thus, employees have a right to vest in the accrued benefits if they continue in employment of employers maintaining the plan unless a forfeitable event recognized by section 411 occurs. For example, if a plan covered employees in Division A of Corporation X under a plan utilizing a 5-year 100 percent vesting schedule, the plan could not forfeit employees' rights on account of their moving to service in Division B of Corporation X prior to completion of 5 years of service even though employees are not vested at that time.

(b) [Reserved]

(c) *Examples*. The rules of this section ae illustrated by the following examples:

Example 1. Corporation A's plan provides that an employee is fully vested in his employer-derived accrued benefit after completion of 3 years of service. The plan also provides that if the employee works for a competitor he forfeits his rights in the plan. Such provision could result in the forfeiture of an employee's rights which are required to be nonforfeitable under section 411 and therefore the plan would not satisfy the requirements of section 411. If the plan limited the forfeiture to employees who completed less than 5 years of service, the plan would not fail to satisfy the requirements of section 411 because the forfeitures under this provision are limited to rights which are in excess of the minimum required to be nonforfeitable under section 411(a)(2)(A).

[T.D. 8170, 53 FR 241, Jan. 6, 1988]

§ 1.411(a)–5 Service included in determination of nonforfeitable percentage.

(a) *In general*. Under section 411(a)(4), for purposes of determining the nonforfeitable percentage of an employee's right to his employer-derived accrued benefit under section 411(a)(2) and § 1.411(a)–3, all of an employee's years of service with an employer or employers maintaining the plan shall be taken into account except that years of service described in paragraph (b) of this section may be disregarded.

(b) *Certain service*. For purposes of paragraph (a) of this section, the following years of service may be disregarded:

(1) *Service before age 22*. (i) In the case of a plan which satisfies the requirements of section 411(a)(2) (A) or (B) (relating to 10-year vesting and 5–15-year vesting, respectively), a year of service completed by an employee before he attains age 22.

(ii) In the case of a plan which does not satisfy the requirements of section 411(a)(2) (A) or (B), a year of service completed by an employee before he attains age 22 if the employee is not a participant (for purposes of section 410) in the plan at any time during such year.

(iii) For purposes of this subparagraph in the case of a plan utilizing computation periods, service during a computation period described in section 411(a)(5)(A) within which the employee attains age 22 may not be disregarded. In the case of a plan utilizing the elapsed time method described in § 1.410(a)–7, service on or after the date on which the employee attains age 22 may not be disregarded.

(2) *Contributory plans*. In the case of a plan utilizing computation periods, a year of service completed by an employee under a plan which requires mandatory contributions (within the meaning of section 411(c)(2)(C) and § 1.411(c)–1(c)(4)) to be made by the employee for such year, if the employee does not participate for such year solely because of his failure to make all mandatory contributions to the plan for such year. If the employee contributes any part of the mandatory contributions for the year, such year may not be excluded by reason of this subparagraph. In the case of a plan utilizing the elapsed time method described in § 1.410(a)–7, the service which may be disregarded is the period with respect to which the mandatory contribution is not made.

(3) *Plan not maintained*—(i) *In general*. An employee's years of service with an employer during any period for which the employer did not maintain the plan or a predecessor plan may be disregarded for purposes of section 411(a)(2). Paragraph (b)(3)(ii) of this section provides rules regarding the period prior to the adoption of a plan. Paragraph (b)(3)(iii) of this section provides rules regarding the period after the termination of a plan. Paragraph

(b)(3)(iv) of this section provides rules regarding employers who have certain relationships with other employers maintaining the plan.

(ii) *Period prior to adoption.* The period for which a plan is not maintained by an employer includes the period before the plan was established. For purposes of this subdivision, a plan is established on the first day of the plan year in which the plan is adopted even though the plan is adopted after such first day. Except as provided in paragraph (b)(3)(iv) of this section if an employer adopts a plan which has previously been established by another employer or group of employers, the plan is not maintained by the adopting employer prior to the first day of the plan year in which the plan is adopted by the adopting employer. In the case of a transfer of assets or liabilities (including a merger or consolidation) involving two plans maintained by a single employer, the successor (or transferee) plan is treated as if it was established at the same time as the date of the establishment of the earliest component plan. In the case of a plan merger, consolidation, or transfer of plan assets or liabilities involving plans of two or more employers, the successor plan is treated as if it were established on each of the separate dates on which such component plan was established for the employees of each employer. Thus, for example, if employer A establishes a plan January 1, 1970, and employer B establishes a plan January 1, 1980, and the plans were subsequently merged, then the merged plan would be treated as if it were in existence on January 1, 1970, with respect to A's employees and as if it were in existence on January 1, 1980, with respect to B's employees.

(iii) *Period after termination or withdrawal.* The period for which a plan is not maintained by an employer includes the period after the plan is terminated. For purposes of this section, a plan is terminated at the date there is a termination of the plan within the meaning of section 411(d)(3)(A) and the regulations thereunder. Notwithstanding the preceding sentence, if contributions to or under a plan are made after termination, the plan is treated as being maintained until such contributions cease, whether or not accruals are made after such termination. If, after termination of a plan in circumstances under which the employer may be liable to the Pension Benefit Guaranty Corporation under section 4062 of the Act, employer contributions are made to or under the plan to fund benefits accrued at the time of termination, such contributions shall, for purposes of this paragraph, be deemed to be payments in satisfaction of employer liability to such Corporation rather than contributions to or under the plan. In the case of a plan maintained by more than one employer, the period for which the plan is not maintained by the withdrawing employer includes the period after the withdrawal from the plan.

(iv) *Certain employers.* For purposes of this subparagraph—

(A) *Predecessor employers.* Service with a predecessor employer who maintained the plan of the current employer is treated as service with such current employer (see section 414(a)(1) and the regulations thereunder), and certain service with a predecessor employer who did not maintain the plan of the current employer is treated as service with the current employer (see section 414(a)(2) and the regulations thereunder).

(B) *Related employers.* Service with an employer is treated as service for certain related employers for the period during which the employers are related. These related employers include members of a controlled group of corporations (within the meaning of section 1563(a), determined without regard to subsections (a)(4) and (e)(3) (C) thereof) and trades or businesses (whether or not incorporated) which are under common control (see section 414 (b) and (c) and 29 CFR Part 2530, Department of Labor regulations relating to minimum standards for employee pension benefits plans).

(C) *Plan maintained by more than one employer.* Service with an employer who maintains a plan is treated as service for each other employer who maintains that plan for the period during which the employers are maintaining the plan (see section 413 (b)(4) and (c)(3) and 29 CFR Part 2530, Department

of Labor regulations relating to minimum standards for employee pension benefit plans).

(v) *Predecessor plan*—(A) *General rule.* In the case of an employee who was covered by a predecessor plan, the time the successor of such plan is maintained for such employee includes the time the predecessor plan was maintained if, as of the later of the time the predecessor plan is terminated or the successor plan is established, the employee's years of service under the predecessor plan are not equalled or exceeded by the aggregate number of consecutive 1-year breaks in service occuring after such years of service. Years of service and breaks in service, without regard to whether the employee has nonforfeitable rights under the predecessor plan, are determined under section 411(a) (5) and (6) except that years between the termination date of the predecessor plan and the date of establishment of the successor plan do not count as years of service.

(B) *Definition of predecessor plan.* For purposes of this section, if—

(*1*) An employer establishes a retirement plan (within the meaning of section 7476(d)) qualified under subchapter D of chapter 1 of the Code within the 5-year period immediately preceding or following the date another such plan terminates, and

(*2*) The other plan is terminated during a plan year to which this section applies.

The terminated plan is a predecessor plan with respect to such other plan.

(C) *Example.* The rules provided by this subparagraph are illustrated by the following example:

Example. (1) Employer X's qualified plan A terminated on January 1, 1977, Employer X established qualified plan B on January 1, 1981. Under paragraph (b)(3)(v)(B) of this section, plan A is a predecessor plan with respect to plan B because plan B is established within the 5-year period immediately following the date plan A terminated.

(2) Employee C was not covered by the A plan. Under the general rule in subdivision (v)(A) of this subparagraph, plan B is not maintained until January 1, 1981, with respect to Employee C.

(3) Employee D was covered by the A plan. On December 31, 1976, D had 4 years of service. D had 4 consecutive 1-year breaks in service because, during the years between the termination of plan A and the establishment of plan B, he did not have more than 500 hours of service in any applicable computation period. Because D's consecutive 1-year breaks (4) equal his years of service prior to his breaks (4), plan B is not maintained until January 1, 1981, with respect to employee D.

(4) Employee E was covered by the A plan. On December 31, 1975, E had 6 years of service. E had a 1-year break in service in 1976. E also had 4 consecutive 1-year breaks in service for the period between plan A's termination and plan B's establishment. Because E's years of service (6) are not less than his consecutive 1-year breaks (5), plan B is maintained for E as of the establishment date of plan A.

(4) *Break in service.* A year of service which is not required to be taken into account by reason of a break in service (within the meaning of section 411(a)(6) and § 1.411(a)–6)).

(5) *Service before January 1, 1971.* A year of service completed by an employee prior to January 1, 1971, unless the employee completes at least 3 years of service at any time after December 31, 1970. For purposes of determining if an employee completes 3 years of service, whether or not consecutive, the exceptions of section 411(a)(4) are not applicable. For the meaning of the term ''year of service'', see regulations prescribed by the Secretary of Labor under 29 CFR Part 2530, relating to minimum standards for employee pension benefit plans.

(6) *Service before effective date.* A year of service completed before the first plan year for which this section applies to the plan, if such service would have been disregarded under the plan rules relating to breaks in service (whether or not such rules are so designated in the plan) as such rules were in effect from time to time under the plan. For this purpose, plan rules which result in the loss of prior vesting or benefit accruals of an employee, or which deny an employee eligibility to participate, by reason of separation or failure to complete a required period of service within a specified priod of time (e.g., 300 hours in one year) will be considered break in service rules See § 1.411(a)–9 for requirements relating to certain amendments to the break in service rules of a plan.

(i) [Reserved]

(ii) *Examples*. The rules of this subparagraph are illustrated by the following examples:

Example 1. The A plan in 1971 provides for immediate participation and vesting at normal retirement age. Employees accrue a unit benefit based on their compensation in each year. The plan provides that if an employee is not employed on the last day of the calendar year, he loses all accrued benefits. The requirement of employment on the last day of the year is a break in service rule because employees can lose benefits by reason of their separation. Accordingly, in the case of employees who separate and do not return by the close of the year, service which is completed prior to separation may be disregarded.

Example 2. The B plan in 1971 excludes from plan participation employees who work less than 1,200 hours per year. Because years of less than 1,200 hours are not taken into account under the B plan for eligibility to participate, such years are excluded under rules relating to breaks in service. Therefore, the years can be disregarded under this subparagraph.

Example 3. The C plan in 1971 provides for immediate participation and provides accruals and vesting credit for 1,200 hours or more in a given year. The plan provides that if a participant works less than 300 hours in a given year, he loses all prior vesting and benefit credits. The 300 hour rule is a break in service rule because the failure to complete 300 hours results in the loss of vesting and prior service credit. The 1,200 hour requirement is not a break in service rule because even though employees do not increase vesting or accrue benefits for service between 300 and 1,200 hours, they cannot lose prior vesting or benefits for such service. Accordingly, the C plan can disregard completed years only on account of less than 300 hours of service by an employee.

(c) *Special continuity rule for certain plans*. For special rules for computing years of service in the case of a plan maintained by more than one employer, see 29 CFR Part 2530 (Department of Labor regulations relating to minimum standards for employee pension benefit plans).

(Sec. 411 (88 Stat. 901, 26 U.S.C. 411))

[T.D. 7501, 42 FR 42327, Aug. 23, 1977, as amended by T.D. 7703, 45 FR 40985, June 17, 1980]

§ 1.411(a)–6 Year of service; hours of service; breaks in service.

(a) *Year of service*. Under section 411 (a)(5)(A), for purposes of the regulations thereunder, the term ''year of service'' is defined in regulations prescribed by the Secretary of Labor under section 203(b)(2)(A) of the Employee Retirement Income Security Act of 1974. For special rules applicable to seasonal industries and maritime industries, see regulations prescribed by the Secretary of Labor under subparagraphs (C) and (D) of section 203(b)(2) of the Employee Retirement Income Security Act of 1974.

(b) *Hours of service*. Under section 411(a)(5)(B), for purposes of the regulations thereunder, the term ''hours of service'' has the meaning provided by section 410(a)(3)(C). See regulations prescribed by the Secretary of Labor under 29 CFR Part 2530, relating to minimum standards for employee pension benefit plans.

(c) *Breaks in service*. Under section 411(a)(6), for purposes of § 1.411(a)–5(b)(4) and of this paragraph—

(1) *In general*—(i) *Year of service after 1-year break in service*. In the case of any employee who has incurred a 1-year break in service, years of service completed before such break are not required to be taken into account until the employee has completed one year of service after his return to service.

(ii) *Defined contribution plan*. In the case of a participant in a defined contribution plan or in an insured defined benefit plan (which plan satisfies the requirements of section 411 (b)(1)(F) and § 1.411(b)–1) who has incurred a 1-year break in service, years of service completed after such break are not required to be taken into account for purposes of determining the nonforfeitable percentage of the participant's right to employer-derived benefits which accrued before such break. This subdivision does not permit years of service completed before a 1-year break in service to be disregarded in determining the nonforfeitable percentage of a participant's right to employer-derived benefits which accrue after such break.

(iii) *Nonvested participants*. In the case of an employee who is a nonvested participant in employer-derived benefits at the time he incurs a 1-year break in service, years of service completed by such participant before such break are not required to be taken into

account for purposes of determining the nonforfeitable percentage of his right to employer-derived benefits if at such time the number of consecutive 1-year breaks in service included in his most recent break in service equals or exceeds the aggregate number of his years of service, whether or not consecutive, completed before such break. In the case of a plan utilizing the elapsed time method described in §1.410(a)–7, the condition in the preceding sentence shall be satisfied if the period of severance is at least one year and the consecutive period of severance equals or exceeds his prior period of service, whether or not consecutive, completed before such period of severance. In computing the aggregate number of years of service prior to such break, years of service which could have been disregarded under this subdivision by reason of any prior break in service may be disregarded.

(2) *One-year break in service defined.* The term ''1-year break in service'' means a calendar year, plan year, or other 12-consecutive month period designated by a plan (and not prohibited under regulations prescribed by the Secretary of Labor) during which the participant has not completed more than 500 hours of service. In the case of a plan utilizing the elapsed time method, the term ''1-year break in service'' means a 12-consecutive month period beginning on the severance from service date or any anniversary thereof and ending on the next succeeding anniversary of such date; provided, however, that the employee during such 12-consecutive-month period does not complete any hours of service within the meaning of 29 CFR Part 2530.200b–2(a) for the employer or employers maintaining the plan. See regulations prescribed by the Secretary of Labor under 29 CFR Part 2530, relating to minimum standards for employee pension benefit plans.

(d) *Examples.* The rules provided by this section are illustrated by the following examples:

Example 1. (i) X Corporation maintains a defined contribution plan to which section 411 applies. The plan uses the calendar year as the vesting computation period. In 1980, Employee A, who was hired at age 35, separates from the service of X Corporation after completing 4 years of service. At the time of his separation, Employee A had a nonforfeitable right to 25 percent of his employer-derived accrued benefit which was not distributed. In 1985, after incurring 5 consecutive one-year breaks in service. Employee A is reemployed by X Corporation and becomes an active participant in the plan. The plan provides that, for 1985 and all subsequent years, Employee A's previous years of service will not be taken into account for purposes of computing the nonforfeitable percentage of his employer-derived accrued benefit, solely because of his break in service.

(ii) The plan fails to satisfy section 411. Section 411(a)(6)(B) would permit the plan to disregard Employee A's prior service for purposes of computing his nonforfeitable percentage in 1985 only, but such service must be taken into account in subsequent years unless there is another break in service. Under section 411(a)(6)(C), the plan is not required to take Employee A's post-break service into account for purposes of computing his nonforfeitable right to his prebreak employer-derived accrued benefits. This provision, however, would not permit the plan to disregard pre-break service in determining his nonforfeitable right to his benefit accrued after the break. The exception provided by section 411(a)(6)(D) does not apply in the case of a participant who has any nonforfeitable right to his accrued benefit derived from employer contributions.

Example 2. (i) X Corporation maintains a qualified plan to which sections 410 and 411 (relating to minimum participation standards and minimum vesting standards, respectively) apply. The plan permits participation upon completion of a year of service and provides that 100% of an employee's employer-derived accrued benefit vests after 10 years of service. The plan uses the calendar year as the vesting computation period. The plan provides that an employee who completes at least 1,000 hours of service in a 12-month period is credited with a year of service for participation and vesting purposes. The plan also provides that an employee who does not complete more than 500 hours of service in that 12-month period incurs a one-year break in service. The plan includes the rule described in section 411 (a)(6)(D) for participation and vesting purposes. Under this rule, an employee's years of service prior to a break in service may be disregarded under certain circumstances if he has no vested right to any employer-derived benefit under the plan. The plan does not contain the rule described in section 411(a)(6)(B) (relating to the requirement of one year of service after a one-year break in service).

(ii) Employee A commences employment with the X Corporation on January 1, 1977. Employee A's employment history for 1977 through 1989 is as follows:

Year ending December 31	Hours of service completed
1977	1,000
1978	800
1979	1,000
1980	400
1981	1,000
1982	0
1983	400
1984	1,000
1985	0
1986	0
1987	500
1988	200
1989	1,000

Employee A's status as a participant during this period is determined as follows:

1978: Employee A was a plan participant on January 1, 1978, because he completed a year of service (1,000 hours) in 1977. He did not complete a year of service in 1978 because he completed fewer than 1,000 hours in that year. Because he completed more than 500 hours of service in 1978, however, Employee A did not incur a one-year break in service that year.

1979: Employee A completes a year of service in 1979. Because he did not incur a one-year break in service in 1978, the plan may not disregard his 1977 service for purposes of determining his years of service as of January 1, 1979.

1980: Employee A incurs a one-year break in service in 1980.

1981: Because Employee A had completed 2 years of service prior to 1981 and had incurred one 1-year break in service prior to 1981, under section 411(a)(6)(D), the plan may not disregard his pre-1980 service in 1981. Employee A completes a year of service in 1981.

1982: Employee A incurs a one-year break in service in 1982.

1983: Employee A incurs a one-year break in service in 1983. As of the end of 1983, he has completed 3 years of service and has incurred 2 consecutive one-year breaks in service.

1984: Employee A completes a year of service in 1984. Under section 411(a)(6)(D), his pre-1982 service may not be disregarded in 1984 because, as of the beginning of 1984, his pre-1984 years of service (3) exceed his consecutive one-year breaks in service (2).

1984–1988: Employee A incurs 4 consecutive one-year breaks in service during the years 1985 through 1988.

1989: Employee A's pre-1989 service is disregarded in 1989 and all subsequent plan years because his years of service as of January 1, 1989, equal the number of consecutive one-year breaks he has incurred as of that date. Therefore, as of the beginning of 1989, Employee A is not a plan participant. Employee A completes a year of service in 1989. (Although section 411(a)(6)(D) does not prohibit the plan provision under which Employee A's pre-1989 service is disregarded, that section does not require such a provision in a qualified plan.)

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42329, Aug. 23, 1977, as amended by T.D. 7703, 45 FR 40985, June 17, 1980]

§ 1.411(a)–7 Definitions and special rules.

(a) *Accrued benefit.* For purposes of section 411 and the regulations thereunder, the term ''accrued benefit'' means—

(1) *Defined benefit plan.* In the case of a defined benefit plan—

(i) If the plan provides an accrued benefit in the form of an annual benefit commencing at normal retirement age, such accrued benefit, or

(ii) If the plan does not provide an accured benefit in the form described in subdivision (i) of this subparagraph, an annual benefit commencing at normal retirement age which is the actuarial equivalent (determined under section 411(c)(3) and § 1.411(c)–(5) of the accrued benefit determined under the plan. In general, the term ''accrued benefits'' refers only to pension or retirement benefits. Consequently, accrued benefits do not include ancillary benefits not directly related to retirement benefits such as payment of medical expenses (or insurance premiums for such expenses), disability benefits not in excess of the qualified disability benefit (see section 411(a)(9) and paragraph (c)(3) of this section), life insurance benefits payable as a lump sum, incidental death benefits, current life insurance protection, or medical benefits described in section 401(h). For purposes of this paragraph a subsidized early retirement benefit which is provided by a plan is not taken into account, except to the extent of determining the normal retirement benefit under the plan (see section 411(a)(9) and paragraph (c) of this section). The accrued benefit includes any optional settlement at normal retirement age under actuarial assumptions no less favorable than those which would be applied if the employee were terminating his employment at normal retirement age. The accrued benefit does not include any subsidized value in a joint and survivor annuity to the extent that

the annual benefit of the joint and survivor annuity does not exceed the annual benefit of a single life annuity.

(2) *Defined contribution plan.* In the case of a defined contribution plan, the balance of the employee's account held under the plan.

(b) *Normal retirement age*—(1) *General rule.* For the purposes of section 411 and the regulations thereunder, the term ''normal retirement age'' means the earlier of—

(i) The time specified by a plan at which a plan participant attains normal retirement age, or

(ii) The later of—

(A) The time the plan participant attains age 65, or

(B) The 10th anniversary of the date the plan participant commences participation in the plan.

If a plan, or the employer sponsoring the plan, imposes a requirement that an employee retire upon reaching a certain age, the normal retirement age may not exceed that mandatory retirement age. The preceding sentence will apply if the employer consistently enforces a mandatory retirement age rule, whether or not set forth in the plan or any related document. For purposes of subdivision (i) of this subparagraph, if an age is not specified by a plan as the normal retirement age then the normal retirement age under the plan is the earliest age beyond which the participant's benefits under the plan are not greater solely on account of his age or service. For purposes of paragraph (b)(1)(ii)(B) of this section, participation commences on the first day of the first year in which the participant commenced his participation in the plan, except that years which may be disregarded under section 410(a)(5)(D) may be disregarded in determining when participation commenced.

(2) *Examples.* The provisions of this paragraph are illustrated by the following examples:

Example 1. Plan A defines normal retirement age as age 65. Under the plan, benefits payable to participants who retire at or after age 60 are not reduced on account of early retirement. For purposes of section 411 and the vesting regulations, normal retirement age under Plan A is age 65 (determined under subparagraph (1)(i) of this paragraph). This is true even if in operation all participants retire at age 60.

Example 2. Plan B does not specify any age as the normal retirement age. Under the plan, participants who have attained age 55 are entitled to benefits commencing upon retirement but the benefits of participants who retire before attaining age 70 are subject to reduction on account of early retirement. For purposes of section 411 and the vesting regulations the normal retirement age under Plan B is the later of (i) age 65, or (ii) the 10th anniversary of the date a plan participant commences participation in the plan (assuming such date is prior to age 70).

Example 3. The facts are the same as in example (2). Employee X first became a participant in Plan B on January 1, 1980 at age 53. His participation continued until December 31, 1980, when he separated from the service with no vested benefits. After incurring 5 consecutive 1-year breaks in service, Employee X again becomes an employee and a plan participant on January 1, 1986, at age 59. For purposes of section 411, Employee X's normal retirement age under Plan B is age 69, the 10th anniversary of the date on which his year of plan participation commenced. His participation in 1980 may be disregarded under the last sentence of paragraph (b)(1) of this section.

(c) *Normal retirement benefit*—(1) *In general.* For purposes of section 411 and the regulations thereunder, the term ''normal retirement benefit'' means the periodic benefit under the plan commencing upon early retirement (if any) or at normal retirement age, whichever benefit is greater.

(2) *Periodic benefit.* For purposes of subparagraph (1) of this paragraph—

(i) In the case of a plan under which a benefit is payable as an annuity in the same form upon early retirement and at normal retirement age, the greater benefit is determined by comparing the amount of such annuity payments.

(ii) In the case of a plan under which an annuity benefit payable upon early retirement is not in the same form as an annuity benefit payable at normal retirement age, the greater benefit is determined by converting the annuity benefit payable upon early retirement age into the same form of annuity benefit as is payable at normal retirement age and by comparing the amount of the converted early retirement benefit payment with the amount of the normal retirement benefit payment.

(iii) In the case of a plan which is integrated with the Social Security Act or any other Federal or State law, the periodic benefit payable upon and after early retirement age is adjusted for any increases in such benefits occurring on or after early retirement age which are taken into account under the plan. See however, section 401(a)(15) and the regulations thereunder.

(3) *Benefits included.* For purposes of this paragraph, the normal retirement benefit under a plan shall be determined without regard to ancillary benefits not directly related to retirement benefits such as medical benefits or disability benefits not in excess of the qualified disability benefit; see section 411(a)(7) and paragraph (a)(1) of this section. For this purpose, a qualified disability benefit is a disability benefit which is not in excess of the amount of the benefit which would be payable to the participant if he separated from service at normal retirement age.

(4) *Early retirement benefit; social security supplement.* (i) For purposes of this paragraph, the early retirement benefit under a plan shall be determined without regard to any social security supplement.

(ii) For purposes of this subparagraph, a social security supplement is a benefit for plan participants which—

(A) Commences before the age and terminates before the age when participants are entitled to old-age insurance benefits, unreduced on account of age, under title II of the Social Security Act, as amended (see section 202 (a) and (g) of such Act), and

(B) Does not exceed such old-age insurance benefit.

(5) *Special limitation.* If a defined benefit plan bases its normal retirement benefits on employee compensation, the compensation must reflect the compensation which would have been paid for a full year of participation within the meaning of section 411(b)(3). If an employee works less than a full year of participation, the compensation used to determine benefits under the plan for such year of participation must be multiplied by the ratio of the number of hours for a complete year of participation to the number of hours worked in such year. A plan whose benefit formula is computed on a computation base which cannot decrease is not required to adjust employee compensation in the manner described in the previous sentence. Thus, for example, if a plan provided a benefit based on an employee's compensation for his highest five consecutive years or a separate benefit for each year of participation based on the employee's compensation for such year the plan would not have to so adjust compensation. However, if a plan provided a benefit based on an employee's compensation for the employee's last five years or the five highest consecutive years out of the last 10 years, the compensation, would have to be so adjusted. For special rules for applying the limitations on proration of a year of participation for benefit accrual, see regulations prescribed by the Secretary of Labor under 29 CFR Part 2530, relating to minimum standards for employee pension benefit plans.

(6) *Examples.* The provisions of this paragraph are illustrated by the following examples:

Example 1. Plan A provides for a benefit equal to 1% of high 5 years compensation for each year of service and a normal retirement age of 65. The plan also provides for a full unreduced accrued benefit without any actuarial reduction for any employee at age 55 with 30 years of service. Even though the actuarial value of the early retirement benefit could exceed the value of the benefit at the normal retirement age, the normal retirement benefit would not include the greater value of the early retirement benefit because actuarial subsidies are ignored.

Example 2. Plan B provides the following benefits: (1) at normal retirement age 65, $300/mo. for life and (2) at early retirement age 60, $400/mo. for life. The normal retirement benefit is $400/mo., the greater of the benefit payable at normal retirement age ($300) or early retirement ($400).

Example 3. Assume the same facts as example (2) except that the early retirement benefit of $400 is reduced to $300 upon attainment of age 65. If each employee's social security benefit at age 65 is not less than $100, the $100 would be considered to be a social security supplement and would therefore be ignored. Consequently, the normal retirement benefit would be $300.

Example 4. Plan C provides a benefit at normal retirement age equal to 1% per year of service, multiplied by the participant's compensation averaged over the 5 years immediately prior to retirement. An early retirement benefit is provided upon attainment of age 60 equal to the benefit accrued to date of early retirement reduced by 4 percent for

each year by which the early retirement date precedes the normal retirement age of 65. Employee A was hired at age 30, participated immediately, and retired at age 65. Employee A's annual compensation was $50,000 between ages 55–60 and was reduced to $33,000 after age 60. The following table indicates the amount of annual benefit that would have been provided by the plan formula if the employee retired at or after age 60:

Age	Final average computated (1)—	Percent accrued benefit (2)—	Reduction (3)—	Annual benefit (4)—
60	$50,000	30	0.80	*$12,000
61	46,600	31	.84	12,135
62	43,200	32	.88	12,165
63	39,800	33	.92	12,083
64	36,400	34	.96	11,881
65	33,000	35	1.00	11,550

NOTE. Col. (1) times col. (2) times col. (3) equals col. (4).

The normal retirement benefit is the greater of the benefit payable at normal retirement age or the early retirment benefit. Employee A's normal retirement benefit is $12,165, the greatest annual benefit Employee A would be entitled to.

(d) *Rules relating to certain distributions and cash-outs of accrued benefits*—(1) *In general.* This paragraph sets forth vesting rules applicable to certain distributions from qualified plans and their related trusts (other than class year plans). Subparagraphs (2) and (3) set forth the exceptions to nonforfeitability on account of withdrawal of mandatory contributions provided by section 411(a)(3)(D). When a plan utilizes these exceptions with respect to a given participant's accrued benefit, such accrued benefit is not subject to the cash-out rules or vesting rules of subparagraphs (4) or (5), respectively. Section 411 prescribes certain requirements with respect to accrued benefits under a qualified plan. These requirements would generally not be satisfied if the plan disregarded service in computing accrued benefits even though amounts were distributed on account of such service. Subparagraph (4) of this paragraph sets forth rules under section 411(a)(7)(B) which allow a plan to make distributions and compute accrued benefits without regard to the accrued benefit attributable to the distribution. When a defined contribution plan utilizes this exception with respect to an accrued benefit, the plan is not required to satisfy the rules of subparagraph (5) of this paragraph. Subparagraph (5) of this paragraph sets forth a vesting requirement applicable to certain distributions from defined contribution plans. Subparagraph (6) sets forth other rules which pertain to the distribution rules of this paragraph.

(2) *Withdrawal of mandatory contribution*—(i) *General rule.* In the case of a participant's right to his employer-derived accrued benefit, a right is not treated as forfeitable merely because all or a portion of such benefit may be forfeited on account of the withdrawal by the participant of any amount attributable to his accrued benefit derived from his mandatory contributions (within the meaning of section 411(c)(2)(C) and §1.411(c)–1) before he has become a 50 percent vested participant (within the meaning of §1.401(a)–19(b)(2)). For purposes of determining the vested percentage, the plan may disregard service after the withdrawal. For example, assume that a plan utilizes 1000 hours for computing years of service and that for the computation period employee A had 1000 hours of service. If A was 40 percent vested at the beginning of the period but only had 800 hours at the time of the withdrawal, the plan could treat A as only 40 percent vested because service after the withdrawal can be disregarded. On the other hand, if A had 1000 hours at the time of the withdrawal, he must receive a year of service for the computation period, even though service is not taken into account until the end of such period.

(ii) *Plan repayment provision.* (A) Subdivision (i) of this subparagraph shall not apply unless, at the time the amount described in such subdivision is withdrawn by the participant, the plan provides the employee with a right to restoration of his employer-derived accrued benefit to the extent forfeited in accordance with such subdivision upon repayment to the plan of the full amount of the withdrawal.

(B) In the case of a defined benefit plan (as defined in section 414(j)) the restoration of the employee's employer-derived accrued benefit may be conditioned upon repayment of interest on the full amount of the distribution.

Such interest shall be computed on the amount of the distribution from the date of such distribution to the date of repayment, compounded annually from the date of distribution, at the rate determined under section 411(c)(2)(C) in effect on the date of repayment. A plan may provide for repayment of interest which is less than the amount determined under the preceding sentence.

(C) In the case of both defined benefit plans and defined contribution plans, the plan repayment provision described in this subparagraph may provide that the employee must repay the full amount of the distribution in order to have the forfeited benefit restored. The plan provision may not require that such repayment be made sooner than the time described in paragraph (d)(2)(ii)(D) of this section.

(D)(*1*) If a distribution is on account of separation from service, the time for repayment may not end before the earlier of—

(*i*) 5 years after the first day the employee is subsequently employed, or

(*ii*) The close of the first period of consecutive 1-year breaks in service commencing after the distribution.

If the distribution occurs for any other reason, the time for repayment may not end earlier than 5 years after the date of distribution. Nevertheless, a plan provision may provide for a longer period in which the employee may repay. For example, a plan could allow repayments to be made at any time before normal retirement age.

(*2*) In the case of a plan utilizing the elapsed time method, described in §1.410(a)–7, the minimum time for repayment shall be determined as in paragraph (d)(2)(ii)(D)(*1*) of this section except as provided in this subdivision. The 5 consecutive 1-year break periods shall be determined by substituting the term ''1-year period of severance'' for the term ''1-year break in service''. Also, the repayment period both commences and closes in a manner determined by the Commissioner that is consistent with the rules in §1.410(a)–7 and the substitution in section 411(a)(6)(C) and (D) of a 5-year break-in-service rule for the former 1-year break-in-service rule.

(E) A defined benefit plan using the break-in-service rule described in section 410(a)(5)(D) or a defined contribution plan using the break-in-service rule described in section 411(a)(6)(C) for determining employees' accrued benefits is not required to provide for repayment by an employee whose accrued benefit is disregarded by reason of a plan provision using these rules.

(iii) *Computation of benefit.* In the case of a defined contribution plan, the employer-derived accrued benefit required to be restored by this subparagraph shall not be less than the amount in the account balance of the employee which was forfeited, unadjusted by any subsequent gains or losses.

(iv) *Delayed forfeiture.* A defined contribution plan may, in lieu of the forfeiture and restoration described in this subparagraph, provide that the forfeiture does not occur until the expiration of the time for repayment described in subdivision (ii) of this subparagraph provided that the conditions of this subparagraph are satisfied.

(3) *Withdrawal of mandatory contributions; accruals before September 2, 1974*—(i) *General rule.* In the case of a participant's right to the portion of the employer-derived benefit which accrued prior to September 2, 1974, a right is not treated as forfeitable merely because all or part of such portion may be forfeited on account of the withdrawal by the participant of an amount attributable to his benefit derived from mandatory contributions (within the meaning of section 411(c)(2)(C) and §1.411(c)–1(c)(4)) made by the participant before September 2, 1974, if the amount so subject to forfeiture is no more than proportional to such amounts withdrawn. This subparagraph shall not apply to any plan to which any mandatory contribution (within the meaning of section 411(c)(2)(C) and §1.411(c)–1(c)(4)) is made after September 2, 1974.

(ii) *Defined contribution plan.* In the case of a defined contribution plan, the portion of a participant's employer-derived benefit which accrued prior to September 2, 1974, shall be determined on the basis of a separate accounting between benefits accruing before and after such date. Gains, losses, withdrawals, forfeitures, and other credits

or charges must be separately allocated to such benefits. Any allocation made on a reasonable and consistent basis prior to September 1, 1977, shall satisfy the requirements of this subdivision.

(iii) *Defined benefit plan.* In the case of a defined benefit plan, the portion of a participant's employer-derived benefit which accrued prior to September 2, 1974, shall be determined in a manner consistent with the determination of an accrued benefit under section 411(b)(1)(D) (see §1.411(b)–1(c)). Any method of determining such accrued benefit which the Commissioner finds to be reasonable shall satisfy the requirements of this subdivision.

(4) *Certain cash-outs of accrued benefits*—(i) *Involuntary cash-outs.* For purposes of determining an employee's right to an accrued benefit derived from employer contributions under a plan, the plan may disregard service performed by the employee with respect to which—

(A) The employee receives a distribution of the present value of his entire nonforfeitable benefit at the time of the distribution;

(B) The requirements of section 411(a)(11) are satisfied at the time of the distribution;

(C) The distribution is made due to the termination of the employee's participation in the plan; and

(D) The plan has a repayment provision which satisfies the requirements of paragraph (d)(4)(iv) of this section in effect at the time of the distribution.

(ii) *Voluntary cash-outs.* For purposes of determining an employee's accrued benefit derived from employer contributions under a plan, the plan may disregard service performed by the employee with respect to which—

(A) The employee receives a distribution of the present value of his nonforfeitable benefit attributable to such service at the time of such distribution,

(B) The employee voluntarily elects to receive such distribution,

(C) The distribution is made on termination of the employee's participation in the plan, and

(D) The plan has a repayment provision in effect at the time of the distribution which satisfies the requirements of subdivision (iv) of this subparagraph.

A distribution shall be deemed to be made on termination of participation in the plan if it is made not later than the close of the second plan year following the plan year in which such termination occurs. For purposes of determining the nonforfeitable benefit, the plan may disregard service after the distribution as illustrated in subparagraph (2)(i) of this subparagraph.

(iii) *Disregard of service.* Service of an employee permitted to be disregarded under subdivision (i) or (ii) of the subparagraph is not required to be taken into account in computing the employee's accrued benefit under the plan. In the case of a voluntary distribution described in subdivision (ii) of this subparagraph which is less than the present value of the employee's total nonforfeitable benefit immediately prior to the distribution, the accrued benefit not required to be taken into account is such total accrued benefit multiplied by a fraction, the numerator of which is the amount of the distribution and the denominator of which is the present value of his total nonforfeitable benefit immediately prior to such distribution. For example, A who is 50 percent vested in an account balance of $1,000 receives a voluntary distribution of $250. The accrued benefit which can be disregarded equals $1,000 times $250/$500, or $500. However, such service may not by reason of this paragraph be disregarded for purposes of determining an employee's years of service under sections 410(a)(3) and 411(a)(4).

(iv) *Plan repayment provision.* (A) A plan repayment provision satisfies the requirements of this subdivision if, under the provision, the accrued benefit of an employee that is disregarded by a plan under this subparagraph is restored upon repayment to the plan by the employee of the full amount of the distribution. An accrued benefit is not restored unless all of the optional forms of benefit and subsidies relating to such benefit are also restored. A plan is not required to provide for repayment of an accrued benefit unless the employee—

(*1*) Received a distribution that is in a plan year to which section 411 applies

(see §1.411(a)–2), which distribution is less than the amount of his accrued benefit determined under the same optional form of benefit as the distribution was made, and

(*2*) Resumes employment covered under the plan.

(B) *Example*. Plan A provides a single sum distribution equal to the present value of the normal form of the accrued benefit payable at normal retirement age which is a single life annuity. Plan A also provides a subsidized joint and survivor annuity and a subsidized early retirement annuity benefit. A participant who is fully vested and receives a single sum distribution equal to the present value of the single life annuity normal retirement benefit is not required to be provided the right under the plan to repay the distribution upon subsequent reemployment even though the participant received a distribution that did not reflect the value of the subsidy in the joint and survivor annuity or the value of the early retirement annuity subsidy. This is true whether or not the participant had satisfied at the time of the distribution all of the conditions necessary to receive the subsidies. However, if a participant does not receive his total accrued benefit in the optional form of benefit under which his benefit was distributed, the plan must provide for repayment. If the employee repays the distribution in accordance with section 411(a)(7), the plan must restore the employee's accrued benefit which would include the right to receive the subsidized joint and survivor annuity and the subsidized early retirement annuity benefit.

(C) A plan may impose the same conditions on repayments for the restoration of employer-derived accrued benefits that are allowed as conditions for restoration of employer-derived accrued benefits upon repayment of mandatory contributions under paragraphs (d)(2)(ii) (B), (C), (D) and (E) of this section.

(v) In the case of a defined contribution plan, the employer-derived accrued benefit required to be restored by this subparagraph shall not be less than the amount in the account balance of the employee, both the amount distributed and the amount forfeited, unadjusted by any subsequent gains or losses. Thus, for example, if an employee received a distribution of $250 when he was 25 percent vested in an account balance of $1,000, upon repayment of $250 the account balance may not be less than $1,000 even if, because of plan losses, the account balance, if not distributed, would have been reduced to $500.

(vi) For purposes of paragraph (d)(4)(i) of this section, a distribution shall be deemed to be made due to the termination of an employee's participation in the plan if it is made no later than the close of the second plan year following the plan year in which such termination occurs, or if such distribution would have been made under the plan by the close of such second plan year but for the fact that the present value of the nonforfeitable accrued benefit then exceeded the cash-out limit in effect under §1.411(a)–11(c)(3)(ii). For purposes of determining the entire nonforfeitable benefit, the plan may disregard service after the distribution, as illustrated in paragraph (d)(2)(i) of this section.

(vii) *Effective date*. Paragraphs (d)(4)(i) and (vi) of this section apply to distributions made on or after March 22, 1999. However, an employer is permitted to apply paragraphs (d)(4)(i) and (vi) of this section to plan years beginning on or after August 6, 1997. Otherwise, for distributions prior to March 22, 1999, §§1.411(a)–7 and 1.411(a)–7T, in effect prior to October 17, 2000 (as contained in 26 CFR part 1, revised as of April 1, 2000) apply.

(5) *Vesting requirement for defined contribution plans*—(i) *Application*. The requirements of this subparagraph apply to a defined contribution plan which makes distributions to employees from their accounts attributable to employer contributions at a time when—

(A) Employees are less than 100 percent vested in such accounts, and

(B) Under the plan, employees can increase their percentage of vesting in such accounts after the distributions.

(ii) *Requirements*. In order for a plan, to which this subparagraph applies, to satisfy the vesting requirements of section 411, account balances under the plan (with respect to which percentage

vesting can increase) must be computed in a manner which satisfies either subdivision (iii) (A) or (B) of this subparagraph.

(iii) *Permissible methods.* A plan many provide for either of the following methods, but not both, for computing account balances with respect to which percentage vesting can increase and from which distributions are made:

(A)(*1*) A separate account is established for the employee's interest in the plan as of the time of the distribution, and

(*2*) At any relevant time the employee's vested portion of the separate account is not less than an amount (''X'') determined by the formula: X = P(AB + (R × D)) − (R × D). For purposes of applying the formula: P is the vested percentage at the relevant time; AB is the account balance at the relevant time; D is the amount of the distribution; R is the ratio of the account balance at the relevant time to the account balance after distribution; and the relevant time is the time at which, under the plan, the vested percentage in the account cannot increase.

A plan is not required to provide for separate accounts provided that account balances are maintained under a method that has the same effect as under this subdivision.

(B) At any relevant time the employee's vested portion is not less than an amount (''X'') determined by the formula: X = P(AB + D) − D. For purposes of applying the formula, the terms have the same meaning as under subdivision (iii)(A)(*2*) of this subparagraph.

(C) An application of the methods described in subdivisions (iii) (A) and (B) of this subparagraph is illustrated by the following examples:

Example 1. The X defined contribution plan uses the method described in subdivision (iii)(A) of this subparagraph for computing account balances and the break in service rule described in section 411(a)(6)(C) (service after a 1-year break does not increase the vesting percentage in account balances accrued prior to the break). The plan distributes $250 to A when A's account balance prior to the distribution equals $1,000 and he is 25 percent vested. At the time of the distribution, A has not incurred a 1-year break so that his vesting percentage can increase. Six years later, when A is 60 percent vested, he incurs a 1-year break so that his vesting percentage cannot increase. At this time his separate account balance equals $1,500. R = $1,500/$750 or 2. A's separate account must equal 60 percent ($1,500 + (2 × $250)) − (2 × $250) or 60 percent ($1,500 + $500) − $500, or $1,200 − $500 equals $700.

Example 2. The Y defined contribution plan uses the method descirbed in subdivision (iii)(B) of this subparagraph for computing account balances and the break in service rule described in section 411(a)(6)(C). The plan distributes $250 to B when B's account balance prior to the distribution equals $1,000 and he is 25 percent vested. At the time of the distribution, B has not incurred a 1-year break so that his vesting percentage can increase. Six years later, when A is 60 percent vested, he incurs a 1-year break so that his vesting percentage cannot increase. At this time his account balance equals $1,500. B's separate account must equal 60 percent ($1,500 + $250) − $250, 60% of $1,750 − $250 equals $800.

(6) *Other rules*—(i) *Distributions on separation or other event.* None of the rules of this paragraph preclude distributions to employees upon separation from service or any other event recognized by the plan for commencing distributions. Such a distribution must, of course, satisfy the applicable qualification requirements pertaining to such distributions. For example, a profitsharing plan could pay the vested portion of an account balance to an employee when he separated from service, but in order to satisfy section 411 the plan might not be able to forfeit the nonvested account balance until the employee has a 1-year break in service. Similarly, the fact that a plan cannot disregard an accrued benefit attributable to service for which an employee has received a distribution because the plan does not satisfy the cash-out requirements of subparagraph (4) of this paragraph does not mean that the employee's accrued benefit (computed by taking into account such service) cannot be offset by the accrued benefit attributable to the distribution.

(ii) *Joint and survivor requirements.* See § 1.401(a)–11(a)(2) (relating to joint and survivor annuities) for special rules applicable to certain distributions described in this paragraph.

(iii) *Plan repayments.* (A) Under subparagraphs (2) and (4) of this paragraph, a plan may be required to restore accrued benefits in the event of repayment by an employee.

(B) For purposes of applying the limitations of section 415 (c) and (e), in the case of a defined contribution plan, the repayment by the employee and the restoration by the employer shall not be treated as annual additions.

(C) In the case of a defined contribution plan, the permissible sources for restoration of the accrued benefit are: income or gain to the plan, forfeitures, or employer contributions. Notwithstanding the provisions of §1.401–1(b)(1)(ii), contributions may be made for such an accrued benefit by a profit-sharing plan even though there are no profits. In order for such a plan to be qualified, account balances (accrued benefits) generally must correspond to assets in the plan. Accordingly, there cannot be an unfunded account balance. However, an account balance will not be deemed to be unfunded in the case of a restoration if assets for the restored benefit are provided by the end of the plan year following the plan year in which the repayment occurs.

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42329, Aug. 23, 1977, as amended by T.D. 8038, 50 FR 29374, July 19, 1985; T.D. 8219, 53 FR 31852, Aug. 22, 1988; 53 FR 48534, Dec. 1, 1988; T.D. 8794, 63 FR 70337, Dec. 21, 1998; T.D. 8891, 65 FR 44681, July 19, 2000]

§1.411(a)–8 Changes in vesting schedule.

(a) *Requirement of prior schedule.* Under section 411(a)(10)(A), for plan years for which section 411 applies, a plan will be treated as not meeting the minimum vesting standards of section 411(a)(2) if the plan does not satisfy the requirements of this paragraph. If the vesting schedule of a plan is amended, then as of the date such amendment is adopted, the plan satisfies the requirements of this paragraph if, under the plan as amended, in the case of an employee who is a participant on—

(1) The date the amendment is adopted, or

(2) The date the amendment is effective, if later.

The nonforfeitable percentage (determined as of such date) of such employee's right to his employer-derived accrued benefit is not less than his percentage computed under the plan without regard to such amendment.

(b) *Election of former schedule*—(1) *In general.* Under section 411 (a)(10)(B), for plan years for which section 411 applies, if the vesting schedule of a plan is amended, the plan will not be treated as meeting the minimum vesting standards of section 411 (a)(2) unless the plan as amended, provides that each participant whose nonforfeitable percentage of his accrued benefit derived from employer contributions is determined under such schedule, and who has completed at least 5 years of service with the employer, may elect, during the election period, to have the nonforfeitable percentage of his accrued benefit derived from employer contributions determined without regard to such amendment. Notwithstanding the preceding sentence, no election need be provided for any participant whose nonforfeitable percentage under the plan, as amended, at any time cannot be less than such percentage determined without regard to such amendment.

(2) *Election period.* For purposes of subparagraph (1) of this paragraph, the election period under the plan must begin no later than the date the plan amendment is adopted and end no earlier than the latest of the following dates:

(i) The date which is 60 days after the day the plan amendment is adopted,

(ii) The date which is 60 days after the day the plan amendment becomes effective, or

(iii) The date which is 60 days after the day the participant is issued written notice of the plan amendment by the employer or plan administrator.

(3) *Service requirement.* For purposes of subparagraph (1) of this paragraph, a participant shall be considered to have completed 5 years of service if such participant has completed 5 years of service, whether or not consecutive, without regard to the exceptions of section 411(a)(4) prior to the expiration of the election period described in subparagraph (2) of this paragraph. For

the meaning of the term ''year of service'', see regulations prescribed by the Secretary of Labor under 29 CFR Part 2530, relating to minimum standards for employee pension benefit plans.

(4) *Election only by participant.* The election described in subparagraph (1) of this paragraph is available only to an individual who is a participant in the plan at the time such election is made.

(5) *Election may be irrevocable.* A plan, as amended, shall not fail to meet the minimum vesting standards of section 411(a)(2) by reason of section 411(a)(10)(B) merely because such plan provides that the election described in subparagraph (1) of this paragraph is irrevocable.

(6) *Relationship with section 411(a)(2).* The election described in subparagraph (1) of this paragraph is available for a vesting schedule which does not satisfy the requirements of section 411(a)(2) only if under such schedule all participants have a 50 percent nonforfeitable right after 10 years of service, and a 100 percent nonforfeitable right after 15 years of service, in their employer-derived accrued benefit. If the vesting schedule provides less vesting than the percentages required by the preceding sentence, the plan can be amended to provide for such vesting.

(c) *Special rules*—(1) *Amendment of vesting schedule.* For purposes of this section, an amendment of a vesting schedule is each plan amendment which directly or indirectly affects the computation of the nonforfeitable percentage of employees' rights to employer-derived accrued benefits. Consequently, such an amendment, for example, includes each change in the plan which affects either the plan's computation of years of service or of vesting percentages for years of service.

(2) *Aggregation of amendments.* All plan amendments which are: (i) amendments of a vesting schedule within the meaning of subparagraph (1) of this paragraph and (ii) adopted and effective at the same time, shall be deemed to be a single amendment for purposes of applying the rules in paragraphs (a) and (b) of this section.

(3) *Relationship with section 411(d)(6).* For additional requirements relating to section 411(d)(6), see § 1.411(d)–3(a)(3).

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42333, Aug. 23, 1977, as amended by T.D. 9280, 71 FR 45383, Aug. 9, 2006]

§ 1.411(a)–8T Changes in vesting schedule (temporary).

(a) [Reserved]

(b) *Election of former schedule*—(1) *In general.* Under section 411(a)(10)(B), for plan years for which section 411 applies, if the vesting schedule of a plan is amended, the plan will not be treated as meeting the minimum vesting standards of section 411(a)(2) unless the plan as amended provides that each participant whose nonforfeitable percentage of his accrued benefit derived from employer contributions is determined under such schedule, and who has completed at least 3 years of service with the employer, may elect, during the election period, to have the nonforfeitable percentage of his accrued benefit derived from employer contributions determined without regard to such amendment. Notwithstanding the preceding sentence, no election need be provided for any participant whose nonforfeitable percentage under the plan, as amended, at any time cannot be less than such percentage determined without regard to such amendment. For employees not described in § 1.411(a)–3T(e)(1), this section shall be applied by substituting ''5 years of service'' for ''3 years of service'' where such language appears.

(2) *Election period.* For purposes of subparagraph (1) of this paragraph, the election period under the plan must begin no later than the date the plan amendment is adopted and end no earlier than the latest of the following dates:

(i) The date which is 60 days after the day the plan amendment is adopted,

(ii) The date which is 60 days after the day the plan amendment becomes effective, or

(iii) The date which is 60 days after the day the participant is issued written notice of the plan amendment by the employer or plan administrator.

(3) *Service requirement.* For purposes of subparagraph (1) of this paragraph, a

participant shall be considered to have completed 3 years of service if such participant has completed 3 years of service, whether or not consecutive, without regard to the exceptions of section 411(a)(4) prior to the expiration of the election period described in subparagraph (2) of this paragraph. For the meaning of the term ''year of service'', see regulations prescribed by the Secretary of Labor under 29 CFR Part 2530, relating to minimum standards for employee pension benefit plans.

[T.D. 8170, 53 FR 241, Jan. 6, 1988]

§ 1.411(a)–9 Amendment of break in service rules; transitional period.

(a) *In general.* Under section 1017(f)(2) of the Employee Retirement Income Security Act of 1974, a plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) if the rules of the plan relating to breaks in service are amended, and—

(1) Such amendment is effective after January 1, 1974, and before the effective date of section 411, and

(2) Under such amendment, the nonforfeitable percentage of any employee's right to his employer-derived accrued benefit is less than the lesser of the nonforfeitable percentage of such employee's right to such benefit—

(i) Under the break in service rules provided by section 411(a)(6) and § 1.411(a)–6(c), or

(ii) The greatest such percentage under the plan as in effect on or after January 1, 1974 (provided the break in service rules of the plan were not in violation of any law or rule of law on January 1, 1974).

(b) *Break in service rules.* For purposes of paragraph (a), the term ''break in service rules'' means the rules provided by a plan relating to circumstances under which a period of an employee's service or plan participation is disregarded, for purposes of determining the extent to which his rights to his accrued benefit under the plan are unconditional, if under such rules such service is disregarded by reason of the employee's failure to complete a required period of service within a specified period of time. For this purpose, plan rules which result in the loss of prior vesting or benefit accruals of an employee, or which deny an employee eligibility to participate, by reason of separation or failure to complete a required period of service within a specified period of time (e.g., 300 hours in one year) will be considered break in service rules. For purposes of section 411(b)(3), service described under the plan's break in service rules, as in effect before the effective date of section 411, need not be counted.

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42333, Aug. 23, 1977]

§ 1.411(a)–11 Restriction and valuation of distributions.

(a) *Scope*—(1) *In general.* Section 411(a)(11) restricts the ability of a plan to distribute any portion of a participant's accrued benefit without the participant's consent. Section 411(a)(11) also restricts the ability of defined benefit plans to distribute any portion of a participant's accrued benefit in optional forms of benefit without complying with specified valuation rules for determining the amount of the distribution. If the consent requirements or the valuation rules of this section are not satisfied, the plan fails to satisfy the requirements of section 411(a).

(2) *Accrued benefit.* For purposes of this section, an accrued benefit is valued taking into consideration the particular optional form in which the benefit is to be distributed. The value of an accrued benefit is the present value of the benefit in the distribution form determined under the plan. For example, a plan that provides a subsidized early retirement annuity benefit may specify that the optional single sum distribution form of benefit available at early retirement age is the present value of the subsidized early retirement annuity benefit. In this case, the subsidized early retirement annuity benefit must be used to apply the valuation requirements of this section and the resulting amount of the single sum distribution. However, if a plan that provides a subsidized early retirement annuity benefit specifies that the single sum distribution benefit available at early retirement age is the present value of the normal retirement annuity benefit, then the normal retirement annuity benefit is used to apply the valuation requirements of this section

and the resulting amount of the single sum distribution available at early retirement age.

(b) *General consent rules.* A plan must satisfy the participant consent requirement with respect to the distribution of a participant's nonforfeitable accrued benefit with a present value in excess of the cash-out limit in effect under paragraph (c)(3)(ii) of this section. See paragraphs (c) (3) and (4) for situations where no consent is required.

(c) *Consent, etc. requirements*—(1) *General rule.* If an accrued benefit is immediately distributable, section 411(a)(11) permits plans to provide for the distribution of any portion of a participant's nonforfeitable accrued benefits only if the applicable consent requirements are satisfied.

(2) *Consent.* (i) No consent is valid unless the participant has received a general description of the material features of the optional forms of benefit available under the plan. In addition, so long as a benefit is immediately distributable, a participant must be informed of the right, if any, to defer receipt of the distribution. Furthermore, consent is not valid if a significant detriment is imposed under the plan on any participant who does not consent to a distribution. Whether or not a significant detriment is imposed shall be determined by the Commissioner by examining the particular facts and circumstances.

(ii) Consent of the participant to the distribution must not be made before the participant receives the notice of his or her rights specified in this paragraph (c)(2) and must not be made more than 90 days before the date the distribution commences.

(iii) A plan must provide a participant with notice of the rights specified in this paragraph (c)(2) at a time that satisfies either paragraph (c)(2)(iii)(A) or (B) of this section:

(A) This paragraph (c)(2)(iii)(A) is satisfied if the plan provides a participant with notice of the rights specified in this paragraph (c)(2) no less than 30 days and no more than 90 days before the date the distribution commences. However, if the participant, after having received this notice, affirmatively elects a distribution, a plan will not fail to satisfy the consent requirement of section 411(a)(11) merely because the distribution commences less than 30 days after the notice was provided to the participant, provided the plan administrator clearly indicates to the participant that the participant has a right to at least 30 days to consider whether to consent to the distribution.

(B) This paragraph (c)(2)(iii)(B) is satisfied if the plan—

(*1*) Provides the participant with notice of the rights specified in this paragraph (c)(2);

(*2*) Provides the participant with a summary of the notice within the time period described in paragraph (c)(2)(iii)(A) of this section; and

(*3*) If the participant so requests after receiving the summary described in paragraph (c)(2)(iii)(B)(*2*) of this section, provides the notice to the participant without charge and no less than 30 days before the date the distribution commences, subject to the rules for the participant's waiver of that 30-day period. The summary described in paragraph (c)(2)(iii)(B)(*2*) of this section must advise the participant of the right, if any, to defer receipt of the distribution, must set forth a summary of the distribution options under the plan, must refer the participant to the most recent version of the notice (and, in the case of a notice provided in any document containing information in addition to the notice, must identify that document and must provide a reasonable indication of where the notice may be found in that document, such as by index reference or by section heading), and must advise the participant that, upon request, a copy of the notice will be provided without charge.

(iv) For purposes of satisfying the requirements of this paragraph (c)(2), the plan administrator may substitute the annuity starting date, within the meaning of § 1.401(a)–20, Q&A–10, for the date the distribution commences.

(v) See § 1.401(a)–20, Q&A–24 for a special rule applicable to consents to plan loans.

(3) *Cash-out limit.* (i) Written consent of the participant is required before the commencement of the distribution of any portion of an accrued benefit if the present value of the nonforfeitable total accrued benefit is greater than

the cash-out limit in effect under paragraph (c)(3)(ii) of this section on the date the distribution commences. The consent requirements are deemed satisfied if such value does not exceed the cash-out limit, and the plan may distribute such portion to the participant as a single sum. Present value for this purpose must be determined in the same manner as under section 417(e); see § 1.417(e)–1(d).

(ii) The cash-out limit in effect for a date is the amount described in section 411(a)(11)(A) for the plan year that includes that date. The cash-out limit in effect for dates in plan years beginning on or after August 6, 1997, is $5,000. The cash-out limit in effect for dates in plan years beginning before August 6, 1997, is $3,500.

(iii) *Effective date*. Paragraphs (c)(3)(i) and (ii) of this section apply to distributions made on or after October 17, 2000. However, an employer is permitted to apply the $5,000 cash-out limit described in paragraph (c)(3)(ii) of this section to plan years beginning on or after August 6, 1997. Otherwise, for distributions prior to October 17, 2000, §§ 1.411(a)–11 and 1.411(a)–11T in effect prior to October 17, 2000 (as contained in 26 CFR Part 1 revised as of April 1, 2000) apply.

(4) *Immediately distributable*. Participant consent is required for any distribution while it is immediately distributable, *i.e.*, prior to the later of the time a participant has attained normal retirement age (as defined in section 411(a)(8)) or age 62. Once a distribution is no longer immediately distributable, a plan may distribute the benefit in the form of a QJSA in the case of a benefit subject to section 417 or in the normal form in other cases without consent.

(5) *Death of participant*. The consent requirements of section 411(a)(11) do not apply after the death of the participant.

(6) *QDROs*. The consent requirements of section 411(a)(11) do not apply to payments to an alternate payee, defined in section 414(p)(8), except as provided in a qualified domestic relations order pursuant to section 414(p).

(7) *Section 401(a)(9), etc*. The consent requirements of section 411(a)(11) do not apply to the extent that a distribution is required to satisfy the requirements of section 401(a)(9) or 415. See section 401(a)(9) and the regulations thereunder and § 1.401(a)–20 Q&A 23 for guidance on these requirements. Notwithstanding any provision to the contrary in section 401(a)(14) or § 1.401(a)–14, a plan may not distribute a participant's nonforfeitable accrued benefit with a present value in excess of the cash-out limit in effect under paragraph (c)(3)(ii) of this section while the benefit is immediately distributable unless the participant consents to such distribution. The failure of a participant to consent is deemed to be an election to defer commencement of payment of the benefit for purposes of section 401(a)(14) and § 1.401(a)–14.

(8) *Delegation to Commissioner*. The Commissioner, in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin, may modify, or provide additional guidance with respect to, the notice and consent requirements of this section. See § 601.601(d)(2)(ii)(*b*) of this chapter.

(d) *Distribution valuation requirements*. In determining the present value of any distribution of any accrued benefit from a defined benefit plan, the plan must take into account specified valuation rules. For this purpose, the valuation rules are the same valuation rules for valuing distributions as set forth in section 417(e); see § 1.417(e)–1(d). This paragraph (d) applies both before and after the participant's death regardless of whether the accrued benefit is immediately distributable. This paragraph also applies whether or not the participant's consent is required under paragraphs (b) and (c) of this section.

(e) *Special rules*—(1) *Plan termination*. The requirements of this section apply before, on and after a plan termination. If a defined contribution plan terminates and the plan does not offer an annuity option (purchased from a commercial provider), then the plan may distribute a participant's accrued benefit without the participant's consent. The preceding sentence does not apply if the employer, or any entity within the same controlled group as the employer, maintains another defined contribution plan, other than an employee

stock ownership plan (as defined in section 4975(e)(7)). In such a case, the participant's accrued benefit may be transferred without the participant's consent to the other plan if the participant does not consent to an immediate distribution from the terminating plan. See section 411(d)(6) and the regulations thereunder for other rules applicable to transferee plans and plan terminations.

(2) *ESOP dividends*. The requirements of this section do not apply to any distribution of dividends to which section 404(k) applies.

(3) *Other rules*. See § 1.401(a)–20 Q&As 14, 17 and 24 for other rules that apply to the section 411(a)(11) requirements.

(f) *Medium for notice and consent*—(1) *Notice*. The notice of a participant's rights described in paragraph (c)(2) of this section or the summary of that notice described in paragraph (c)(2)(iii)(B)(2) of this section must be provided on a written paper document. However, see § 1.401(a)–21 of this chapter for rules permitting the use of electronic media to provide applicable notices to recipients with respect to retirement plans.

(2) *Consent*. The consent described in paragraphs (c)(2) and (3) of this section must be given on a written paper document. However, see § 1.401(a)–21 of this chapter for rules permitting the use of electronic media to make participant elections with respect to retirement plans.

[T.D. 8219, 53 FR 31853, Aug. 22, 1988; 53 FR 48534, Dec. 1, 1988, as amended by T.D. 8620, 60 FR 49221, Sept. 22, 1995; T.D. 8796, 63 FR 70011, Dec. 18, 1998; T.D. 8794, 63 FR 70338, Dec. 21, 1998; T.D. 8873, 65 FR 6006, Feb. 8, 2000; T.D. 8891, 65 FR 44681, 44682, July 19, 2000; T.D. 9294, 71 FR 61887, Oct. 20, 2006]

§ 1.411(a)(13)–1 Statutory hybrid plans.

(a) *In general*. This section sets forth certain rules that apply to statutory hybrid plans under section 411(a)(13). Paragraph (b) of this section describes special rules for certain statutory hybrid plans that determine benefits under a lump sum-based benefit formula. Paragraph (c) of this section describes the vesting requirement for statutory hybrid plans. Paragraphs (d) and (e) of this section contain definitions and effective/applicability dates, respectively.

(b) *Calculation of benefit by reference to hypothetical account balance or accumulated percentage*—(1) *Payment of a current balance or current value under a lump sum-based benefit formula*. Pursuant to section 411(a)(13)(A), a statutory hybrid plan that determines any portion of a participant's benefits under a lump sum-based benefit formula is not treated as failing to meet the following requirements solely because, with respect to benefits determined under that formula, the present value of those benefits is, under the terms of the plan, equal to the then-current balance of the hypothetical account maintained for the participant or to the then-current value of the accumulated percentage of the participant's final average compensation under that formula—

(i) Section 411(a)(2); or

(ii) With respect to the participant's accrued benefit derived from employer contributions, section 411(a)(11), 411(c), or 417(e).

(2) *General rules with respect to current account balance or current value*—(i) *Benefit after normal retirement age*. The relief of section 411(a)(13) does not override the requirement for a plan that, with respect to a participant with an annuity starting date after normal retirement age, the plan either provide an actuarial increase after normal retirement age or satisfy the requirements for suspension of benefits under section 411(a)(3)(B). Accordingly, with respect to such a participant, a plan with a lump sum based benefit formula violates the requirements of section 411(a) if the balance of the hypothetical account or the value of the accumulated percentage of the participant's final average compensation is not increased sufficiently to satisfy the requirements of section 411(a)(2) for distributions commencing after normal retirement age, unless the plan suspends benefits in accordance with section 411(a)(3)(B).

(ii) *Reductions limited*. The relief of section 411(a)(13) does not permit the accumulated benefit under a lump sum-based benefit formula to be reduced in a manner that would be prohibited if that reduction were applied to the accrued benefit. Accordingly,

the only reductions that can apply to the balance of the hypothetical account or accumulated percentage of the participant's final average compensation are reductions as a result of—

(A) Benefit payments;

(B) Qualified domestic relations orders under section 414(p);

(C) Forfeitures that are permitted under section 411(a) (such as charges for providing a qualified preretirement survivor annuity);

(D) Amendments that would reduce the accrued benefit but that are permitted under section 411(d)(6);

(E) Adjustments resulting in a decrease in the balance of the hypothetical account due to the application of interest credits (as defined in §1.411(b)(5)–1(d)(1)(ii)(A)) that are negative for an interest crediting period;

(F) In the case of a formula that expresses the accumulated benefit as an accumulated percentage of the participant's final average compensation, adjustments resulting in a decrease in the dollar amount of the accumulated percentage of the participant's final average compensation—

(*1*) Due to a decrease in the dollar amount of the participant's final average compensation; or

(*2*) Due to an increase in the integration level, under a formula that is integrated with Social Security (for example, as a result of an increase in the Social Security taxable wage base or in Social Security covered compensation); or

(G) Other reductions to the extent provided by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*)).

(3) *Payment of benefits based on current account balance or current value*—(i) *Optional forms that are actuarially equivalent*. With respect to the benefits under a lump sum-based benefit formula, the relief of paragraph (b)(1) of this section applies to an optional form of benefit that is determined as of the annuity starting date as the actuarial equivalent, using reasonable actuarial assumptions, of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation.

(ii) *Optional forms that are subsidized*. With respect to the benefits under a lump sum-based benefit formula, if an optional form of benefit is payable in an amount that is greater than the actuarial equivalent, determined using reasonable actuarial assumptions, of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation, then the plan satisfies the requirements of sections 411(a)(2), 411(a)(11), 411(c) and 417(e) with respect to the amount of that optional form of benefit. However, see §1.411(b)(5)–1(b)(1)(iii) for rules relating to early retirement subsidies.

(iii) *Optional forms that are less valuable*. Except as otherwise provided in paragraph (b)(4)(i) of this section, if an optional form of benefit is not at least the actuarial equivalent, using reasonable actuarial assumptions, of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation, then the relief under section 411(a)(13) (permitting a plan to treat the account balance or accumulated percentage as the actuarial equivalent of the portion of the accrued benefit determined under the lump sum-based benefit formula) does not apply in determining whether the optional form of benefit is the actuarial equivalent of the portion of the accrued benefit determined under the lump sum-based benefit formula. As a result, payment of that optional form of benefit must satisfy the rules applicable to payment of the accrued benefit generally under a defined benefit plan (without regard to the special rules of section 411(a)(13)(A) and paragraph (b)(1) of this section), including the requirements of section 411(a)(2) and, for optional forms subject to the minimum present value requirements of section 417(e)(3), those minimum present value requirements.

(4) *Rules of application*—(i) *Relief applies on proportionate basis with respect*

to payment of only a portion of the benefit under a lump sum-based benefit formula. The relief of paragraph (b)(1) of this section applies on a proportionate basis to a payment of a portion of the benefit under a lump sum-based benefit formula, such as a payment of a specified dollar amount or percentage of the then-current balance of a hypothetical account maintained for the participant or then-current value of an accumulated percentage of the participant's final average compensation. Thus, for example, if a plan that expresses the participant's entire accumulated benefit as the balance of a hypothetical account distributes 40 percent of the participant's then-current hypothetical account balance in a single payment, the plan is treated as satisfying the requirements of section 411(a) and the minimum present value rules of section 417(e) with respect to 40 percent of the participant's then-current accrued benefit.

(ii) *Relief applies only to portion of benefit determined under lump sum-based benefit formula.* The relief of paragraph (b)(1) of this section generally applies only to the portion of the participant's benefit that is determined under a lump sum-based benefit formula and generally does not apply to any portion of the participant's benefit that is determined under a formula that is not a lump sum-based benefit formula. The following rules apply for purposes of satisfying section 417(e):

(A) *''Greater-of'' formulas.* If the participant's accrued benefit equals the greater of the accrued benefit under a lump sum-based benefit formula and the accrued benefit under another formula that is not a lump-sum based benefit formula, a single-sum payment of the participant's entire benefit must be no less than the greater of the then-current accumulated benefit under the lump sum-based benefit formula and the present value, determined in accordance with section 417(e), of the benefit under the other formula. For example, assume that the accrued benefit under a plan is determined as the greater of the accrued benefit attributable to the balance of a hypothetical account and the accrued benefit equal to a pro rata portion of a normal retirement benefit determined by projecting the hypothetical account balance (including future principal and interest credits) to normal retirement age. In such a case, a single-sum payment of the participant's entire benefit must be no less than the greater of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of the pro rata benefit determined by projecting the hypothetical account balance to normal retirement age.

(B) *''Sum-of'' formulas.* If the participant's accrued benefit equals the sum of the accrued benefit under a lump sum-based benefit formula and the accrued benefit under another formula that is not a lump-sum based benefit formula, a single-sum payment of the participant's entire benefit must be no less than the sum of the then-current accumulated benefit under the lump sum-based benefit formula and the present value, determined in accordance with section 417(e), of the benefit under the other formula. For example, assume that the accrued benefit under a plan is determined as the sum of the accrued benefit attributable to the balance of a hypothetical account and the accrued benefit equal to the excess of the benefit under another formula over the benefit under the hypothetical account formula. In such a case, a single-sum payment of the participant's entire benefit must be no less than the sum of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of the excess of the benefit under the other formula over the benefit under the hypothetical account formula.

(C) *''Lesser-of'' formulas.* If the participant's accrued benefit equals the lesser of the accrued benefit under a lump sum-based benefit formula and the accrued benefit under another formula that is not a lump-sum based benefit formula, a single-sum payment of the participant's entire benefit must be no less than the lesser of the then-current accumulated benefit under the lump sum-based benefit formula and the present value, determined in accordance with section 417(e), of the benefit under the other formula. For

example, assume that the accrued benefit under a plan is determined as the accrued benefit attributable to the balance of a hypothetical account, but no greater than an accrued benefit payable at normal retirement age in the form of a straight life annuity of $100,000 per year. In such a case, a single-sum payment of the participant's entire benefit must be no less than the lesser of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of a benefit payable at normal retirement age in the form of a straight life annuity of $100,000 per year. If the formula that is not a lump sum-based benefit formula is the maximum annual benefit described in section 415(b), then the single-sum payment of the participant's entire benefit must not exceed the then-current accumulated benefit under the lump sum-based benefit formula.

(c) *Three-year vesting requirement*—(1) *In general*. Pursuant to section 411(a)(13)(B), if any portion of the participant's accrued benefit under a defined benefit plan is determined under a statutory hybrid benefit formula, the plan is treated as failing to satisfy the requirements of section 411(a)(2) unless the plan provides that the participant has a nonforfeitable right to 100 percent of the participant's accrued benefit if the participant has three or more years of service. Thus, this 3-year vesting requirement applies with respect to the entire accrued benefit of a participant under a defined benefit plan even if only a portion of the participant's accrued benefit under the plan is determined under a statutory hybrid benefit formula. Similarly, if the participant's accrued benefit under a defined benefit plan is, under the plan's terms, the larger of two (or more) benefit amounts, where each amount is determined under a different benefit formula (including a benefit determined pursuant to an offset among formulas within the plan or a benefit determined as the greater of a protected benefit under section 411(d)(6) and another benefit amount) and at least one of those formulas is a statutory hybrid benefit formula, the participant's entire accrued benefit under the defined benefit plan is subject to the 3-year vesting rule of section 411(a)(13)(B) and this paragraph (c). The rule described in the preceding sentence applies even if the larger benefit is ultimately the benefit determined under a formula that is not a statutory hybrid benefit formula.

(2) *Examples*. The provisions of this paragraph (c) are illustrated by the following examples:

Example 1. Employer M sponsors Plan X, a defined benefit plan under which each participant's accrued benefit is equal to the sum of the benefit provided under two benefit formulas. The first benefit formula is a statutory hybrid benefit formula, and the second formula is not. Because a portion of each participant's accrued benefit provided under Plan X is determined under a statutory hybrid benefit formula, the 3-year vesting requirement described in paragraph (c)(1) of this section applies to each participant's entire accrued benefit provided under Plan X.

Example 2. The facts are the same as in *Example 1*, except that the benefit formulas described in *Example 1* only apply to participants for service performed in Division A of Employer M and a different benefit formula applies to participants for service performed in Division B of Employer M. Pursuant to the terms of Plan X, the accrued benefit of a participant attributable to service performed in Division B is based on a benefit formula that is not a statutory hybrid benefit formula. Therefore, the 3-year vesting requirement described in paragraph (c)(1) of this section does not apply to a participant with an accrued benefit under Plan X if the participant's benefit is solely attributable to service performed in Division B.

Example 3. Employer N sponsors defined benefit Plan Y, an independent plan that provides benefits based solely on a lump sum-based benefit formula, and defined benefit Plan Z, which provides benefits based on a formula which is not a statutory hybrid benefit formula, but which is a floor plan that provides for the benefits payable to a participant under Plan Z to be reduced by the amount of the vested accrued benefit payable under Plan Y. The formula under Plan Y is a statutory hybrid benefit formula. Accordingly, Plan Y is subject to the 3-year vesting requirement described in paragraph (c)(1) of this section. The formula provided under Plan Z, even taking into account the offset for vested accrued benefits under Plan Y, is not a statutory hybrid benefit formula. Therefore, Plan Z is not subject to the 3-year vesting requirement in paragraph (c)(1) of this section.

(d) *Definitions*—(1) *In general*. The definitions in this paragraph (d) apply for purposes of this section.

(2) *Accumulated benefit*. A participant's accumulated benefit at any date means the participant's benefit, as expressed under the terms of the plan, accrued to that date. For this purpose, if a participant's benefit is expressed under the terms of the plan as the current balance of a hypothetical account or the current value of an accumulated percentage of the participant's final average compensation, the participant's accumulated benefit is expressed in that manner regardless of how the plan defines the participant's accrued benefit. Thus, for example, the accumulated benefit of a participant may be expressed under the terms of the plan as either the current balance of a hypothetical account or the current value of an accumulated percentage of the participant's final average compensation, even if the plan defines the participant's accrued benefit as an annuity beginning at normal retirement age that is actuarially equivalent to that balance or value.

(3) *Lump sum-based benefit formula*—(i) *In general*. A lump sum-based benefit formula means a benefit formula used to determine all or any part of a participant's accumulated benefit under a defined benefit plan under which the accumulated benefit provided under the formula is expressed as the current balance of a hypothetical account maintained for the participant or as the current value of an accumulated percentage of the participant's final average compensation. A benefit formula is expressed as the current balance of a hypothetical account maintained for the participant if it is expressed as a current single-sum dollar amount equal to that balance. A benefit formula is expressed as the current value of an accumulated percentage of the participant's final average compensation if it is expressed as a current single-sum dollar amount equal to a percentage of the participant's final average compensation or, for plan years described in paragraph (e)(2)(ii)(A) or (e)(2)(ii)(B) of this section, as applicable (or any earlier date as elected by the taxpayer), a percentage of the participant's highest average compensation (regardless of whether the plan applies a limitation on the past period for which compensation is taken into account in determining highest average compensation). Whether a benefit formula is a lump sum-based benefit formula is determined based on how the accumulated benefit of a participant is expressed under the terms of the plan, and does not depend on whether the plan provides an optional form of benefit in the form of a single-sum payment. However, for plan years described in paragraph (e)(2)(ii)(A) or (e)(2)(ii)(B) of this section (as applicable), a benefit formula does not constitute a lump sum-based benefit formula unless a distribution of the benefits under that formula in the form of a single-sum payment equals the accumulated benefit under that formula (except to the extent the single-sum payment is greater to satisfy the requirements of section 411(d)(6)). In addition, for plan years described in paragraph (e)(2)(ii)(A) or (e)(2)(ii)(B) of this section (as applicable), a benefit formula does not constitute a lump sum-based benefit formula unless the portion of the participant's accrued benefit that is determined under that formula and the then-current balance of the hypothetical account or the then-current value of the accumulated percentage of the participant's final average compensation are actuarially equivalent (determined using reasonable actuarial assumptions) either—

(A) Upon attainment of normal retirement age; or

(B) At the annuity starting date for a distribution with respect to that portion.

(ii) *Exception for employee contributions*. For purposes of the definition of a lump sum-based benefit formula in paragraph (d)(3)(i) of this section, the benefit properly attributable to after-tax employee contributions, rollover contributions from eligible retirement plans under section 402(c)(8), and other similar employee contributions (such as repayments of distributions pursuant to section 411(a)(7)(C) and employee contributions that are pickup contributions pursuant to section 414(h)(2)) is disregarded. However, a benefit is not properly attributable to contributions described in this paragraph (d)(3)(ii) if

the contributions are credited with interest at a rate that exceeds a reasonable rate of interest or if the conversion factors used to calculate such benefit are not actuarially reasonable. See section 411(c) for an example of a calculation of a benefit that is properly attributable to employee contributions.

(4) *Statutory hybrid benefit formula*—(i) *In general.* A statutory hybrid benefit formula means a benefit formula that is either a lump sum-based benefit formula or a formula that is not a lump sum-based benefit formula but that has an effect similar to a lump sum-based benefit formula.

(ii) *Effect similar to a lump sum-based benefit formula*— (A) *In general.* Except as provided in paragraphs (d)(4)(ii)(B) through (E) of this section, a benefit formula under a defined benefit plan that is not a lump sum-based benefit formula has an effect similar to a lump sum-based benefit formula if the formula provides that a participant's accumulated benefit is expressed as a benefit that includes the right to adjustments (including a formula that provides for indexed benefits under §1.411(b)(5)–1(b)(2)) for a future period and the total dollar amount of those adjustments is reasonably expected to be smaller for the participant than for any similarly situated, younger individual (within the meaning of §1.411(b)(5)–1(b)(5)) who is or could be a participant in the plan. For this purpose, the right to adjustments for a future period means, for plan years described in paragraph (e)(2)(ii)(A) or (e)(2)(ii)(B) of this section (as applicable), the right to any changes in the dollar amount of benefits over time, regardless of whether those adjustments are denominated as interest credits. A benefit formula that does not include adjustments for any future period is treated as a formula with an effect similar to a lump sum-based benefit formula if the formula would be described in this paragraph (d)(4)(ii)(A) except for the fact that the adjustments are provided pursuant to a pattern of repeated plan amendments. See §1.411(d)–4, A–1(c)(1).

(B) *Exception for post-retirement benefit adjustments.* Post-annuity starting date adjustments in the amount payable to a participant (such as cost-of-living increases) are disregarded in determining whether a benefit formula under a defined benefit plan has an effect similar to a lump sum-based benefit formula.

(C) *Exception for certain variable annuity benefit formulas.* If a variable annuity benefit formula adjusts benefits by reference to the difference between a rate of return on plan assets (or specified market indices) and a specified assumed interest rate of 5 percent or higher, then the variable annuity benefit formula is not treated as being reasonably expected to provide a smaller total dollar amount of future adjustments for the participant than for any similarly situated, younger individual who is or could be a participant in the plan, and thus such a variable annuity benefit formula does not have an effect similar to a lump sum-based benefit formula. For plan years described in paragraph (e)(2)(ii)(A) or (e)(2)(ii)(B) of this section (as applicable) (or any earlier date as elected by the taxpayer), the rate of return on plan assets (or specified market index) by reference to which the benefit formula adjusts must be a rate of return described in §1.411(b)(5)–1(d)(5) (which includes, in the case of a benefit formula determined with reference to an annuity contract for an employee issued by an insurance company licensed under the laws of a State, the rate of return on the market index specified under that contract).

(D) *Exception for employee contributions.* Benefits that are disregarded under paragraph (d)(3)(ii) of this section (benefits properly attributable to certain employee contributions) are also disregarded for purposes of determining whether a benefit formula has an effect similar to a lump sum-based benefit formula.

(E) *Exception for certain actuarial reductions for early commencement under traditional formula.* A defined benefit formula is not treated as having an effect similar to a lump sum-based benefit formula with respect to a participant merely because the formula provides for a reduction in the benefit payable at early retirement due to early commencement (with the result that the benefit payable at normal retirement age is greater than the benefit

payable at early retirement), provided that the benefit payable at normal retirement age to the participant cannot be less than the benefit payable at normal retirement age to any similarly situated, younger individual who is or could be a participant in the plan. Thus, for example, a plan that provides a benefit equal to 1 percent of final average pay per year of service, payable as a life annuity at normal retirement age, is not treated as having an effect similar to a lump sum-based benefit formula by reason of an actuarial reduction in the benefit payable under the plan for early commencement.

(5) *Statutory hybrid plan.* A statutory hybrid plan means a defined benefit plan that contains a statutory hybrid benefit formula.

(6) *Variable annuity benefit formula.* A variable annuity benefit formula means any benefit formula under a defined benefit plan which provides that the amount payable is periodically adjusted by reference to the difference between a rate of return and a specified assumed interest rate.

(e) *Effective/applicability date*—(1) *Statutory effective/applicability date*—(i) *In general.* Except as provided in paragraphs (e)(1)(ii) and (e)(1)(iii) of this section, section 411(a)(13) applies for periods beginning on or after June 29, 2005.

(ii) *Calculation of benefits.* Section 411(a)(13)(A) applies to distributions made after August 17, 2006.

(iii) *Vesting*—(A) *Plans in existence on June 29, 2005*—(*1*) *General rule.* In the case of a plan that is in existence on June 29, 2005 (regardless of whether the plan is a statutory hybrid plan on that date), section 411(a)(13)(B) applies to plan years that begin on or after January 1, 2008.

(*2*) *Exception for plan sponsor election. See* §1.411(b)(5)–1(f)(1)(iii)(A)(*2*) for a special election for early application of section 411(a)(13)(B).

(B) *Plans not in existence on June 29, 2005.* In the case of a plan not in existence on June 29, 2005, section 411(a)(13)(B) applies to plan years that end on or after June 29, 2005.

(C) *Collectively bargained plans.* Notwithstanding paragraphs (e)(1)(iii)(A) and (B) of this section, in the case of a collectively bargained plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified on or before August 17, 2006, the requirements of section 411(a)(13)(B) do not apply to plan years that begin before the earlier of—

(*1*) The later of—

(*i*) The date on which the last of those collective bargaining agreements terminates (determined without regard to any extension thereof on or after August 17, 2006); or

(*ii*) January 1, 2008; or

(*2*) January 1, 2010.

(D) *Treatment of plans with both collectively bargained and non-collectively bargained employees.* In the case of a plan with respect to which a collective bargaining agreement applies to some, but not all, of the plan participants, the plan is considered a collectively bargained plan for purposes of paragraph (e)(1)(iii)(C) of this section if it is considered a collectively bargained plan under the rules of §1.436–1(a)(5)(ii)(B).

(E) *Hour of service required.* Section 411(a)(13)(B) does not apply to a participant who does not have an hour of service after section 411(a)(13)(B) would otherwise apply to the participant under the rules of paragraph (e)(1)(iii)(A), (B), or (C) of this section.

(2) *Effective/applicability date of regulations*—(i) *In general.* Except as provided in paragraph (e)(2)(ii) of this section, this section applies to plan years that begin on or after January 1, 2011. For the periods after the statutory effective date set forth in paragraph (e)(1) of this section and before the regulatory effective date set forth in the preceding sentence, the relief of section 411(a)(13)(A) applies and the 3-year vesting requirement of section 411(a)(13)(B) must be satisfied. During these periods, a plan is permitted to rely on the provisions of this section for purposes of applying the relief of section 411(a)(13)(A) and satisfying the requirements of section 411(a)(13)(B).

(ii) *Special effective date*—(A) *In general.* Except as otherwise provided in this paragraph (e)(2)(ii), paragraphs (b)(2), (3), and (4) of this section apply to plan years that begin on or after January 1, 2017.

(B) *Collectively bargained plans.* In the case of a plan maintained pursuant to

one or more collective bargaining agreements between employee representatives and one or more employers ratified on or before November 13, 2015, that constitutes a collectively bargained plan under the rules of § 1.436–1(a)(5)(ii)(B), paragraphs (b)(2), (3), and (4) of this section apply to plan years that begin on or after the later of—

(*1*) January 1, 2017; and

(*2*) The earlier of—

(*i*) January 1, 2019; and

(*ii*) The date on which the last of those collective bargaining agreements terminates (determined without regard to any extension thereof on or after November 13, 2015).

(iii) *Hour of service required.* A benefit formula is not treated as having an effect similar to a lump sum-based benefit formula under paragraph (d)(4)(ii) of this section with respect to a participant who does not have an hour of service after the regulatory effective date set forth in paragraph (e)(2)(i) of this section.

[T.D. 9505, 75 FR 64135, Oct. 19, 2010, as amended by 76 FR 4244, Jan. 25, 2011; T.D. 9693, 79 FR 56457, Sept. 19, 2014; T.D. 9743, 80 FR 70683, 70684, Nov. 16, 2015]

§ 1.411(b)–1 Accrued benefit requirements.

(a) *Accrued benefit requirements*—(1) *In general.* Under section 411(b), for plan years beginning after the applicable effective date of section 411, rules are provided for the determination of the accrued benefit to which a participant is entitled under a plan. Under a defined contribution plan, a participant's accrued benefit is the balance to the credit of the participant's account. Under a defined benefit plan, a participant's accrued benefit is his accrued benefit determined under the plan. A defined benefit plan is not a qualified plan unless the method provided by the plan for determining accrued benefits satisfies at least one of the alternative methods (described in paragraph (b) of this section) for determining accrued benefits with respect to all active participants under the plan. A defined benefit plan may provide that accrued benefits for participants are determined under more than one plan formula. In such a case, the accrued benefits under all such formulas must be aggregated in order to determine whether or not the accrued benefits under the plan for participants satisfy one of the alternative methods. A plan may satisfy different methods with respect to different classifications of employees, or separately satisfy one method with respect to the accrued benefits for each such classification, provided that such classifications are not so structured as to evade the accrued benefit requirements of section 411(b) and this section. (For example, if a plan provides that employees who commence participation at or before age 40 accrue benefits in a manner which satisfies the 133⅓ percent method of determining accrued benefits and employees who commence participation after age 40 accrue benefits in a manner which satisfies the 3 percent method of determining accrued benefits, the plan would be so structured as to evade the requirements of section 411(b).) A defined benefit plan does not satisfy the requirements of section 411(b) and this section merely because the accrued benefit is defined as the ''reserve under the plan''. Special rules are provided for the first two years of service by a participant, certain insured defined benefit plans, and certain reductions in accrued benefits due to increasing age or service. In addition, a special rule is provided with respect to accruals for service before the effective date of section 411.

(2) *Cross references*—(i) *3 percent method.* For rules relating to the 3 percent method of determining accrued benefits, see paragraph (b)(1) of this section.

(ii) *133⅓ percent method.* For rules relating to the 133⅓ percent method of determining accrued benefits, see paragraph (b)(2) of this section.

(iii) *Fractional method.* For rules relating to the fractional method of determining accrued benefits, see paragraph (b)(3) of this section.

(iv) *Accruals before effective date.* For rules relating to accruals for service before the effective date of section 411, see paragraph (c) of this section.

(v) *First 2 years of service.* For special rules relating to determination of accrued benefit for first 2 continuous years of service, see paragraph (d)(1) of this section.

(vi) *Certain insured plans.* For special rules relating to determination of accrued benefit under a defined benefit plan funded exclusively by insurance contracts, see paragraph (d)(2) of this section.

(vii) *Accruals decreased by increasing age or service.* For special rules relating to prohibition of decrease in accrued benefit on account of increasing age or service, see paragraph (d)(3) of this section.

(viii) *Separate accounting.* For rules relating to requirements for separate accounting, see paragraph (e) of this section.

(ix) *Year of participation.* For definition of ''year of participation'', see paragraph (f) of this section.

(b) *Defined benefit plans.* A defined benefit plan satisfies the requirements of section 411(b)(1) and this paragrah for a plan year to which section 411 and this section apply if it satisfies the requirements of subparagraph (1), (2), or (3) of this paragraph for such year.

(1) *3 percent method*—(i) *General rule.* A defined benefit plan satisfies the requirements of this paragraph for a plan year if, as of the close of the plan year, the accrued benefit to which each participant is entitled, computed as if the participant separated from the service as of the close of such plan year, is not less than 3 percent of the 3 percent method benefit, multiplied by the number of years (not in excess of 33⅓) of his participation in the plan including years after his normal retirement age. For purposes of this subparagraph, the ''3 percent method benefit'' is the normal retirement benefit to which the participant would be entitled if he commenced participation at the earliest possible entry age for any individual who is or could be a participant under the plan and if he served continuously until the earlier of age 65 or the normal retirement age under the plan.

(ii) *Special rules*—(A) *Compensation.* In the case of a plan providing a retirement benefit based upon compensation during any period, the normal retirement benefit to which a participant would be entitled is determined as if he continued to earn annually the average rate of compensation which he earned during consecutive years of service, not in excess of 10, for which his compensation was the highest. For purposes of this subdivision (A), the number of consecutive years of service used in computing average compensation shall be the number of years of service specified under the plan (not in excess of 10) for computing normal retirement benefits.

(B) *Social security, etc.* For purposes of this subparagraph, for any plan year, social security benefits and all relevant factors used to compute benefits, e.g., consumer price index, are treated as remaining constant as of the beginning of the current plan year for all subsequent plan years.

(C) *Computation in certain cases.* In the case of any plan to which the provisions of section 411(b)(1)(D) and paragraph (c) of this section are applicable, for any plan year the accrued benefit of any participant shall not be less than the accrued benefit otherwise determined under this subparagraph, reduced by the excess of the accrued benefit determined under this subparagraph as of the first day of the first plan year to which section 411 applies over the accrued benefit determined under section 411(b)(1)(D) and paragraph (c) of this section and increased by the amount determined under paragraph (c)(2)(v) of this section.

(iii) *Examples.* The application of this subparagraph is illustrated by the following examples.

Example 1. The M Corporation's defined benefit benefit plan provides an annual retirement benefit commencing at age 65 or $4 per month for each year of participation. As a condition of participation, the plan requires that an employee have attained age 25. The normal retirement age specified under the plan is age 65. The plan provides for no limit on the number of years of credited service. A, age 40, is a participant in the M Corporation's plan.

A has completed 12 years of participation in the plan of the M Corporation as of the close of the plan year. Under subdivision (i) of this subparagraph, the normal retirement benefit commencing at age 65 to which a participant would be entitled if he commenced participation at the earliest possible entry age (25) under the plan and served continuously until normal retirement age (65) is an annual benefit of $1,920 [40 × (12 × $4)]. Under paragraph (b)(1)(i) of this section, the plan does not satisfy the requirements of this subparagraph unless A has accrued an annual benefit of at least $691 [0.03 × ($1,920 × 12)] as of the close of the plan year. Under the M

Corporation plan, A is entitled to an accrued benefit of $576 [(12 × 12) × $4] as of the close of the plan year. Thus, with respect to A, the accrued benefit provided under the M Corporation plan does not satisfy the requirements of this subparagraph.

Example 2. Assume the same facts as in example (1) except that the M Corporation's plan provides that only the first 30 years of participation are taken into account. Under subdivision (i) of this subparagraph, the normal retirement benefit commencing at age 65 to which a participant would be entitled if he commenced participation at the earliest possible entry age under the plan (25) and served continuously until normal retirement age (65) is an annual benefit of $1.440 [30 × $48]. Under paragraph (b)(1)(i) of this section, the plan does not satisfy the requirements of this subparagraph unless A has accrued an annual benefit of at least $518 [0.03 × ($1,440 × 12)] as of the close of the plan year. Under the M Corporation plan, A is entitled to an accrued benefit of $576 [(12 × $48]. Thus, with respect to A, the accrued benefit provided under the M Corporation plan satisfies the requirements of this subparagraph.

Example 3. The N Corporation's defined benefit plan provides an annual retirement benefit commencing at age 65 of 50 percent of average compensation for the highest 3 consecutive years of compensation for an employee with 25 years of participation. A participant who separates from service before age 65 is entitled to 2 percent of average compensation for the highest 3 consecutive years of compensation for each year of participation not in excess of 25. The plan has no minimum age or service requirement for participation. The normal retirement age specified under the plan is age 65. On December 31, 1990, B, age 40, is a participant in the N Corporation's plan. B began employment with the N Corporation and became a participant in the N Corporation's plan on January 1, 1980. Under this subparagraph, the normal retirement benefit to which a participant would be entitled if he commenced participation at the earliest possible entry age (0) under the plan and served continuously until normal retirement age (65) is 50 percent of average compensation for the highest 3 consecutive years of compensation per year commencing at age 65. Under this subparagraph, B must have accrued an annual benefit of at least 16.5 percent of his highest 3 consecutive years of compensation per year commencing at age 65 [0.03 × 50 percent of average compensation for the highest 3 consecutive years of compensation × 11] as of the close of the plan year. Under the N Corporation plan, B has accrued an annual benefit of 22 percent of average compensation for his highest 3 consecutive years of compensation per year commencing at age 65. Thus, with respect to B, the accrued benefit under the N Corporation plan satisfies the requirements of this subparagraph.

Example 4. The P Corporation's defined benefit plan provides an annual retirement benefit commencing at age 65 of 50 percent of average compensation for the 3 consecutive years of compensation from the P Corporation next preceding normal retirement age. The plan has no minimum age or service requirement for participation. The normal retirement age under the plan is age 65. On December 31, 1990, C, age 55, separates from service with the P Corporation. C began employment with the P Corporation and became a participant in the P Corporation's plan on January 1, 1980. As of December 31, 1990. C's average compensation for the 3 consecutive years preceding his separation from service is $15,000. Under this subparagraph, the normal retirement benefit to which a participant would be entitled if he commenced participation at the earliest possible entry age (0) under the plan and served continuously until normal retirement age (65) is an annual benefit of 50 percent of average compensation for the 3 consecutive years of compensation from the P Corporation next preceding normal retirement age commencing at age 65. C must have accrued an annual benefit of at least $2,475 commencing at age 65 [0.03 × (0.050 × $15,000) × 11] as of his separation from the service with the P Corporation in order for the P Corporation's plan to satisfy the requirements of this subparagraph with respect to C.

Example 5. On December 31, 1985, the R Corporation's defined benefit plan provided an annual retirement benefit commencing at age 65 of $100 for each year of participation, not to exceed 30. As a condition of participation, the plan requires that an employee have attained age 25. The normal retirement age specified under the plan is age 65. The appropriate computation period is the calendar year. On January 1, 1986, the plan is amended to provide an annual retirement benefit commencing at age 65 of $200 for each year of participation (before and after the amendment), not to exceed 30. B, age 40, is a participant in the R Corporation's plan. B has completed 15 years of participation in the plan of the R Corporation as of December 31, 1990. Under paragraph (b)(1)(i) of this section, the normal retirement benefit commencing at age 65 to which a participant would be entitled if he commenced participation at the earliest possible entry age (25) under the plan and served continuously until normal retirement age (65) is an annual benefit of $6,000 [30 × 200]. Under subdivision (i) of this subparagraph, the plan does not satisfy the requirements of this subparagraph unless B has accrued an annual benefit of at least $2,700 [0.03 × $6,000 × 15] as of December 31, 1990. Under the R Corporation plan, B is entitled to an accrued benefit of $3,000 [$200

× 15] as of December 31, 1990. Thus, with respect to B, the accrued benefit provided under the R Corporation plan satisfies the requirements of this subparagraph.

Example 6. On December 31, 1995, the J Corporation's defined benefit plan provided an annual retirement benefit commencing at age 65 of $4,800 after 30 years of participation. The normal retirement age specified under the plan is age 65. The appropriate computation period is the calendar year. On January 1, 1996, the plan is amended to provide an annual retirement benefit commencing at age 65 of $6,000. A, age 40, is a participant in the J Corporation's plan since its adoption on January 1, 1986. Under paragraph (b)(1)(i) of this section, on December 31, 1995, the normal retirement benefit commencing at age 5 to which a participant would be entitled if he commenced participation at the earliest possible entry age (0) under the plan and served continuously until normal retirement age (65) is an annual benefit of $4,800. Under paragraph (b)(1)(i) of this section, on January 1, 1996, the normal retirement benefit commencing at age 65 to which a participant would be entitled if he commenced participation at the earliest possible entry age (0) under the plan and served continuously until normal retirement age (65) is an annual benefit of $6,000. Under subdivision (i) of this subparagraph, the plan does not satisfy the requirements of this subparagraph unless A has an accrued benefit on December 31, 1995 of at least $1,440 [$4,800 × 0.02 × 10] and an accrued benefit on January 1, 1996 of at least $1,800 [$6,000 × 0.03 × 10].

Example 7. The X Company's defined benefit plan provides an annual retirement benefit commencing at age 65 of $4 per month for each year of participation (not to exceed 30). As a condition of participation, the plan requires that an employee have attained age 25. The normal retirement age specified under the plan is age 65. D, age 68, is a participant in the X Company's plan. D has completed 20 years of participation in the X Company plan as of the close of the plan year. Under paragraph (b)(1)(i) of this section, the normal retirement benefit commencing at age 65 to which a participant would be entitled if he commenced participation at the earliest possible entry age (25) under the plan and served continuously until normal retirement age (65) is an annual benefit, commencing at age 65, of $1,440 [30 × $48]. Under paragraph (b)(1)(i) of this section, the plan does not satisfy the requirements of this subparagraph unless D has accrued an annual benefit, commencing at age 65, of $864 [0.03 × $1,440 × 20] as of the close of the plan year. Under the X Company plan, D has accrued an annual benefit, commencing at age 65, of $960 [20 × $48]. Thus, with respect to D the accrued benefit provided under the X Company plan satisfies the requirements of this subparagraph.

Example 8. Assume the same facts as in example (7) except that for purposes of determining accrued benefits under the plan the X Company's plan disregards all years of participation after normal retirement age. Under paragraph (b)(1)(i) of this section, the normal retirement benefit commencing at age 65 to which a participant would be entitled if he commenced participation at the earliest possible entry age (25) under the plan and served continuously until normal retirement age (65) is an annual benefit of $1,440 [30 × $48]. Under paragraph (b)(1)(i) of this section the plan does not satisfy the requirements of this subparagraph unless D has accrued an annual benefit, commencing at age 65, of $864 [0.03 × $1,440 × 20] as of the close of the plan year. Under the X Company's plan D has accrued an annual benefit commencing at age 65, of $816 [17 × $48]. Thus, with respect to D, the accrued benefit provided under the X Company plan does not satisfy the requirements of this subparagraph.

(2) *133⅓ percent rule*—(i) *General rule.* A defined benefit plan satisfies the requirements of this subparagraph for a particular plan year if—

(A) Under the plan the accrued benefit payable at the normal retirement age (determined under the plan) is equal to the normal retirement benefit (determined under the plan), and

(B) The annual rate at which any individual who is or could be a participant can accrue the retirement benefits payable at normal retirement age under the plan for any later plan year cannot be more than 133⅓ percent of the annual rate at which he can accrue benefits for any plan year beginning on or after such particular plan year and before such later plan year.

(ii) *Special rules.* For purposes of this subparagraph—

(A) *Plan amendments.* Any amendment to the plan which is in effect for the current plan year shall be treated as if it were in effect for all other plan years.

(B) *Change in accrual rate.* Any change in an accrual rate which change does not apply to any individual who is of could be a participant in the plan year is disregarded. Thus, for example, if for its plan year beginning January 1, 1980, a defined benefit plan provides an accrued benefit in plan year 1980 of 2 percent of a participant's average compensation for his highest 3 years of compensation for each year of service

and provides that in plan year 1981 the accrued benefit will be 3 percent of such average compensation, the plan will not be treated as failing to satisfy the requirements of this subparagraph for plan year 1980 because in plan year 1980 the change in the accrual rate does not apply to any individual who is or could be a participant in plan year 1980. However, if, for example, a defined benefit plan provided for an accrued benefit of 1 percent of a participant's average compensation for his highest 3 years of compensation for each of the first 10 years of service and 1.5 percent of such average compensations for each year of service thereafter, the plan will be treated as failing to satisfy the requirements of this subparagraph for the plan year even though no participant is actually accruing at the 1.5 percent rate because an individual who could be a participant and who had over 10 years of service would accrue at the 1.5 percent rate, which rate exceeds 133⅓ percent of the 1 percent rate.

(C) *Early retirement benefits.* The fact that certain benefits under the plan may be payable to certain participants before normal retirement age is disregarded. Thus, the requirements of subdivision (i) of this subparagraph must be satisfied without regard to any benefit payable prior to the normal retirement benefit (such as an early retirement benefit which is not the normal retirement benefit (see §1.411(a)–7(c).

(D) *Social security, etc.* For purposes of this paragraph, for any plan year, social security benefits and all relevant factors used to compute benefits, e.g., consumer price index, are treated as remaining constant as of the beginning of the current plan year for all subsequent plan years.

(E) *Postponed retirement.* A plan shall not be treated as failing to satisfy the requirements of this subparagraph for a plan year merely because no benefits under the plan accrue to a participant who continues service with the employer after such participant has attained normal retirement age.

(F) *Computation of benefit.* A plan shall not satisfy the requirements of this subparagraph if the base for the computation of retirement benefits changes solely by reason of an increase in the number of years of participation. Thus, for example, a plan will not satisfy the requirements of this subparagraph if it provides a benefit, commencing at normal retirement age, of the sum of (*1*) 1 percent of average compensation for a participant's first 3 years of participation multiplied by his first 10 years of participation (or, if less than 10 his total years of participation) and (*2*) 1 percent of average compensation for a participant's 3 highest years of participation multiplied by each year of participation subsequent to the 10th year.

(G) *Variable interest crediting rate under a statutory hybrid benefit formula.* For plan years that begin on or after January 1, 2012 (or an earlier date as elected by the taxpayer), a plan that determines any portion of the participant's accrued benefit pursuant to a statutory hybrid benefit formula (as defined in §1.411(a)(13)–1(d)(4)) that utilizes an interest crediting rate described in §1.411(b)(5)–1(d) that is a variable rate that was less than zero for the prior plan year is not treated as failing to satisfy the requirements of paragraph (b)(2) of this section for the current plan year merely because the plan assumes for purposes of paragraph (b)(2) of this section that the variable rate is zero for the current plan year and all future plan years.

(H) *Special rule for multiple formulas.* [Reserved]

(iii) *Examples.* The application of this subparagraph is illustrated by the following examples:

Example 1. On January 1, 1980, the R Corporation's defined benefit plan provides for an annual benefit (commencing at age 65) of a percentage of a participant's average compensation for the period of 5 consecutive years of participation for which his compensation is the highest. The percentage is 2 percent for each of the first 20 years of participation and 1 percent per year thereafter. The appropriate computation period is the calendar year. The R Corporation's plan satisfies the requirements of this subparagraph because the 133⅓ percent rule does not restrict subsequent accrual rate decreases.

Example 2. On January 1, 1980, the J Corporation's defined benefit plan provides for an annual benefit (commencing at age 65) of a percentage of a participant's average compensation for the period of his final 5 consecutive years of participation. The percentage is 1 percent for each of the first 5 years

of participation; 1⅓ percent for each of the next 5 years of participation; and 1⅞ percent for each year thereafter. The appropriate computation period is the calendar year. Even though no single accrual rate under the J Corporation's plan exceeds 133⅓ percent of the immediately preceding accrual rate, the J Corporation's plan does not satisfy the requirements of this subparagraph because the rate of accrual for all years of participation in excess of 10 (1⅞ percent) exceeds 133⅓ percent of the rate of accrual for any of the first 5 years of participation (1 percent).

Example 3. On January 1, 1980, the C Corporation's defined benefit plan provides for an annual benefit (commencing at age 65) of a percentage of a participant's average compensation for the period of 3 consecutive years of participation for which his compensation is the highest. The percentage is 2 percent for each of the first 5 years of participation; 1 percent for each of the next 5 years of participation; and 1½ percent for each year thereafter. The appropriate computation period is the calendar year. Even though the average rate of accrual under the C Corporation's plan is not less rapidly than ratably, the C Corporation's plan does not satisfy the requirements of this subparagraph because the rate of accrual for all years of participation in excess of 10 (1½ percent) for any employee who is actually accruing benefits or who could accrue benefits exceeds 133⅓ percent of the rate of accrual for the sixth through tenth years of participation, respectively (1 percent).

(3) *Fractional rule*—(i) *In general.* A defined benefit plan satisfies the requirements of this paragraph if the accrued benefit to which any participant is entitled is not less than the fractional rule benefit multiplied by a fraction (not exceeding 1)—

(A) The numerator of which is his total number of years of participation in the plan, and

(B) The denominator of which is the total number of years he would have participated in the plan if he separated from the service at the normal retirement age under the plan.

(ii) *Special rules.* For purposes of this subparagraph—

(A) *Fractional rule benefit.* The ''fractional rule benefit'' is the annual benefit commencing at the normal retirement age under the plan to which a participant would be entitled if he continued to earn annually until such normal retirement age the same rate of compensation upon which his normal retirement benefit would be computed. Such rate of compensation shall be computed on the basis of compensation taken into account under the plan (but taking into account average compensation for no more than the 10 years of service immediately preceding the determination). For purposes of this subdivision (A), the normal retirement benefit shall be determined as if the participant had attained normal retirement age on the date any such determination is made.

(B) *Social security, etc.* For purposes of this subparagraph, for any plan year, social security benefits and all relevant factors used to compute benefits, e.g., consumer price index, are treated as remaining constant as of the beginning of the current plan year for all subsequent plan years.

(C) *Postponed retirement.* A plan shall not be treated as failing to satisfy the requirements of this subparagraph merely because no benefits under the plan accrue to a participant who continues service with the employer after such participant has attained normal retirement age under the plan.

(D) *Computation in certain cases.* In the case of any plan to which the provisions of section 411(b)(1)(D) and paragraph (c) of this section are applicable, for any plan year the accrued benefit of any participant shall not be less than the accrued benefit otherwise determined under this subparagraph, reduced by the excess of the accrued benefit determined under this subparagraph as of the first day of the first plan year to which section 411 applies over the accrued benefit determined under section 411(b)(1)(D) and paragraph (c) of this section and increased by the amount determined under paragraph (c)(2)(v) of this section.

(iii) *Examples.* The application of this subparagraph is illustrated by the following examples:

Example 1. The R Corporation's defined benefit plan provides an annual retirement benefit commencing at age 65 of 30 percent of a participant's average compensation for his highest 3 consecutive years of participation. If a participant separates from service prior to normal retirement age, the R Corporation's plan provides a benefit equal to an amount which bears the same ratio to 30 percent of such average compensation as the participant's actual number of years of participation in the plan bears to the number of

years the participant would have participated in the plan had he separated from service at age 65. The plan further provides that normal retirement age is age 65. A, age 55, is a participant in the R Corporation's plan for the current year, and A has 15 years of participation in the R Corporation's plan. As of the current year, A's average compensation for his highest 3 years of compensation is $20,000. The R Corporation's plan satisfies the requirements of this subparagraph because if A separates from the service in the current year he will be entitled to an annual benefit of $3,600 commencing at age 65 [0.3 × $20,000 × 15/25].

Example 2. The J Corporation's defined benefit plan provides a normal retirement benefit of 1 percent per year of a participant's average compensation from the employer. In the case of a participant who separates from service prior to normal retirement age (65), the plan provides that the annual benefit is an amount which is equal to 1 percent of such compensation multiplied by the number of years of plan participation actually completed by the participant. The plan year of the J Corporation's plan is the calendar year. B, age 55, is a participant in the J Corporation's plan for the current year. B became a participant in the J Corporation's plan on January 1, 1980. As of December 31, 1990, B's compensation history is as follows:

Year	Compensation
1980	$17,000
1981	18,000
1982	20,000
1983	20,000
1984	21,000
1985	22,000
1986	23,000
1987	25,000
1988	26,000
1989	29,000
1990	32,000

If B separates from service on December 31, 1990, he would be entitled to an annual benefit of $2,530 commencing at age 65. Because the J Corporation's plan does not limit the number of years of compensation to be taken into account in determining the normal retirement benefit, B's rate of compensation for purposes of determining his normal retirement benefit is $23,600 [$18,000 + $20,000 + $20,000 + $21,000 + $22,000 + $23,000 + $25,000 + $26,000 + $29,000 + $32,000]/10.

Under this subparagraph, B's accrued benefit under the J Corporation's plan as of December 31, 1990 must be not less than $2,561 per year commencing at age 65 [0.01 × ($17,000 + $18,000 + $20,000 + $20,000 + $21,000 + $22,000 + $23,000 + $25,000 + $26,000 + $29,000 + $32,000 + ($23,600 × 10)) × 11/21]. Thus, the J Corporation's plan would not satisfy the requirements of this subparagraph.

(c) *Accruals for service before effective date*—(1) *General rule.* For a plan year to which section 411 applies, a defined benefit plan does not satisfy the requirements of section 411(b)(1) and this section unless, under the plan, the accrued benefit of each participant for plan years beginning before section 411 applies is not less than the greater of—

(i) Such participant's accrued benefit (as of the day before section 411 applies) determined under the plan as in effect from time to time prior to September 2, 1974 (without regard to any amendment adopted after such date), or

(ii) One-half of the accrued benefit that would be determined with respect to the participant as of the day before section 411 applies if the participant's accrued benefit were computed for such prior plan years under a method which satisfies the requirements of section 411(b)(1) (A), (B), or (C) and paragraph (b) (1), (2), or (3) of this section. See 29 CFR Part 2530, Department of Labor regulations relating to minimum standards for employee pension benefit plans, for time participation deemed to begin.

(2) *Special rules*—(i) A plan shall not be deemed to fail to satisfy the requirements of section 411(b) and this section merely because the method for computing the accrued benefit of a participant for years of participation prior to the first plan year for which section 411 is effective with respect to the plan is not the same method for computing the accrued benefit of a participant for years of participation subsequent to such plan year.

(ii) For purposes of paragraph (c)(1)(ii) of this section, section 411(b)(1)(A) and paragraph (b)(1) of this section shall be applied as if the participant separated from service with the employer on the day before the first day of the first plan year to which section 411 applies.

(iii) For purposes of paragraph (c)(1)(ii) of this section, section 411(b)(1)(B) and paragraph (b)(2) of this section shall be applied in the following manner:

(A) Except as provided in (c)(2)(iii)(B) of this section, section 411(b)(1)(B) and paragraph (b)(2) of this section shall be applied as if the participant separated

from service with the employer on the day before the first day of the first plan year to which section 411 applies.

(B) In the case that the plan does not satisfy the requirements of section 411(b)(1)(B) and paragraph (b)(2) of this section at any time prior to the day specified in (c)(2)(iii)(A) of this section, the plan shall be deemed revised to the extent necessary to satisfy the requirements of section 411(b)(1)(B) and paragraph (b)(2) of this section for all plan years beginning before the applicable effective date of section 411 and this section. For purposes of the preceding sentence, a plan shall not be deemed revised to the extent necessary to satisfy the requirements of section 411(b)(1)(B) and paragraph (b)(2) of this section for a plan year if the benefit a participant would receive if he were employed until normal retirement age is reduced by such revision or if the revised rate of accrual with respect to such accrued benefit does not otherwise satisfy the requirements of section 411(b)(1)(B) and paragraph (b)(2) of this section.

(iv) For purposes of paragraph (c)(1)(ii) of this section, section 411(b)(1)(C) and paragraph (b)(3) of this section shall be applied as if the participant separated from service on the day before the first day of the first plan year to which section 411 applies.

(v) The excess of the accrued benefit payable at normal retirement age of any participant determined under section 411(b)(1) (A), (B), or (C) (without regard to section 411(b)(1)(D)), and paragraph (b)(1), (2), or (3) of this section (without regard to this paragraph) as of the day before the first day of the first plan year to which section 411 and this section applies over the accrued benefit determined under paragraph (c)(1) of this section shall be accrued in accordance with the provisions of the plan as in effect after the applicable effective date of section 411, as if the plan had been initially adopted on such effective date.

(d) *Special rules*—(1) *First 2 years of service.* Notwithstanding paragraphs (1), (2), and (3) of paragraph (b) of this section, under section 411(b)(1)(E) and this subparagraph, a plan shall not be treated as failing to satisfy the requirements of paragraph (b) of this section solely because the accrual of benefits under the plan does not become effective until the employee has completed 2 continuous years of service. For purposes of this subparagraph, continuous years of service are years of service (within the meaning of section 410(a)(3)(A)) which are not separated by a break in service (within the meaning of section 410(a)(5)). For years of service beginning after such 2 years of service, the accrued benefit of an employee shall not be less than that to which the employee would be entitled if section 411(b)(1)(E) and this subparagraph did not apply. Thus, for example, a plan which otherwise satisfies the requirements of paragraph (b)(2) of this section provides for a rate of accrual of 1 percent of average compensation for the highest 3 years of compensation beginning with the third year of service of a participant shall not be treated as satisfying paragraph (b)(2) of this section because as of the time the employee completes 3 continuous years of service there is no accrual during the first 2 years of service. In addition, a plan which otherwise satisfies the requirements of paragraph (b)(1) of this section and which requires that an employee must attain age 25 and complete 1 year of service prior to becoming a participant will not satisfy the requirements of paragraph (b)(1) of this section if an employee who completes 2 years of service prior to attaining age 25 does not begin accruals immediately upon commencement of participation in the plan. For rules relating to years of service, see 29 CFR part 2530, Department of Labor regulations relating to minimum standards for employee pension benefit plans.

(2) *Certain insured defined benefit plans.* Notwithstanding paragraphs (b)(1), (2), and (3) of this section, a defined benefit plan satisfies the requirements of paragraph (b) of this section if such plan is funded exclusively by the purchase of contracts from a life insurance company and such contracts satisfy the requirements of sections 412(i) (2) and (3) and the regulations thereunder. The preceding sentence is applicable only if an employee's accrued benefit as of any applicable date is not less than the cash surrender value such employee's insurance contracts would

have on such applicable date if the requirements of section 412(i) (4), (5), and (6) and the regulations thereunder were satisfied.

(3) *Accrued benefit may not decrease on account of increasing age or service.* Notwithstanding paragraphs (b) (1), (2), and (3) of this section and paragraphs (d) (1) and (2) of this section, a defined benefit plan shall be treated as not satisfying the requirements of paragraphs (b) and (d) of this section if the participant's accrued benefit is reduced on account of any increase in his age or years of service. The preceding sentence shall not apply to social security supplements described in §1.411(a)–7(c)(4).

(e) *Separate accounting.* A plan satisfies the requirements of this paragraph if the requirements of paragraph (e) (1) or (2) of this paragraph are met.

(1) *Defined benefit plan.* In the case of a defined benefit plan, the requirements of this paragraph are satisfied if the plan requires separate accounting for the portion of each employee's accrued benefit derived from any voluntary employee contributions permitted under the plan. For purposes of this subparagraph the term ''voluntary employee contributions'' means all employee contributions which are not mandatory contributions within the meaning of section 411(c)(2)(C) and the regulations thereunder. See §1.411(c)–1(b)(1) for rules requiring the determination of such an accrued benefit by the use of a separate account.

(2) *Defined contribution plan.* In the case of a defined contribution plan, the requirements of this paragraph are not satisfied unless the plan requires separate accounting for each employee's accrued benefit. If a plan utilizes the break in service rule of section 411(a)(6)(C), an employee could have different percentages of vesting between pre-break and post-break accrued benefits. In such a case, the requirements of this paragraph are not satisfied unless the plan computes accrued benefits in a manner which takes into account different percentages. A plan which provides separate accounts for pre-break and post-break accrued benefits will be deemed to compute benefits in a reasonable manner.

(f) *Year of participation*—(1) *In general.* This paragraph is inapplicable to a defined contribution plan. For purposes of determining an employee's accrued benefit, a ''year of participation'' is a period of service determined under regulations prescribed by the Secretary of Labor in 29 CFR Part 2530, relating to minimum standards for employee pension benefit plans.

(2) *Additional rule relating to year of participation.* A trust shall not constitute a qualified trust if the plan of which such trust is a part provides for the crediting of a year of participation, or part thereof, and such credit results in the discrimination prohibited by section 401(a)(4).

(g) *Additional illustrations.* The application of this section may be illustrated by the following example:

Example. (i) The S Corporation established a defined benefit plan on January 1, 1980. The plan provides a minimum age for participation of age 25. The normal retirement age under the plan is age 65. The appropriate computation periods are the calendar year. The plan provides an annual benefit, commencing at age 65, equal to $96 per year of service for the first 25 years of service, and $48 per year of service for each additional year of service.

(ii) The plan of the S Corporation does not satisfy the requirements of section 411(b)(1)(A) and paragraph (b)(1) of this section because the accrued benefit under the plan at some point will be less than the accrued benefit required under section 411(b)(1)(A) and paragraph (b)(1) of this section (i.e., 3 percent × normal retirement benefit × years of participation).

(iii) The plan of the S Corporation does satisfy the requirements of section 411(b)(1)(B) and paragraph (b)(2) of this section because the rate of benefit accrual is equal in each of the first 25 years of service and the rate decreases thereafter.

(iv) The plan of the S Corporation does satisfy the requirements of section 411(b)(1)(C) and paragraph (b)(3) of this section because the accrued benefit under the plan will equal or exceed the normal retirement benefit multiplied by the fraction described in paragraph (b)(3)(i) of this section.

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42334, Aug. 23, 1977, as amended by T.D. 9693, 79 FR 56459, Sept. 19, 2014]

§ 1.411(b)(5)–1 Reduction in rate of benefit accrual under a defined benefit plan.

(a) *In general*—(1) *Organization of regulation.* This section sets forth certain rules for determining whether a reduction occurs in the rate of benefit accrual under a defined benefit plan because of the attainment of any age for purposes of section 411(b)(1)(H)(i). Paragraph (b) of this section describes safe harbors for certain plan designs (including statutory hybrid plans) that are deemed to satisfy the age discrimination rules under section 411(b)(1)(H). Paragraph (c) of this section describes rules relating to statutory hybrid plan conversion amendments. Paragraph (d) of this section describes rules restricting interest credits (or equivalent amounts) under a statutory hybrid plan to a market rate of return. Paragraph (e) of this section contains additional rules related to market rates of return. Paragraph (f) of this section contains effective/applicability dates.

(2) *Definitions.* The definitions of accumulated benefit, lump sum-based benefit formula, statutory hybrid benefit formula, statutory hybrid plan, and variable annuity benefit formula in § 1.411(a)(13)–1(d) apply for purposes of this section.

(b) *Safe harbors for certain plan designs*—(1) *Accumulated benefit testing*—(i) *In general.* Pursuant to section 411(b)(5)(A), and subject to paragraph (b)(1)(ii) of this section, a plan is not treated as failing to meet the requirements of section 411(b)(1)(H)(i) with respect to an individual who is or could be a participant if, as of any date, the accumulated benefit of the individual would not be less than the accumulated benefit of any similarly situated, younger individual who is or could be a participant. Thus, this test involves a comparison of the accumulated benefit of an individual who is or could be a participant in the plan with the accumulated benefit of each similarly situated, younger individual who is or could be a participant in the plan. See paragraph (b)(5) of this section for rules regarding whether a younger individual who is or could be a participant is similarly situated to a participant. The comparison described in this paragraph (b)(1)(i) is based on any one of the following benefit measures, each of which is referred to as a *safe-harbor formula measure:*

(A) The annuity payable at normal retirement age (or current age, if later) if the accumulated benefit of the participant under the terms of the plan is an annuity payable at normal retirement age (or current age, if later).

(B) The current balance of a hypothetical account maintained for the participant if the accumulated benefit of the participant is the current balance of a hypothetical account.

(C) The current value of an accumulated percentage of the participant's final average compensation if the accumulated benefit of the participant is the current value of an accumulated percentage of the participant's final average compensation.

(ii) *Benefit formulas for comparison*—(A) *In general.* Except as provided in paragraphs (b)(1)(ii)(B), (C), (D) and (E) of this section, the safe harbor provided by section 411(b)(5)(A) and paragraph (b)(1)(i) of this section is available only with respect to a participant if the participant's accumulated benefit under the plan is expressed in terms of only one safe-harbor formula measure and no similarly situated, younger individual who is or could be a participant has an accumulated benefit that is expressed in terms of any measure other than that same safe-harbor formula measure. Thus, for example, if a plan provides that the accumulated benefit of participants who are age 55 or older is expressed under the terms of the plan as a life annuity payable at normal retirement age (or current age if later) as described in paragraph (b)(1)(i)(A) of this section and the plan provides that the accumulated benefit of participants who are younger than age 55 is expressed as the current balance of a hypothetical account as described in paragraph (b)(1)(i)(B) of this section, then the safe harbor described in section 411(b)(5)(A) and paragraph (b)(1)(i) of this section does not apply to individuals who are or could be participants and who are age 55 or older.

(B) *Sum-of benefit formulas.* If a plan provides that a participant's accumulated benefit is expressed as the sum of benefits determined in terms of two or more benefit formulas, each of which is

expressed in terms of a different safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant, provided that the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as—

(*1*) The sum of benefits under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures as is used for the participant's ''sum-of'' benefit;

(*2*) The greater of benefits under two or more benefit formulas, each of which is expressed in terms of any one of those same safe-harbor formula measures;

(*3*) The choice of benefits under two or more benefit formulas, each of which is expressed in terms of any one of those same safe-harbor formula measures;

(*4*) A benefit that is determined in terms of only one of those same safe-harbor formula measures; or

(*5*) The lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of one of those same safe-harbor formula measures.

(C) *Greater-of benefit formulas.* If a plan provides that a participant's accumulated benefit is expressed as the greater of benefits under two or more benefit formulas, each of which is determined in terms of a different safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant, provided that the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as—

(*1*) The greater of benefits determined under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures as is used for the participant's ''greater-of'' benefit;

(*2*) The choice of benefits determined under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures;

(*3*) A benefit that is determined in terms of only one of those same safe-harbor formula measures; or

(*4*) The lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of one of those same safe-harbor formula measures.

(D) *Choice-of benefit formulas.* If a plan provides that a participant's accumulated benefit is determined pursuant to a choice by the participant between benefits determined in terms of two or more different safe-harbor formula measures, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant, provided that the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as—

(*1*) The choice of benefits determined under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures as is used for the participant's ''choice-of'' benefit;

(*2*) A benefit that is determined in terms of only one of those same safe-harbor formula measures; or

(*3*) The lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of one of those same safe-harbor formula measures.

(E) *Lesser-of benefit formulas.* If a plan provides that a participant's accumulated benefit is expressed as a single safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed

other than as a benefit that is determined under the same safe-harbor formula measure or as the lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of the same safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant only if the plan satisfies the comparison described in paragraph (b)(1)(i) of this section for benefits determined in terms of the same safe-harbor formula measure. Similarly, if a plan provides that a participant's accumulated benefit is expressed as the lesser of benefits under two or more benefit formulas, each of which is determined in terms of a different safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant only if the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as the lesser of benefits under two or more benefit formulas, expressed in terms of all of those same safe-harbor formula measures (and any other additional formula measures).

(F) *Limitations on plan formulas that provide for hypothetical accounts or accumulated percentages of final average compensation*. For plan years described in paragraph (f)(2)(i)(B)(*1*) or (f)(2)(i)(B)(*3*) of this section (as applicable), a benefit measure is a safe harbor formula measure described in paragraph (b)(1)(i)(B) or (C) of this section only if the formula under which the balance of a hypothetical account or the accumulated percentage of final average compensation is determined is a lump-sum based benefit formula.

(iii) *Disregard of certain subsidized benefits*. For purposes of paragraph (b)(1)(i) of this section, any subsidized portion of an early retirement benefit that is included in a participant's accumulated benefit is disregarded. For this purpose, an early retirement benefit includes a subsidized portion only if it provides a higher actuarial present value on account of commencement before normal retirement age. However, for plan years described in paragraph (f)(2)(i)(B)(*1*) or (f)(2)(i)(B)(*3*) of this section (as applicable), if the annual benefit payable before normal retirement age is greater for a participant than the annual benefit under the corresponding form of benefit for any similarly situated, older individual who is or could be a participant and who is currently at or before normal retirement age, then that excess is not part of the subsidized portion of an early retirement benefit and, accordingly, is not disregarded under this paragraph (b)(1)(iii). For purposes of determining whether the annual benefit payable before normal retirement age is greater for a participant than the annual benefit under the corresponding form of benefit for any similarly situated, older individual who is or could be a participant, social security leveling options and social security supplements are disregarded. In addition, a plan is not treated as providing a greater annual benefit to a participant than to a similarly situated, older individual who is or could be a participant merely because the reduction (based on actuarial equivalence, using reasonable actuarial assumptions) in the amount of an annuity to reflect a survivor benefit is smaller for the participant than for a similarly situated, older individual who is or could be a participant.

(iv) *Examples*. The provisions of this paragraph (b)(1) are illustrated by the following examples:

Example 1. (i) *Facts relating to formulas described in paragraph (b)(1)(i)(A) of this section*. Employer X maintains a defined benefit plan that provides a straight life annuity payable commencing at normal retirement age (which is age 65) equal to 1 percent of the participant's highest 3 consecutive years' compensation times years of service and provides for suspension of benefits as permitted under section 411(a)(3)(B). In the case of a participant whose service continues after normal retirement age, the amount payable is the greater of (i) the benefit payable at normal retirement age, and for each year thereafter, actuarially increased to account for delayed commencement, and (ii) the retirement benefit determined under the formula at the date the employee's service ceases (calculated by including years of service and increases in compensation after normal retirement age).

(ii) *Conclusion.* Under these facts, the plan formula is a formula described in paragraph (b)(1)(i)(A) of this section. The formula is not a statutory hybrid benefit formula merely because the plan formula includes a benefit that is based on the participant's benefit at normal retirement age (and each year thereafter) that is actuarially increased for commencement after attainment of normal retirement age. In addition, the plan formula would satisfy the comparison under paragraph (b)(1)(i) of this section for each individual who is or could be a participant because, as of any date (including any date after normal retirement age), the accumulated benefit of the individual would not be less than the accumulated benefit of any similarly situated, younger individual who is or could be a participant.

Example 2. (i) *Facts relating to formulas described in paragraph (b)(1)(i)(B) of this section.* Employer Y maintains a defined benefit plan that expresses each participant's accumulated benefit as the balance of a hypothetical account. Under the formula, the hypothetical account balance of each participant is credited monthly with interest at a specified rate and the hypothetical account balance of each employee who is a participant is also credited with a pay credit under the plan equal to 7 percent of the participant's compensation for the month.

(ii) *Conclusion.* The plan formula is a lump sum-based benefit formula described in paragraph (b)(1)(i)(B) of this section and the formula would satisfy the comparison under paragraph (b)(1)(i) of this section for each individual who is or could be a participant because, as of any date, the hypothetical account balance of the individual would not be less than the hypothetical account balance of any similarly situated, younger individual who is or could be a participant.

Example 3. (i) *Facts where plan suspends interest credits after normal retirement age.* The facts are the same as in *Example 2* except that the plan provides for suspension of benefits as permitted under section 411(a)(3)(B). Pursuant to the plan's suspension of benefits provision, the plan provides for interest credits to cease during service after normal retirement age or for the amount of the interest credits during this service to be reduced to reflect principal credits credited.

(ii) *Conclusion.* The plan does not satisfy the safe harbor in paragraph (b)(1)(i) of this section. Applying the rule of paragraph (b)(1)(i) of this section, the plan formula would fail to satisfy the safe harbor comparison under paragraph (b)(1)(i) of this section with respect to an individual whose benefits have been suspended because, as of any date after attainment of normal retirement age, the hypothetical account balance of this individual would be less than the hypothetical account balance of one or more similarly situated individuals who have not attained normal retirement age.

Example 4. (i) *Facts providing greater-of benefits as described in paragraph (b)(1)(ii)(C) of this section.* Employer Z sponsors a defined benefit plan that provides an accumulated benefit expressed as a straight life annuity commencing at the plan's normal retirement age (age 65), based on a percentage of average annual compensation times the participant's years of service. On November 2, 2011, the plan is amended effective as of January 1, 2012, to provide participants who have attained age 55 by January 1, 2012, with a benefit that is the greater of the benefit under the average annual compensation formula and a benefit that is based on the balance of a hypothetical account, which provides for annual pay credits of a specified percentage of the participant's compensation and annual interest credits based on the third segment rate.

(ii) *Conclusion where plan provides greater-of benefits to older participants.* The plan satisfies the safe harbor of paragraph (b)(1)(i) of this section with respect to all individuals who are or could be participants. Pursuant to the rules of paragraph (b)(1)(ii)(C) of this section, the plan satisfies the safe harbor with respect to individuals who have attained age 55 by January 1, 2012, because (A) with respect to the benefit described in paragraph (b)(1)(i)(A) of this section (the benefit based on average annual compensation, disregarding the benefit based on the balance of a hypothetical account), the accumulated benefit for any individual who is or could be a participant and who is at least age 55 on January 1, 2012, would in no event be less than the accumulated benefit for a similarly situated, younger individual who is or could be participant and who has not yet attained age 55 by January 1, 2012, (B) with respect to the benefit described in paragraph (b)(1)(i)(B) of this section (the benefit based on the balance of a hypothetical account, disregarding the benefit based on average annual compensation), the accumulated benefit for any individual who is or could be a participant and who is at least age 55 on January 1, 2012, would in no event be less than the accumulated benefit for a similarly situated, younger individual who is or could be a participant and who has not yet attained age 55 by January 1, 2012, and (C) the benefit of any individual who is or could be a participant who has not yet attained age 55 by January 1, 2012, is only expressed as an annuity payable at normal retirement age as described in paragraph (b)(1)(i)(A) of this section, and this safe-harbor formula measure applies also to participants who have attained age 55 by January 1, 2012. Furthermore, the plan satisfies the safe harbor with respect to individuals who have not yet attained age 55 by January 1, 2012, because the benefit of these

individuals satisfies the general rule of paragraph (b)(1)(ii)(A) of this section.

(iii) *Conclusion where plan provides greater-of benefits only to younger participants.* If, instead of the facts in paragraph (i) of this *Example 4*, the plan had been amended to provide only participants who have not yet attained age 55 by January 1, 2012, with a benefit that is the greater of the benefit under the average annual compensation formula and a benefit that is based on the balance of a hypothetical account, then the safe harbor would not be satisfied with respect to individuals who have attained age 55 by January 1, 2012. Under paragraph (b)(1)(ii)(A) of this section, except as provided in paragraphs (b)(1)(ii)(B), (C), and (D) of this section, the safe harbor of paragraph (b)(1)(i) of this section is available only with respect to individuals over age 55, whose benefit is expressed in terms of only one safe-harbor formula measure, if no similarly situated, younger individual has an accumulated benefit that is expressed in terms of any measure other than that same safe-harbor formula measure. This is not the case under these facts. The greater-of rule of paragraph (b)(1)(ii)(C) of this section would not apply to individuals who have attained age 55 because the accumulated benefits of these individuals is not equal to the greater of benefits under two or more benefit formulas.

Example 5. (i) *Facts where plan provides choice-of benefits to older participants.* The facts are the same as in paragraph (i) of *Example 4*, except that for service after December 31, 2011, the amendment permits participants who have attained age 55 by January 1, 2012, to choose between benefits under the average annual compensation benefit formula or benefits under the hypothetical account balance formula (but, if a participant chooses the hypothetical account balance formula, his or her benefit under the plan is in no event to be less than the benefit determined under the average annual compensation benefit formula for service before January 1, 2012), while other participants receive benefits solely under the hypothetical account balance formula (but individuals who are participants on December 31, 2011, are in no event to receive less than the benefit determined under the average annual compensation benefit formula for service before January 1, 2012).

(ii) *Conclusion where plan provides choice to older participants.* The plan satisfies the safe harbor with respect to all individuals who are or could be participants. Pursuant to the rule of paragraph (b)(1)(ii)(D) of this section, the plan satisfies the safe harbor of paragraph (b)(1)(i) of this section with respect to individuals who have attained age 55 by January 1, 2012, and, pursuant to the rule of paragraph (b)(1)(ii)(A), the plan satisfies the safe harbor with respect to individuals who have not yet attained 55 by January 1, 2012.

(iii) *Conclusion where plan provides choice-of benefits to older workers and greater-of benefits to younger participants.* If, in addition to the facts in paragraph (i) of this *Example 5*, the plan were also to provide participants who had not yet attained age 55 by January 1, 2012, the greater of the benefits under the average annual compensation benefit formula or the benefits under the hypothetical account balance formula, then pursuant to the rules of paragraph (b)(1)(ii)(A) and (D) of this section, the safe harbor would not be satisfied with respect to participants who have attained age 55 by January 1, 2012.

(2) *Indexed benefits*— (i) *In general.* Except as provided in paragraph (b)(2)(iii) of this section, pursuant to section 411(b)(5)(E) and this paragraph (b)(2)(i), a defined benefit plan is not treated as failing to meet the requirements of section 411(b)(1)(H) with respect to a participant solely because a benefit formula (other than a lump sum-based benefit formula) under the plan provides for the periodic adjustment of the participant's accrued benefit under the plan by means of the application of a recognized index or methodology. An indexing rate that does not exceed a market rate of return, as defined in paragraph (d) of this section, is deemed to be a recognized index or methodology for purposes of the preceding sentence. In addition, for plan years described in paragraph (f)(2)(i)(B)(*1*) or (f)(2)(i)(B)(*3*) of this section, as applicable (or an earlier date as elected by the taxpayer), any subsidized portion of any early retirement benefit under such a plan that meets the requirements of paragraph (b)(1)(iii) is disregarded in determining whether the plan meets the requirements of section 411(b)(1)(H). However, such a plan must satisfy the qualification requirements otherwise applicable to statutory hybrid plans, including the requirements of §1.411(a)(13)–1(c) (relating to minimum vesting standards) and paragraph (c) of this section (relating to plan conversion amendments) if the plan has an effect similar to a lump sum-based benefit formula, pursuant to the rules of §1.411(a)(13)–1(d)(4)(ii).

(ii) *Similarly situated participant test.* Paragraph (b)(2)(i) of this section does not apply unless the aggregate adjustments made to a participant's accrued benefit under the plan (determined as a

percentage of the unadjusted accrued benefit) in a period would not be less than the aggregate adjustments for any similarly situated, younger participant. This test requires a comparison, for each period, of the aggregate adjustments for each individual who is or could be a participant in the plan for the period with the aggregate adjustments of each other similarly situated, younger individual who is or could be a participant in the plan for that period. See paragraph (b)(5) of this section for rules regarding whether each younger individual who is or could be a participant is similarly situated to a participant.

(iii) *Protection against loss*—(A) *In general*. Paragraph (b)(2)(i) of this section does not apply unless the plan satisfies section 411(b)(5)(E)(ii) and paragraph (d)(2) of this section (relating to preservation of capital).

(B) *Exception for variable annuity benefit formulas*. The requirement to satisfy section 411(b)(5)(B)(i)(II), as set forth in paragraph (d)(2) of this section, as well as section 411(b)(5)(E)(ii), as set forth in this paragraph (b)(2)(iii), does not apply in the case of a benefit provided under a variable annuity benefit formula as defined in §1.411(a)(13)–1(d)(6).

(3) *Certain offsets permitted*. A plan is not treated as failing to meet the requirements of section 411(b)(1)(H) solely because the plan provides offsets against benefits under the plan to the extent the offsets are allowable in applying the requirements of section 401(a) and the applicable requirements of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)), and the Age Discrimination in Employment Act of 1967, Public Law 90–202 (81 Stat. 602 (1967)).

(4) *Permitted disparities in plan contributions or benefits*. A plan is not treated as failing to meet the requirements of section 411(b)(1)(H) solely because the plan provides a disparity in contributions or benefits with respect to which the requirements of section 401(l) are met.

(5) *Definition of similarly situated*. For purposes of paragraphs (b)(1) and (b)(2) of this section, an individual is similarly situated to another individual if the individual is identical to that other individual in every respect that is relevant in determining a participant's benefit under the plan (including period of service, compensation, position, date of hire, work history, and any other respect) except for age. In determining whether an individual is similarly situated to another individual, any characteristic that is relevant for determining benefits under the plan and that is based directly or indirectly on age is disregarded. For example, if a particular benefit formula applies to a participant on account of the participant's age, an individual to whom the benefit formula does not apply and who is identical to the participant in all other respects is similarly situated to the participant. By contrast, an individual is not similarly situated to a participant if a different benefit formula applies to the individual and the application of the different formula is not based directly or indirectly on age.

(c) *Special rules for plan conversion amendments*—(1) *In general*. Pursuant to section 411(b)(5)(B)(ii), (iii), and (iv), if there is a conversion amendment within the meaning of paragraph (c)(4) of this section with respect to a defined benefit plan, then the plan is treated as failing to meet the requirements of section 411(b)(1)(H) unless the plan, after the amendment, satisfies the requirements of paragraph (c)(2) of this section.

(2) *Separate calculation of post-conversion benefit*—(i) *In general*. A statutory hybrid plan satisfies the requirements of this paragraph (c)(2) if the plan provides that, in the case of an individual who was a participant in the plan immediately before the date of adoption of the conversion amendment, the participant's benefit at any subsequent annuity starting date is not less than the sum of—

(A) The participant's section 411(d)(6) protected benefit (as defined in §1.411(d)–3(g)(14)) with respect to service before the effective date of the conversion amendment, determined under the terms of the plan as in effect immediately before the effective date of the conversion amendment; and

(B) The participant's section 411(d)(6) protected benefit with respect to service on and after the effective date of

the conversion amendment, determined under the terms of the plan as in effect after the effective date of the conversion amendment.

(ii) *Rules of application.* For purposes of this paragraph (c)(2), except as provided in paragraph (c)(3) of this section, the benefits under paragraphs (c)(2)(i)(A) and (c)(2)(i)(B) of this section must each be determined in the same manner as if they were provided under separate plans that are independent of each other (for example, without any benefit offsets), and, except to the extent permitted under §1.411(d)–3 or §1.411(d)–4 (or other applicable law), each optional form of payment provided under the terms of the plan with respect to a participant's section 411(d)(6) protected benefit as in effect before the conversion amendment must be available thereafter to the extent of the plan's benefits for service prior to the effective date of the conversion amendment.

(3) *Establishment of opening hypothetical account balance or opening accumulated percentage*—(i) Provided that the requirements of paragraph (c)(3)(ii) of this section are satisfied, a statutory hybrid plan under which an opening hypothetical account balance or opening accumulated percentage of the participant's final average compensation is established as of the effective date of the conversion amendment does not fail to satisfy the requirements of paragraph (c)(2) of this section merely because benefits attributable to that opening hypothetical account balance or opening accumulated percentage (that is, benefits that are not described in paragraph (c)(2)(i)(B) of this section) are substituted for benefits described in paragraph (c)(2)(i)(A) of this section.

(ii) *Comparison of benefits at annuity starting date*—(A) *Testing requirement.* The requirements of this paragraph (c)(3)(ii) are satisfied with respect to an optional form of benefit payable at an annuity starting date only if the plan provides that the amount of the benefit payable in that optional form under the lump sum-based benefit formula that is attributable to the opening hypothetical account balance or opening accumulated percentage as described in paragraph (c)(3)(i) of this section is not less than the benefit under the comparable optional form of benefit under paragraph (c)(2)(i)(A) of this section. To satisfy this requirement, if the benefit under the optional form attributable to the opening hypothetical account balance or opening accumulated percentage is less than the benefit under the comparable optional form of benefit described in paragraph (c)(2)(i)(A) of this section, then the benefit attributable to the opening hypothetical account balance or opening accumulated percentage must be increased to the extent necessary to provide the minimum benefit described in this paragraph (c)(3)(ii). Thus, if a plan is using the option under this paragraph (c)(3)(ii) to satisfy paragraph (c)(2) of this section with respect to a participant, the participant must receive a benefit equal to not less than the sum of—

(*1*) The benefit described in paragraph (c)(2)(i)(B) of this section; and

(*2*) The greater of—

(*i*) The benefit attributable to the opening hypothetical account balance or attributable to the opening accumulated percentage of the participant's final average compensation as described in this paragraph (c)(3)(ii); or

(*ii*) The benefit described in paragraph (c)(2)(i)(A) of this section.

(B) *Comparable optional form of benefit.* If there was an optional form of benefit within the same generalized optional form of benefit (within the meaning of §1.411(d)–3(g)(8)) that would have been available to the participant at that annuity starting date under the terms of the plan as in effect immediately before the effective date of the conversion amendment, then that optional form of benefit is the comparable optional form of benefit.

(C) *Special rule for new post-conversion optional forms of benefit.* If an optional form of benefit is available on the annuity starting date with respect to the benefit attributable to the opening hypothetical account balance or opening accumulated percentage, but no optional form within the same generalized optional form of benefit (within the meaning of §1.411(d)–3(g)(8)) was available at that annuity starting date under the terms of the plan as in effect immediately prior to the effective date of the conversion amendment, then, for

purposes of this paragraph (c)(3)(ii), the plan is treated as if such an optional form of benefit were available immediately prior to the effective date of the conversion amendment for purposes of this paragraph (c)(3)(ii). Thus, for example, if a single-sum optional form of payment is not available under the plan terms applicable to the accrued benefit described in paragraph (c)(2)(i)(A) of this section, but a single-sum optional form of payment is available with respect to the benefit attributable to the opening hypothetical account balance or opening accumulated percentage as of the annuity starting date, then, for purposes of this paragraph (c)(3)(ii), the plan is treated as if a single sum (which satisfies the requirements of section 417(e)(3)) were available under the terms of the plan as in effect immediately prior to the effective date of the conversion amendment.

(4) *Conversion amendment*—(i) *In general.* An amendment is a conversion amendment that is subject to the requirements of this paragraph (c) with respect to a participant if—

(A) The amendment reduces or eliminates the benefits that, but for the amendment, the participant would have accrued after the effective date of the amendment under a benefit formula that is not a statutory hybrid benefit formula (and under which the participant was accruing benefits prior to the amendment); and

(B) After the effective date of the amendment, all or a portion of the participant's benefit accruals under the plan are determined under a statutory hybrid benefit formula.

(ii) *Rules of application*—(A) *In general.* Paragraphs (c)(4)(iii), (iv), and (v) of this section describe special rules that treat certain arrangements as conversion amendments. The rules described in those paragraphs apply both separately and in combination. Thus, for example, in an acquisition described in §1.410(b)–2(f), if the buyer adopts an amendment under which a participant's benefits under the seller's plan that is not a statutory hybrid plan are coordinated with a separate plan of the buyer that is a statutory hybrid plan, such as through an offset of the participant's benefit under the buyer's plan by the participant's benefit under the seller's plan, the seller and buyer are treated as a single employer under paragraph (c)(4)(iv) of this section and they are treated as having adopted a conversion amendment under paragraph (c)(4)(iii) of this section. However, pursuant to paragraph (c)(4)(iii) of this section, if there is no coordination between the two plans, there is no conversion amendment.

(B) *Covered amendments.* Only amendments that eliminate or reduce accrued benefits described in section 411(a)(7), or a retirement-type subsidy described in section 411(d)(6)(B)(i), that would otherwise accrue as a result of future service are treated as amendments described in paragraph (c)(4)(i)(A) of this section.

(C) *Operation of plan terms treated as covered amendment.* If, under the terms of a plan, a change in the conditions of a participant's employment results in a reduction of the participant's benefits that would have accrued in the future under a benefit formula that is not a statutory hybrid benefit formula, the plan is treated for purposes of this paragraph (c)(4) as if such plan terms constitute an amendment that reduces the participant's benefits that would have accrued after the effective date of the change under a benefit formula that is not a statutory hybrid benefit formula. Thus, for example, if a participant transfers from an operating division that is covered by a non-statutory hybrid benefit formula to an operating division that is covered by a statutory hybrid benefit formula, there has been a conversion amendment and the effective date of the conversion amendment is the date of the transfer. For purposes of applying the effective date rule of paragraph (f)(1)(ii) of this section, the date that the relevant plan terms were adopted is treated as the adoption date of the amendment.

(iii) *Multiple plans.* An employer is treated as having adopted a conversion amendment if the employer adopts an amendment under which a participant's benefits under a plan that is not a statutory hybrid plan are coordinated with a separate plan that is a statutory hybrid plan, such as through a reduction (offset) of the benefit under

the plan that is not a statutory hybrid plan.

(iv) *Multiple employers.* If the employer of an employee changes as a result of a transaction described in §1.410(b)–2(f), then the two employers are treated as a single employer for purposes of this paragraph (c)(4).

(v) *Multiple amendments*—(A) *In general*—(*1*) *General rule.* For purposes of this paragraph (c)(4), a conversion amendment includes multiple amendments that result in a conversion amendment even if the amendments are not conversion amendments individually. For example, an employer is treated as having adopted a conversion amendment if the employer first adopts an amendment described in paragraph (c)(4)(i)(A) of this section and, at a later date, adopts an amendment that adds a benefit under a statutory hybrid benefit formula as described in paragraph (c)(4)(i)(B) of this section, if they are consolidated under paragraph (c)(4)(v)(A)(*2*) of this section.

(*2*) *Delay between plan amendments.* In determining whether a conversion amendment has been adopted, an amendment to provide a benefit under a statutory hybrid benefit formula is consolidated with a prior amendment to reduce non-statutory hybrid benefit formula benefits if the amendment providing benefits under a statutory hybrid benefit formula is adopted within three years after adoption of the amendment reducing non-statutory hybrid benefit formula benefits. Thus, the later adoption of the statutory hybrid benefit formula will cause the earlier amendment to be treated as part of a conversion amendment. In the case of an amendment to provide a benefit under a statutory hybrid benefit formula that is adopted more than three years after adoption of an amendment to reduce benefits under a non-statutory hybrid benefit formula, there is a presumption that the amendments are not consolidated unless the facts and circumstances indicate that adoption of the amendment to provide a benefit under a statutory hybrid benefit formula was intended at the time of reduction in the non-statutory hybrid benefit formula.

(B) *Multiple conversion amendments.* If an employer adopts multiple amendments reducing benefits described in paragraph (c)(4)(i)(A) of this section, each amendment is treated as a separate conversion amendment, provided that paragraph (c)(4)(i)(B) of this section is applicable at the time of the amendment (taking into account the rules of this paragraph (c)(4)).

(vi) *Effective date of a conversion amendment.* The effective date of a conversion amendment is, with respect to a participant, the date as of which the reduction of the participant's benefits described in paragraph (c)(4)(i)(A) of this section occurs. In accordance with section 411(d)(6), the date of a reduction of those benefits cannot be earlier than the date of adoption of the conversion amendment.

(5) *Examples.* The following examples illustrate the application of this paragraph (c):

Example 1. (i) *Facts where plan does not establish opening hypothetical account balance for participants and participant elects life annuity at normal retirement age.* Employer N sponsors Plan E, a defined benefit plan that provides an accumulated benefit, payable as a straight life annuity commencing at age 65 (which is Plan E's normal retirement age), based on a percentage of highest average compensation times the participant's years of service. Plan E permits any participant who has had a severance from employment to elect payment in the following optional forms of benefit (with spousal consent if applicable), with any payment not made in a straight life annuity converted to an equivalent form based on reasonable actuarial assumptions: A straight life annuity; and a 50 percent, 75 percent, or 100 percent joint and survivor annuity. The payment of benefits may commence at any time after attainment of age 55, with an actuarial reduction if the commencement is before normal retirement age. In addition, the plan offers a single-sum payment after attainment of age 55 equal to the present value of the normal retirement benefit using the applicable interest rate and mortality table under section 417(e)(3) in effect under the terms of the plan on the annuity starting date.

(ii) *Facts relating to the conversion amendment.* On January 1, 2012, Plan E is amended to eliminate future accruals under the highest average compensation benefit formula and to base future benefit accruals under a hypothetical account balance formula. For service on or after January 1, 2012, each participant's hypothetical account balance is credited monthly with a pay credit equal to a specified percentage of the participant's compensation during the month and also

with interest based on the third segment rate described in section 430(h)(2)(C)(iii). With respect to benefits under the hypothetical account balance attributable to service on and after January 1, 2012, a participant is permitted to elect (with spousal consent if applicable) payment in the same generalized optional forms of benefit (even though different actuarial factors apply) as under the terms of the plan in effect before January 1, 2012, and also as a single-sum distribution. The plan provides for the benefit attributable to service before January 1, 2012, to be determined under the terms of the plan as in effect immediately before the effective date of the amendment, and the benefit attributable to service on and after January 1, 2012, to be determined separately, under the terms of the plan as in effect after the effective date of the amendment, with neither benefit offsetting the other in any manner. Thus, each participant's benefit is equal to the sum of the benefit attributable to service before January 1, 2012 (to be determined under the terms of the plan as in effect immediately before the effective date of the amendment), plus the benefit attributable to the participant's hypothetical account balance.

(iii) *Facts relating to an affected participant.* Participant A is age 62 on January 1, 2012. On December 31, 2011, A's benefit for years of service before January 1, 2012, payable as a straight life annuity commencing at A's normal retirement age (age 65), which is January 1, 2015, is $1,000 per month. On January 1, 2015, when Participant A has a severance from employment, the then-current hypothetical account balance, with pay credits and interest from January 1, 2012, to January 1, 2015, is $11,000. Using the conversion factors applicable under the plan on January 1, 2015, that balance is equivalent to a straight life annuity of $100 per month commencing on January 1, 2015. This benefit is in addition to the benefit attributable to service before January 1, 2012. Participant A elects (with spousal consent) a straight life annuity of $1,100 per month commencing January 1, 2015.

(iv) *Conclusion.* Participant A's benefit satisfies the requirements of paragraph (c) of this section because Participant A's benefit is not less than the sum of Participant A's section 411(d)(6) protected benefit (as defined in §1.411(d)–3(g)(14)) with respect to service before the effective date of the conversion amendment, determined under the terms of the plan as in effect immediately before the effective date of the amendment, and Participant A's section 411(d)(6) protected benefit with respect to service on and after the effective date of the conversion amendment, determined under the terms of the plan as in effect after the effective date of the amendment.

Example 2. (i) *Facts involving plan's establishment of opening hypothetical account balance and payment of pre-conversion accumulated benefit in life annuity at normal retirement age.* Except as indicated in this *Example 2,* the facts are the same as the facts under paragraph (i) of *Example 1.*

(ii) *Facts relating to the conversion amendment.* On January 1, 2012, Plan E is amended to eliminate future accruals under the highest average compensation benefit formula and to provide future benefit accruals under a hypothetical account balance formula. An opening hypothetical account balance is established for each participant, and, under the plan's terms, that balance is equal to the present value of the participant's accumulated benefit on December 31, 2011 (payable as a straight life annuity at normal retirement age or immediately, if later), using the applicable interest rate and applicable mortality table under section 417(e)(3) on January 1, 2012. Under Plan E, the account based on this opening hypothetical account balance is maintained as a separate account from the account for accruals on or after January 1, 2012. The hypothetical account balance maintained for each participant for accruals on or after January 1, 2012, is credited monthly with a pay credit equal to a specified percentage of the participant's compensation during the month. A participant's hypothetical account balance (including both of the separate accounts) is credited monthly with interest based on the third segment rate described in section 430(h)(2)(C)(iii).

(iii) *Facts relating to optional forms of benefit.* Following severance from employment and attainment of age 55, a participant is permitted to elect (with spousal consent, if applicable) payment in the same generalized optional forms of benefit as under the plan in effect prior to January 1, 2012, with the amount payable calculated based on the hypothetical account balance on the annuity starting date and the applicable interest rate and applicable mortality table on the annuity starting date. The single-sum distribution is equal to the hypothetical account balance.

(iv) *Facts relating to conversion protection.* The plan provides that, as of a participant's annuity starting date, the plan will determine whether the benefit attributable to the opening hypothetical account balance payable in the particular optional form of benefit selected is equal to or greater than the benefit accrued under the plan through the date of conversion and payable in the same generalized optional form of benefit with the same annuity starting date. If the benefit attributable to the opening hypothetical account balance is equal to or greater than the pre-conversion benefit, the plan provides that such benefit is paid in lieu of the pre-conversion benefit, together with the benefit

attributable to post-conversion pay-based principal credits. If the benefit attributable to the opening hypothetical account balance is less than the pre-conversion benefit, the plan provides that such benefit is increased sufficiently to provide the pre-conversion benefit, together with the benefit attributable to post-conversion pay-based principal credits.

(v) *Facts relating to an affected participant.* On January 1, 2012, the opening hypothetical account balance established for Participant A is $80,000, which is the present value of Participant A's straight life annuity of $1,000 per month commencing at January 1, 2015, using the applicable interest rate and applicable mortality table under section 417(e)(3) in effect on January 1, 2012. On January 1, 2012, the applicable interest rate for Participant A is equivalent to a level rate of 5.5 percent. Thereafter, Participant A's hypothetical account balance for subsequent accruals is credited monthly with a pay credit equal to a specified percentage of the participant's compensation during the month. In addition, Participant A's hypothetical account balance (including both of the separate accounts) is credited monthly with interest based on the third segment rate described in section 430(h)(2)(C)(iii).

(vi) *Facts relating to calculation of the participant's benefit.* Participant A has a severance from employment on January 1, 2015 at age 65, and elects (with spousal consent) a straight life annuity commencing January 1, 2015. On January 1, 2015, the opening hypothetical account balance, with interest credits from January 1, 2012, to January 1, 2015, has become $95,000, which, using the conversion factors under the plan on January 1, 2015, is equivalent to a straight life annuity of $1,005 per month commencing on January 1, 2015 (which is greater than the $1,000 a month payable at age 65 under the terms of the plan in effect before January 1, 2012). This benefit is in addition to the benefit determined using the hypothetical account balance for service after January 1, 2012.

(vii) *Conclusion.* The benefit satisfies the requirements of paragraph (c)(3)(ii)(A) of this section with respect to Participant A because A's benefit is not less than the sum of (A) the greater of Participant A's benefits attributable to the opening hypothetical account balance and A's section 411(d)(6) protected benefit (as defined in §1.411(d)–3(g)(14)) with respect to service before the effective date of the conversion amendment, determined under the terms of the plan as in effect immediately before the effective date of the amendment, and (B) Participant A's section 411(d)(6) protected benefit with respect to service on and after the effective date of the conversion amendment, determined under the terms of the plan as in effect after the effective date of the amendment.

Example 3. (i) *Facts involving a subsequent decrease in interest rates.* The facts are the same as in *Example 2*, except that, because of a decrease in bond rates after January 1, 2012, and before January 1, 2015, the rate of interest credited in that period averages less than 5.5 percent, and, on January 1, 2015, the effective applicable interest rate under section 417(e)(3) under the plan's terms is 4.7 percent. As a result, Participant A's opening hypothetical account balance plus attributable interest credits has increased to only $87,000 on January 1, 2015, and, using the conversion factors under the plan on January 1, 2015, is equivalent to a straight life annuity commencing on January 1, 2015, of $775 per month. Under the terms of Plan E, the benefit attributable to A's opening hypothetical account balance is increased so that A's straight life annuity commencing on January 1, 2015, is $1,000 per month. This benefit is in addition to the benefit attributable to the hypothetical account balance for service after January 1, 2012.

(ii) *Conclusion.* The benefit satisfies the requirements of paragraph (c)(3)(ii)(A) of this section with respect to Participant A because A's benefit is not less than the sum of—

(A) The greater of A's benefits attributable to the opening hypothetical account balance and A's section 411(d)(6) protected benefit (as defined in §1.411(d)–3(g)(14)) with respect to service before the effective date of the conversion amendment, determined under the terms of the plan as in effect immediately before the effective date of the amendment; and

(B) A's section 411(d)(6) protected benefit with respect to service on and after the effective date of the conversion amendment, determined under the terms of the plan as in effect after the effective date of the amendment.

Example 4. (i) *Facts involving payment of a subsidized early retirement benefit.* The facts are the same as in *Example 2*, except that under the terms of Plan E on December 31, 2011, a participant who retires before age 65 and after age 55 with 30 years of service has only a 3 percent per year actuarial reduction. Participant A has a severance from employment on January 1, 2013, when A is age 63 and has 30 years of service. On January 1, 2013, A's opening hypothetical account balance, with interest from January 1, 2012, to January 1, 2013, has become $86,000, which, using the conversion factors under the plan (as amended) on January 1, 2013, is equivalent to a straight life annuity commencing on January 1, 2013, of $850 per month.

(ii) *Facts relating to calculation of the participant's benefit.* Under the terms of Plan E on December 31, 2011, Participant A is entitled to a straight life annuity commencing on January 1, 2013, equal to at least $940 per month ($1,000 reduced by 3 percent for each

of the 2 years that A's benefits commence before normal retirement age). Under the terms of Plan E, the benefit attributable to A's opening account balance is increased so that A is entitled to a straight life annuity of $940 per month commencing on January 1, 2015. This benefit is in addition to the benefit determined using the hypothetical account balance for service after January 1, 2012.

(iii) *Conclusion*. The benefit satisfies the requirements of paragraph (c)(3)(ii)(A) of this section with respect to Participant A because A's benefit is not less than the sum of—

(A) The greater of Participant A's benefits attributable to the opening hypothetical account balance (increased by attributable interest credits) and A's section 411(d)(6) protected benefit (as defined in §1.411(d)–3(g)(14)) with respect to service before the effective date of the conversion amendment, determined under the terms of the plan as in effect immediately before the effective date of the amendment; and

(B) Participant A's section 411(d)(6) protected benefit with respect to service on and after the effective date of the conversion amendment, determined under the terms of the plan as in effect after the effective date of the amendment.

Example 5. (i) *Facts involving addition of a single-sum payment option*. The facts are the same as in *Example 2*, except that, before January 1, 2012, Plan E did not offer payment in a single-sum distribution for amounts in excess of $5,000. Plan E, as amended on January 1, 2012, offers payment in any of the available annuity distribution forms commencing at any time following severance from employment as were provided under Plan E before January 1, 2012. In addition, Plan E, as amended on January 1, 2012, offers payment in the form of a single sum attributable to service before January 1, 2012, which is the greater of the opening hypothetical account balance (increased by attributable interest credits) or a single-sum distribution of the straight life annuity payable at age 65 using the same actuarial factors as are used for mandatory cashouts for amounts equal to $5,000 or less under the terms of the plan on December 31, 2011. Participant B is age 40 on January 1, 2012, and B's opening hypothetical account balance (increased by attributable interest credits) is $33,000 (which is the present value, using the conversion factors under the plan (as amended) on January 1, 2012, of Participant B's straight life annuity of $1,000 per month commencing at January 1, 2037, which is when B will be age 65). Participant B has a severance from employment on January 1, 2015, and elects (with spousal consent) an immediate single-sum distribution. Participant B's opening hypothetical account balance (increased by attributable interest) on January 1, 2015, is $45,000. The present value, on January 1, 2015, of Participant B's benefit of $1,000 per month, commencing immediately using the actuarial factors for mandatory cashouts under the terms of the plan on December 31, 2011, would result in a single-sum payment of $44,750. Participant B is paid a single-sum distribution equal to the sum of $45,000 plus an amount equal to B's January 1, 2015, hypothetical account balance for benefit accruals for service after January 1, 2012.

(ii) *Conclusion*. Because, under Plan E, Participant B is entitled to the sum of—

(A) The greater of the $45,000 opening hypothetical account balance (increased by attributable interest credits) and $44,750 (present value of the benefit with respect to service prior to January 1, 2012, using the actuarial factors for mandatory cashout distributions under the terms of the plan on December 31, 2011); and

(B) An amount equal to B's hypothetical account balance for benefit accruals for service after January 1, 2012, the benefit satisfies the requirements of paragraph (c)(3)(ii)(A) of this section with respect to Participant B. If Participant B's hypothetical account balance under Plan E was instead less than $44,750 on January 1, 2015, Participant B would be entitled to a single-sum payment equal to the sum of $44,750 and an amount equal to B's hypothetical account balance for benefit accruals for service after January 1, 2012.

Example 6. (i) *Facts involving addition of new annuity optional form of benefit*. The facts are the same as in *Example 2*, except that, after December 31, 2011, and before January 1, 2015, Plan E is amended to offer payment in a 5-, 10-, or 15-year term certain and life annuity, using the same actuarial assumptions that apply for other optional forms of distribution. When Participant A has a severance from employment on January 1, 2015, A elects (with spousal consent) a 5-year term certain and life annuity commencing immediately equal to $935 per month. Application of the same actuarial assumptions to Participant A's benefit of $1,000 per month (under Plan E as in effect on December 31, 2011), commencing immediately on January 1, 2015, would result in a 5-year term certain and life annuity commencing immediately equal to $955 per month. Under the terms of Plan E, the benefit attributable to A's opening account balance is increased so that, using the conversion factors under the plan (as amended) on January 1, 2015, A's opening hypothetical account balance (increased by attributable interest credits) produces a 5-year term certain and life annuity commencing immediately equal to $955 per month commencing on January 1, 2015. This benefit is in addition to the benefit determined using the January 1, 2015, hypothetical account balance for service after January 1, 2012.

(ii) *Conclusion*. This benefit satisfies the requirements of paragraph (c)(3)(ii)(A) of this section with respect to Participant A.

Example 7. (i) *Facts involving addition of distribution option before age 55*. The facts are the same as in *Example 5*, except that Participant B (age 43) elects (with spousal consent) a straight life annuity commencing immediately on January 1, 2015. Under Plan E, the straight life annuity attributable to Participant B's opening hypothetical account balance at age 43 is $221 per month. Application of the same actuarial assumptions to Participant B's benefit of $1,000 per month commencing at age 65 (under Plan E as in effect on December 31, 2011) would result in a straight life annuity commencing immediately on January 1, 2015, equal to $219 per month.

(ii) *Conclusion*. Because, under its terms, Plan E provides that Participant B is entitled to an amount not less than the present value (using the same actuarial assumptions as apply on January 1, 2015, in converting the $45,000 hypothetical account balance attributable to the opening hypothetical account balance to the $221 straight life annuity) of Participant B's straight life annuity of $1,000 per month commencing at age 65, and the $221 straight life annuity is in addition to the benefit accruals for service after January 1, 2012, payment of the $221 monthly annuity would satisfy the requirements of paragraph (c)(3)(ii)(A) of this section with respect to Participant B.

Example 8. (i) *Facts involving establishment of opening hypothetical account balance*. A defined benefit plan provides an accrued benefit expressed as a straight life annuity commencing at the plan's normal retirement age (age 65), based on a percentage of average annual compensation multiplied by the participant's years of service. On January 1, 2009, a conversion amendment is adopted that converts the plan to a statutory hybrid plan. Participant A, age 55, had an accrued benefit under the pre-conversion formula of $1,500 per month payable at normal retirement age. In conjunction with this conversion, the plan provides each participant with an opening hypothetical account balance equal to the present value, determined in accordance with section 417(e)(3) of the participant's pre-conversion benefit. Participant A's opening hypothetical account balance was calculated as $121,146. The opening account balance (along with any subsequent amounts credited to the hypothetical account) is credited annually with interest credits at the rate of 5.0 percent up to the annuity starting date of each participant.

(ii) *Facts relating to changes between establishment of opening hypothetical account balance and age 65*. Upon attainment of age 65, Participant A elects to receive Participant A's entire benefit under the plan as a single sum distribution. At the annuity starting date, Participant A's hypothetical account balance attributable to Participant A's opening account balance has increased to $197,334. However, under the terms of the plan and in accordance with section 417(e)(3), the present value at the annuity starting date of Participant A's pre-conversion benefit of $1,500 per month is $221,383.

(iii) *Conclusion*. Pursuant to paragraph (c)(3)(ii)(A) of this section, Participant A must receive the benefit attributable to post-conversion service, plus the greater of the benefit attributable to the opening hypothetical account balance and the pre-conversion benefit (with the determination as to which is greater made at the annuity starting date). Accordingly the single-sum distribution must equal the benefit attributable to post-conversion service plus $221,383.

(d) *Market rate of return*—(1) *In general*—(i) *Basic test*. Subject to the rules of paragraph (e) of this section, a statutory hybrid plan satisfies the requirements of section 411(b)(1)(H) and this paragraph (d) only if, for any plan year, the interest crediting rate with respect to benefits determined under a statutory hybrid benefit formula is not greater than a market rate of return.

(ii) *Definitions relating to market rate of return*—(A) *Interest credit*. Subject to other rules in this paragraph (d), an interest credit for purposes of this paragraph (d) and section 411(b)(5)(B) means the following adjustments to a participant's accumulated benefit under a statutory hybrid benefit formula, to the extent not conditioned on current service and not made on account of imputed service (as defined in § 1.401(a)(4)–11(d)(3)(ii)(B))—

(*1*) Any increase or decrease for a period, under the terms of the plan at the beginning of the period, that is calculated by applying a rate of interest or rate of return (including a rate of increase or decrease under an index) to the participant's accumulated benefit (or a portion thereof) as of the beginning of the period; and

(*2*) Any other increase for a period, under the terms of the plan at the beginning of the period.

(B) *Treatment of plan amendments*. An increase to a participant's accumulated benefit is not treated as an interest credit to the extent the increase is made as a result of a plan amendment providing for a one-time adjustment to the participant's accumulated benefit. However, a pattern of repeated plan

amendments each of which provides for a one-time adjustment to a participant's accumulated benefit will cause such adjustments to be treated as provided on a permanent basis under the terms of the plan. *See* §1.411(d)–4, A–1(c)(1).

(C) *Interest crediting rate.* Except as otherwise provided in this paragraph (d), the interest crediting rate, or effective rate of return, for a period with respect to a participant equals the total amount of interest credits for the period divided by the participant's accumulated benefit at the beginning of the period.

(D) *Principal credit.* For purposes of this paragraph (d), a principal credit means any increase to a participant's accumulated benefit under a statutory hybrid benefit formula that is not an interest credit. Thus, for example, a principal credit includes an increase to a participant's accumulated benefit to the extent the increase is conditioned on current service or made on account of imputed service. As a result, a principal credit includes an increase to the value of an accumulated percentage of the participant's final average compensation. For indexed benefits described in paragraph (b)(2) of this section, a principal credit includes an increase to the participant's accrued benefit other than an increase provided by indexing. In addition, pursuant to the rule in paragraph (d)(1)(ii)(B) of this section, a principal credit generally includes an increase to a participant's accumulated benefit to the extent the increase is made as a result of a plan amendment providing for a one-time adjustment to the participant's accumulated benefit. As a result, a principal credit includes an opening hypothetical account balance or opening accumulated percentage of the participant's final average compensation, as described in paragraph (c)(3) of this section.

(iii) *Market rate of return for single rates.* Except as otherwise provided in this paragraph (d)(1), an interest crediting rate is not in excess of a market rate of return only if the plan terms provide that the interest credit for each plan year is determined using one of the following specified interest crediting rates:

(A) The interest rate on long-term investment grade corporate bonds (as described in paragraph (d)(3) of this section).

(B) An interest rate that, under paragraph (d)(4) of this section, is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section.

(C) A rate of return that, under paragraph (d)(5) of this section, is not in excess of a market rate of return.

(iv) *Timing and other rules related to interest crediting rate*—(A) *In general.* A plan that provides interest credits must specify how the plan determines interest credits and must specify how and when interest credits are credited. The plan must specify the method for determining interest credits in accordance with the requirements of paragraph (d)(1)(iv)(B) of this section, the frequency of interest crediting in accordance with the requirements of paragraph (d)(1)(iv)(C) of this section, and the treatment of interest credits on distributed amounts, as well as other debits and credits during the period, in accordance with the rules of paragraph (d)(1)(iv)(D) of this section. In addition, a plan is permitted to round the calculated interest rate or rate of return in accordance with paragraph (d)(1)(iv)(E) of this section. See paragraph (e) of this section for additional rules that apply to changes in the interest crediting rate.

(B) *Methods to determine interest credits.* A plan that is using any specified interest crediting rate can determine interest credits for each current interest crediting period based on the effective periodic interest crediting rate that applies over the period. Alternatively, a plan that is using one of the interest crediting rates described in paragraph (d)(3) or (d)(4) of this section can determine interest credits for a stability period based on the interest crediting rate for a specified lookback month with respect to that stability period. For purposes of the preceding sentence, the stability period and lookback month must satisfy the rules for selecting the stability period and lookback month under §1.417(e)–1(d)(4), although the interest crediting rate can be any one of the rates in paragraph (d)(3) or (d)(4) of this section and

the stability period and lookback month need not be the same as those used under the plan for purposes of section 417(e)(3).

(C) *Frequency of interest crediting.* Interest credits under a plan must be provided on an annual or more frequent periodic basis and interest credits for each interest crediting period must be credited as of the end of the period. If a plan provides for the crediting of interest more frequently than annually (for example, daily, monthly or quarterly) based on one of the annual interest rates described in paragraph (d)(3) or (d)(4) of this section, then the plan generally provides an above market rate of return unless each periodic interest credit is determined using an interest crediting rate that is no greater than a pro rata portion of the applicable annual interest crediting rate. However, a plan that credits interest daily based on one of the annual interest rates described in paragraph (d)(3) or (d)(4) of this section is not treated as providing an above market rate of return merely because the plan determines each daily interest credit using a daily interest crediting rate that is 1/360 of the applicable annual interest crediting rate. In addition, interest credits determined, under the terms of a plan, based on one of the annual interest rates described in paragraph (d)(3) or (d)(4) of this section are not treated as creating an effective rate of return that is in excess of a market rate of return merely because an otherwise permissible interest crediting rate for a plan year is compounded more frequently than annually. Thus, for example, if a plan's terms provide for interest to be credited monthly and for the interest crediting rate to be equal to the interest rate on long-term investment grade corporate bonds (as described in paragraph (d)(3) of this section) and the applicable annual rate on these bonds for the plan year is 6 percent, then the accumulated benefit at the beginning of each month could be increased as a result of interest credits by as much as 0.5 percent per month during the plan year without resulting in an interest crediting rate that is in excess of a market rate of return.

(D) *Debits and credits during the interest crediting period.* A plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan does not provide for interest credits on amounts distributed prior to the end of the interest crediting period. Furthermore, a plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan calculates increases or decreases to the participant's accumulated benefit by applying a rate of interest or rate of return (including a rate of increase or decrease under an index) to the participant's adjusted accumulated benefit (or portion thereof) for the period. For this purpose, the participant's adjusted accumulated benefit equals the participant's accumulated benefit as of the beginning of the period, adjusted for debits and credits (other than interest credits) made to the accumulated benefit prior to the end of the interest crediting period, with appropriate weighting for those debits and credits based on their timing within the period. For plans that calculate increases or decreases to the participant's accumulated benefit by applying a rate of interest or rate of return to the participant's adjusted accumulated benefit (or portion thereof) for the period, interest credits include these increases and decreases, to the extent provided under the terms of the plan at the beginning of the period and to the extent not conditioned on current service and not made on account of imputed service (as defined in §1.401(a)(4)–11(d)(3)(ii)(B)), and the interest crediting rate with respect to a participant equals the total amount of interest credits for the period divided by the participant's adjusted accumulated benefit for the period.

(E) *Rounding of interest crediting rate.* A plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan determines interest credits for an interest crediting period by rounding the calculated interest rate or rate of return in accordance with this paragraph (d)(1)(iv)(E). An annual rate may be rounded to the nearest multiple of 25 basis points (or a smaller rounding interval). If a plan provides for the crediting of interest more frequently than annually, then the rounding interval must not exceed a pro-rata portion of 25 basis points.

Notwithstanding the preceding sentence, a plan is permitted to round to the nearest basis point regardless of the length of the interest crediting period.

(v) *Lesser rates.* An interest crediting rate is not in excess of a market rate of return if the rate can never be in excess of a particular rate that is described in paragraph (d)(1)(iii) of this section. Thus, for example, an interest crediting rate that always equals the rate described in paragraph (d)(3) of this section minus 200 basis points is not in excess of a market rate of return because it can never be in excess of the rate described in paragraph (d)(3) of this section. Similarly, an interest crediting rate that always equals the lesser of the yield on 30-year Treasury Constant Maturities and a fixed 7 percent interest rate is not in excess of a market rate of return because it can never be in excess of the yield on 30-year Treasury Constant Maturities.

(vi) *Greater-of rates.* If a statutory hybrid plan determines an interest credit by applying the greater of 2 or more different rates to the accumulated benefit, the effective interest crediting rate is not in excess of a market rate of return only if each of the different rates would separately satisfy the requirements of this paragraph (d) and the requirements of paragraph (d)(6) of this section are also satisfied.

(vii) *Blended rates.* A statutory hybrid plan does not provide an effective interest crediting rate that is in excess of a market rate of return merely because the plan determines an interest credit by applying different rates to different predetermined portions of the accumulated benefit, provided each rate would separately satisfy the requirements of this paragraph (d) if the rate applied to the entire accumulated benefit.

(viii) *Increases to existing rates and addition of other rates*—(A) *Increases to existing rates.* The Commissioner may, in guidance published in the Internal Revenue Bulletin, see § 601.601(d)(2)(ii)(*b*) of this chapter, increase an interest crediting rate set forth in this paragraph (d), so that the increased rate is treated as satisfying the requirement that the rate not exceed a market rate of return for purposes of this paragraph (d) and section 411(b)(5)(B). For this purpose, these increases can include increases to the maximum permitted margin that can be added to one or more of the safe harbor rates set forth in paragraph (d)(4) of this section, increases to the maximum permitted fixed rate set forth in paragraph (d)(4)(v) of this section, or increases to a maximum permitted annual floor set forth in paragraph (d)(6) of this section.

(B) *Additional rates.* The Commissioner may, in guidance published in the Internal Revenue Bulletin, see § 601.601(d)(2)(ii)(*b*) of this chapter, provide for additional interest crediting rates that satisfy the requirement that they not exceed a market rate of return for purposes of this paragraph (d) and section 411(b)(5)(B) (including providing for additional combinations of rates, such as annual minimums in conjunction with rates that are based on rates described in paragraph (d)(5) of this section but that are reduced in order to ensure that the effective rate of return does not exceed a market rate of return).

(2) *Preservation of capital requirement*—(i) *General rule.* A statutory hybrid plan satisfies the requirements of section 411(b)(1)(H) only if the plan provides that the participant's benefit under the statutory hybrid benefit formula determined as of the participant's annuity starting date is no less than the benefit determined as if the accumulated benefit were equal to the sum of all principal credits (as described in paragraph (d)(1)(ii)(D) of this section) credited under the plan to the participant as of that date (including principal credits that were credited before the applicable statutory effective date of paragraph (f)(1) of this section). This paragraph (d)(2) applies only as of an annuity starting date, within the meaning of § 1.401(a)–20, A–10(b), with respect to which a distribution of the participant's entire vested benefit under the plan's statutory hybrid benefit formula as of that date commences. For a participant who has more than one annuity starting date, paragraph (d)(2)(ii) of this section provides rules to account for prior annuity starting dates when applying this paragraph (d)(2)(i).

(ii) *Application to multiple annuity starting dates*—(A) *In general.* If the

comparison under paragraph (d)(2)(ii)(B) of this section results in the sum of all principal credits credited to the participant (as of the current annuity starting date) exceeding the sum of the amounts described in paragraphs (d)(2)(ii)(B)(*1*) through (d)(2)(ii)(B)(*3*) of this section, then the participant's benefit to be distributed at the current annuity starting date must be no less than would be provided if that excess were included in the current accumulated benefit.

(B) *Comparison to reflect prior distributions.* For a participant who has more than one annuity starting date, the sum of all principal credits credited to the participant under the plan, as of the current annuity starting date, is compared to the sum of—

(*1*) The remaining balance of the participant's accumulated benefit as of the current annuity starting date;

(*2*) The amount of the reduction to the participant's accumulated benefit under the statutory hybrid benefit formula that is attributable to any prior distribution of the participant's benefit under that formula; and

(*3*) Any amount that was treated as included in the accumulated benefit under the rules of this paragraph (d)(2) as of any prior annuity starting date.

(C) *Special rule for participants with 5 or more breaks in service.* A plan is permitted to provide that, in the case of a participant who receives a distribution of the entire vested benefit under the plan and thereafter completes 5 consecutive 1-year breaks in service, as defined in section 411(a)(6)(A), the rules of this paragraph (d)(2) are applied without regard to the prior period of service. Thus, in the case of such a participant, the plan is permitted to provide that the rules of this paragraph (d)(2) are applied disregarding the principal credits and distributions that occurred before the breaks in service.

(iii) *Exception for variable annuity benefit formulas. See* paragraph (b)(2)(iii)(B) of this section for an exception to this paragraph (d)(2).

(3) *Long-term investment grade corporate bonds.* For purposes of this paragraph (d), the rate of interest on long-term investment grade corporate bonds means the third segment rate described in section 417(e)(3)(D) or 430(h)(2)(C)(iii) (determined with or without regard to section 430(h)(2)(C)(iv) and with or without regard to the transition rules of section 417(e)(3)(D)(ii) or 430(h)(2)(G)). However, for plan years beginning prior to January 1, 2008, the rate of interest on long-term investment grade corporate bonds means the rate described in section 412(b)(5)(B)(ii)(II) prior to amendment by the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780 (2006)) (PPA '06).

(4) *Safe harbor rates of interest*—(i) *In general.* This paragraph (d)(4) identifies interest rates that are deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section. The Commissioner may, in guidance of general applicability, specify additional interest crediting rates that are deemed to be not in excess of the rate described in paragraph (d)(3) of this section. See § 601.601(d)(2)(ii)(*b*).

(ii) *Rates based on government bonds with margins.* An interest crediting rate is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section if the rate is equal to the sum of any of the following rates of interest for bonds and the associated margin for that interest rate:

Interest rate bond index	Associated margin
The discount rate on 3-month Treasury Bills	175 basis points.
The discount rate on 12-month or shorter Treasury Bills	150 basis points.
The yield on 1-year Treasury Constant Maturities	100 basis points.
The yield on 3-year or shorter Treasury Constant Maturities	50 basis points.
The yield on 7-year or shorter Treasury Constant Maturities	25 basis points.
The yield on 30-year or shorter Treasury Constant Maturities	0 basis points.

(iii) *Eligible cost-of-living indices.* An interest crediting rate is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section if the rate is adjusted no less frequently than annually and is equal to the rate of increase with respect to an eligible cost-of-living index described

in §1.401(a)(9)–6, A–14(b), except that, for purposes of this paragraph (d)(4)(iii), the eligible cost-of-living index described in §1.401(a)(9)–6, A–14(b)(2) is increased by 300 basis points.

(iv) *Short and mid-term investment grade corporate bonds.* An interest crediting rate equal to the first segment rate is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section. Similarly, an interest crediting rate equal to the second segment rate is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section. For this purpose, the first and second segment rates mean the first and second segment rates described in section 417(e)(3)(D) or 430(h)(2)(C), determined with or without regard to section 430(h)(2)(C)(iv) and with or without regard to the transition rules of section 417(e)(3)(D)(ii) or 430(h)(2)(G).

(v) *Fixed rate of interest.* An annual interest crediting rate equal to a fixed 6 percent is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section.

(5) *Other rates of return*—(i) *General rule.* This paragraph (d)(5) sets forth additional methods for determining an interest crediting rate that is not in excess of a market rate of return.

(ii) *Actual rate of return on plan assets*—(A) *In general.* An interest crediting rate equal to the actual rate of return on the aggregate assets of the plan, including both positive returns and negative returns, is not in excess of a market rate of return if the plan's assets are diversified so as to minimize the volatility of returns. This requirement that plan assets be diversified so as to minimize the volatility of returns does not require greater diversification than is required under section 404(a)(1)(C) of Title I of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)), as amended (ERISA), with respect to defined benefit pension plans.

(B) *Subset of plan assets.* An interest crediting rate equal to the actual rate of return on the assets within a specified subset of plan assets, including both positive and negative returns, is not in excess of a market rate of return if—

(*1*) The subset of plan assets is diversified so as to minimize the volatility of returns, within the meaning of paragraph (d)(5)(ii)(A) of this section (thus, this requirement is satisfied if the subset of plan assets is diversified such that it would meet the requirements of paragraph (d)(5)(ii)(A) of this section if the subset were aggregate plan assets);

(*2*) The aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the subset of plan assets does not exceed 10 percent of the fair market value of the aggregate assets in the subset; and

(*3*) The fair market value of the assets within the subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions.

(C) *Examples.* The following examples illustrate the application of paragraph (d)(5)(ii)(B) of this section:

Example 1. (i) *Facts.* (a) Employer A sponsors a defined benefit plan under which benefit accruals are determined under a formula that is not a statutory hybrid benefit formula. Effective January 1, 2015, the plan is amended to cease future accruals under the existing formula and to provide future benefit accruals under a statutory hybrid benefit formula that uses hypothetical accounts. For service on or after January 1, 2015, the terms of the plan provide that each participant's hypothetical account balance is credited monthly with a pay credit equal to a specified percentage of the participant's compensation during the month. The plan also provides that hypothetical account balance is increased or decreased by an interest credit, which is calculated as the product of the account balance at the beginning of the period and the net rate of return on the assets within a specified subset of plan assets during that period. Under the terms of the plan, the net rate of return is equal to the actual rate of return adjusted to reflect a reduction for specified plan expenses. The plan does not provide for interest credits on amounts that are distributed prior to the end of an interest crediting period.

(b) As of the effective date of the amendment, there are no assets in the specified subset of plan assets. Under the terms of the plan, an amount is added to the specified subset at the time each subsequent contribution for any plan year starting on or after the effective date of the amendment is made to the plan. The amount added (the formula

contribution) is the amount deemed necessary to fund benefit accruals under the statutory hybrid benefit formula. Investment of the specified subset is diversified so as to minimize the volatility of returns, within the meaning of paragraph (d)(5)(ii)(A) of this section, and no qualifying employer securities or qualifying employer real property (within the meaning of section 407 of ERISA) are held in the subset. Benefits accrued under the statutory hybrid benefit formula are paid from the specified subset. However, if assets of the specified subset are insufficient to pay benefits accrued under the statutory hybrid benefit formula, the plan provides that assets of the residual legacy subset of plan assets (from which benefits accrued before January 1, 2015 are paid) are available to pay those benefits in accordance with the requirement that all assets of the plan be available to pay all plan benefits. Except as described in this paragraph, no other amounts are added to or subtracted from the specified subset of plan assets.

(c) The formula contribution for each plan year that is added to the specified subset of plan assets is an amount equal to the sum of the target normal cost of the statutory hybrid benefit formula for the plan year plus an additional amount intended to reflect gains or losses. This additional amount is equal to the annual amount necessary to amortize the difference between the funding target attributable to the statutory hybrid benefit formula portion of the plan for the plan year over the value of plan assets included in the specified subset of plan assets for the plan year in level annual installments over a 7-year period. For this purpose, target normal cost and funding target are determined under the rules of §1.430(d)–1 as if the statutory hybrid benefit formula portion of the plan were the entire plan and without regard to special rules that are applicable to a plan in at-risk status, even if the plan is in at-risk status for a plan year. If the formula contribution for a plan year exceeds the amount of the actual contribution to the plan for a year (such as could be the case if all or a portion of the contribution is offset by all or a portion of the plan's prefunding balance), then an amount equal to the excess of the formula contribution over the actual contribution is transferred from the residual legacy subset of plan assets to the specified subset of plan assets on the plan's due date for the minimum required contribution for the year.

(ii) *Conclusion*. The specified subset is diversified so as to minimize the volatility of returns (within the meaning of paragraph (d)(5)(ii)(A) of this section). The aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the specified subset do not exceed 10 percent of the fair market value of the aggregate assets in the subset. The fair market value of the assets within the specified subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions, within the meaning of paragraph (d)(5)(ii)(B)(*3*) of this section. Therefore, the interest crediting rate under the statutory hybrid benefit formula portion of Employer A's defined benefit plan is not in excess of a market rate of return.

Example 2. (i) *Facts*. (a) Pursuant to a collective bargaining agreement, Employer X, Employer Y and Employer Z maintain and contribute to a multiemployer plan (as defined in section 414(f)) that is established as of January 1, 2015 under which benefit accruals are determined under a variable annuity benefit formula. The plan provides that, on an annual basis, the benefit of each participant who has not yet retired is adjusted by reference to the difference between the actual return on the assets within a specified subset of plan assets and 4 percent. A participant's benefits are fixed at retirement and thereafter are not adjusted.

(b) As of the effective date of the plan, there are no assets in the specified subset. Under the terms of the plan, any amount contributed to the plan by a contributing employer is added to the specified subset at the time of the contribution. Investment of the specified subset is diversified so as to minimize the volatility of returns, within the meaning of paragraph (d)(5)(ii)(A) of this section, and no qualifying employer securities or qualifying employer real property (within the meaning of section 407 of ERISA) are held in the subset. The plan provides that, at the time of a participant's retirement, an amount equal to the present value of the liability for benefits payable to that participant is transferred to a separate subset of plan assets (the retiree pool). The retiree pool is invested in high-quality bonds in an attempt to achieve cash-flow matching of the retiree liabilities. Benefits are paid from the retiree pool. However, if assets of the retiree pool are insufficient to pay benefits, the plan provides that assets of the specified subset are available to pay benefits in accordance with the requirement that all assets of the plan be available to pay all plan benefits. Except as described in this paragraph, no other amounts are added to or subtracted from the specified subset of plan assets.

(ii) *Conclusion*. The specified subset is diversified so as to minimize the volatility of returns (within the meaning of paragraph (d)(5)(ii)(A) of this section). The aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the specified subset do not

exceed 10 percent of the fair market value of the aggregate assets in the subset. The fair market value of the assets within the specified subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions, within the meaning of paragraph (d)(5)(ii)(B)(*3*) of this section. Therefore, the methodology used to adjust participant benefits under the plan's variable annuity benefit formula, which is a statutory hybrid benefit formula under §1.411(a)(13)–1(d)(4), is not in excess of a market rate of return.

(iii) *Annuity contract rates.* The rate of return on the annuity contract for the employee issued by an insurance company licensed under the laws of a State is not in excess of a market rate of return. However, this paragraph (d)(5)(iii) does not apply if the Commissioner determines that the annuity contract has been structured to provide an interest crediting rate that is in excess of a market rate of return.

(iv) *Rate of return on certain RICs.* An interest crediting rate is not in excess of a market rate of return if it is equal to the rate of return on a regulated investment company (RIC), as defined in section 851, that is reasonably expected to be not significantly more volatile than the broad United States equities market or a similarly broad international equities market. For example, a RIC that has most of its assets invested in securities of issuers (including other RICs) concentrated in an industry sector or a country other than the United States generally would not meet this requirement. Likewise a RIC that uses leverage, or that has significant investment in derivative financial products, for the purpose of achieving returns that amplify the returns of an unleveraged investment, generally would not meet this requirement. Thus, a RIC that has most of its investments concentrated in the semiconductor industry or that uses leverage in order to provide a rate of return that is twice the rate of return on the Standard & Poor's 500 index (S&P 500) would not meet this requirement. On the other hand, a RIC with investments that track the rate of return on the S&P 500, a broad-based ''small-cap'' index (such as the Russell 2000 index), or a broad-based international equities index would meet this requirement.

(6) *Combinations of rates of return*—(i) *In general.* A plan that determines interest credits based, in whole or in part, on the greater of two or more different interest crediting rates provides an effective interest crediting rate in excess of a market rate of return unless the combination of rates is described in paragraph (d)(6)(ii), (d)(6)(iii), (e)(3)(iii), or (e)(4) of this section. However, a plan is not treated as providing the greater of two or more interest crediting rates merely because the plan satisfies the requirements of paragraph (d)(2) of this section. In addition, a plan is not treated as providing the greater of two or more interest crediting rates merely because a rate of return described in paragraph (d)(5)(iii) of this section is itself based on the greater of two or more rates.

(ii) *Annual or more frequent floor*—(A) *Application to segment rates.* An interest crediting rate under a plan does not fail to be described in paragraph (d)(3) or (d)(4)(iv) of this section for an interest crediting period merely because the plan provides that the interest crediting rate for that interest crediting period equals the greater of—

(*1*) An interest crediting rate described in paragraph (d)(3) or (d)(4)(iv) of this section; and

(*2*) An annual interest rate of 4 percent or less (or a pro rata portion of an annual interest rate of 4 percent or less for plans that provide interest credits more frequently than annually).

(B) *Application to other bond-based rates.* An interest crediting rate under a plan does not fail to be described in paragraph (d)(4) of this section for an interest crediting period merely because the plan provides that the interest crediting rate for that interest crediting period equals the greater of—

(*1*) An interest crediting rate described in paragraph (d)(4)(ii) or (d)(4)(iii) of this section; and

(*2*) An annual interest rate of 5 percent or less (or a pro rata portion of an annual interest rate of 5 percent or less for plans that provide interest credits more frequently than annually).

(iii) *Cumulative floor applied to investment-based or bond-based rates*—(A) *In*

general. A plan that determines interest credits under a statutory hybrid benefit formula using a particular interest crediting rate described in paragraph (d)(3), (d)(4), or (d)(5) of this section (or an interest crediting rate that can never be in excess of a particular interest crediting rate described in paragraph (d)(3), (d)(4) or (d)(5) of this section) does not provide an effective interest crediting rate in excess of a market rate of return merely because the plan provides that the participant's benefit under the statutory hybrid benefit formula determined as of the participant's annuity starting date is equal to the benefit determined as if the accumulated benefit were equal to the greater of—

(*1*) The accumulated benefit determined using the interest crediting rate; and

(*2*) The accumulated benefit determined as if the plan had used a fixed annual interest crediting rate equal to 3 percent (or a lower rate) for all principal credits that are credited under the plan to the participant during the guarantee period (minimum guarantee amount).

(B) *Guarantee period defined*. The guarantee period is the prospective period that begins on the date the cumulative floor described in this paragraph (d)(6)(iii) begins to apply to the participant's benefit and that ends on the date on which that cumulative floor ceases to apply to the participant's benefit.

(C) *Application to multiple annuity starting dates*. The determination under this paragraph (d)(6)(iii) is made only as of an annuity starting date, within the meaning of §1.401(a)–20, A–10(b), with respect to which a distribution of the participant's entire vested benefit under the plan's statutory hybrid benefit formula as of that date commences. For a participant who has more than one annuity starting date, paragraph (d)(6)(iii)(D) of this section provides rules to account for prior annuity starting dates when applying paragraph (d)(6)(iii)(A) of this section. If the comparison under paragraph (d)(6)(iii)(D) of this section results in the minimum guarantee amount exceeding the sum of the amounts described in paragraphs (d)(6)(iii)(D)(*1*) through (d)(6)(iii)(D)(*3*) of this section, then the participant's benefit to be distributed at the current annuity starting date must be no less than would be provided if that excess were included in the current accumulated benefit.

(D) *Comparison to reflect prior distributions*. For a participant who has more than one annuity starting date, the minimum guarantee amount (described in paragraph (d)(6)(iii)(A)(*2*) of this section), as of the current annuity starting date, is compared to the sum of—

(*1*) The remaining balance of the participant's accumulated benefit, as of the current annuity starting date, to which a minimum guaranteed rate described in paragraph (d)(6)(iii)(A)(*2*) of this section applies;

(*2*) The amount of the reduction to the participant's accumulated benefit under the statutory hybrid benefit formula that is attributable to any prior distribution of the participant's benefit under that formula and to which a minimum guaranteed rate described in paragraph (d)(6)(iii)(A)(*2*) of this section applied, together with interest at that minimum guaranteed rate annually from the prior annuity starting date to the current annuity starting date; and

(*3*) Any amount that was treated as included in the accumulated benefit under the rules of this paragraph (d)(6)(iii) as of any prior annuity starting date, together with interest annually at the minimum guaranteed rate that applied to the prior distribution from the prior annuity starting date to the current annuity starting date.

(E) *Application to portion of participant's benefit*. A cumulative floor described in this paragraph (d)(6)(iii) may be applied to a portion of a participant's benefit, provided the requirements of this paragraph (d)(6)(iii) are satisfied with respect to that portion of the benefit. If a cumulative floor described in this paragraph (d)(6)(iii) applies to a portion of a participant's benefit, only the principal credits that are attributable to that portion of the participant's benefit are taken into account in determining the amount of the guarantee described in paragraph (d)(6)(iii)(A)(*2*) of this section.

(e) *Other rules regarding market rates of return*—(1) *In general*. This paragraph

(e) sets forth additional rules regarding the application of the market rate of return requirement with respect to benefits determined under a statutory hybrid benefit formula.

(2) *Plan termination*—(i) *In general.* This paragraph (e)(2) provides special rules that apply for purposes of determining certain plan factors under a statutory hybrid benefit formula after the plan termination date of a statutory hybrid plan. The terms of a statutory hybrid plan must reflect the requirements of this paragraph (e)(2). Paragraph (e)(2)(ii) of this section sets forth rules relating to the interest crediting rate for interest crediting periods that end after the plan termination date. Paragraph (e)(2)(iii) of this section sets forth rules for converting a participant's accumulated benefit to an annuity after the plan termination date. Paragraph (e)(2)(iv) of this section sets forth rules of application. Paragraph (e)(2)(v) of this section contains examples. The Commissioner may, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin, provide for additional rules that apply for purposes of this paragraph (e)(2) and the plan termination provisions of section 411(b)(5)(B)(vi). See § 601.601(d)(2)(ii)(*b*) of this chapter. See also regulations of the Pension Benefit Guaranty Corporation for additional rules that apply when a pension plan subject to Title IV of ERISA is terminated.

(ii) *Interest crediting rates used to determine accumulated benefits*—(A) *General rule.* The interest crediting rate used under the plan to determine a participant's accumulated benefit for interest crediting periods that end after the plan termination date must be equal to the average of the interest rates used under the plan during the 5-year period ending on the plan termination date. Except as otherwise provided in this paragraph (e)(2)(ii), the actual annual interest rate (taking into account minimums, maximums, and other adjustments) used to determine interest credits under the plan for each of the interest crediting periods is used for purposes of determining the average of the interest rates.

(B) *Special rule for variable interest crediting rates that are other rates of return*—(*1*) *Application to interest crediting periods.* This paragraph (e)(2)(ii)(B) applies for an interest crediting period if the interest crediting rate that was used for that interest crediting period was a rate of return described in paragraph (d)(5) of this section. This paragraph (e)(2)(ii)(B) also applies for an interest crediting period that begins before the first plan year described in paragraph (f)(2)(i)(B)(*1*) or (f)(2)(i)(B)(*3*) of this section (as applicable), if the interest crediting rate that was used for that interest crediting period had the potential to be negative. For this purpose, a rate is not treated as having the potential to be negative if it is a rate described in paragraph (d)(3) or (d)(4) of this section or is any other rate that is based solely on current bond yields.

(*2*) *Use of substitution rate.* For any interest crediting period to which this paragraph (e)(2)(ii)(B) applies, for purposes of determining the average of the interest rates under this paragraph (e)(2)(ii), the interest rate used under the plan for the interest crediting period is deemed to be equal to the substitution rate (as described in paragraph (e)(2)(ii)(C) of this section) for the period.

(C) *Definition of substitution rate.* The substitution rate for any interest crediting period equals the second segment rate under section 430(h)(2)(C)(ii) (determined without regard to section 430(h)(2)(C)(iv)) for the last calendar month ending before the beginning of the interest crediting period, as adjusted to account for any minimums or maximums that applied in the period (other than cumulative floors under paragraph (d)(6)(iii) of this section), but without regard to other reductions that applied in the period. Thus, for example, if the actual interest crediting rate in an interest crediting period is equal to the rate of return on plan assets, but not greater than 5 percent, then the substitution rate for that interest crediting period is equal to the lesser of the applicable second segment rate for the period and 5 percent. However, if the actual interest crediting rate for an interest crediting period is equal to the rate of return on plan assets minus 200 basis points, then the

substitution rate for that interest crediting period is equal to the applicable second segment rate for the period.

(D) *Cumulative floors.* Cumulative floors under paragraph (d)(6)(iii) of this section that applied during the 5-year period ending on the plan termination date are not taken into account for purposes of determining the average of the interest rates under this paragraph (e)(2)(ii). However, the rules of paragraph (d)(6)(iii) of this section continue to apply to determine benefits as of annuity starting dates on or after the plan termination date. Thus, if, as of an annuity starting date on or after the plan termination date, the benefit provided by applying an applicable cumulative minimum rate under paragraph (d)(6)(iii)(A)(*2*) of this section exceeds the benefit determined by applying interest credits to the participant's accumulated benefit (with interest credits for interest crediting periods that end after the plan termination date determined under this paragraph (e)(2)), then that cumulative minimum rate is used to determine benefits as of that annuity starting date.

(iii) *Annuity conversion rates and factors*—(A) *Conversion factors where a separate mortality table was used prior to plan termination*—(*1*) *Use of a separate mortality table.* This paragraph (e)(2)(iii)(A) applies for purposes of converting a participant's accumulated benefit to an annuity after the plan termination date if, for the entire 5-year period ending on the plan termination date, the plan provides for a mortality table in conjunction with an interest rate to be used to convert a participant's accumulated benefit (or a portion thereof) to an annuity. If this paragraph (e)(2)(iii)(A) applies, then the plan is treated as meeting the requirements of section 411(b)(5)(B)(i) and paragraph (d)(1) of this section only if, for purposes of converting a participant's accumulated benefit (or portion thereof) to an annuity for annuity starting dates after the plan termination date, the mortality table used is the table described in paragraph (e)(2)(iii)(A)(*2*) of this section and the interest rate is the rate described in paragraph (e)(2)(iii)(A)(*3*) of this section.

(*2*) *Specific mortality table.* The mortality table used is the mortality table specified under the plan for purposes of converting a participant's accumulated benefit to an annuity as of the termination date. This mortality table is used regardless of whether it was used during the entire 5-year period ending on the plan termination date. For purposes of applying this paragraph (e)(2)(iii)(A)(*2*), if the mortality table specified in the plan, as of the plan termination date, is a mortality table that is updated to reflect expected improvements in mortality experience (such as occurs with the applicable mortality table under section 417(e)(3)), then the table used for an annuity starting date after the plan termination date takes into account updates through the annuity starting date.

(*3*) *Specific interest rate.* The interest rate used is the interest rate specified under the plan for purposes of converting a participant's accumulated benefit to an annuity for annuity starting dates after the plan termination date. However, if the interest rate used under the plan for purposes of converting a participant's accumulated benefit to an annuity has not been the same fixed rate during the 5-year period ending on the plan termination date, then the interest rate used for purposes of converting a participant's accumulated benefit to an annuity for annuity starting dates after the plan termination date is the average interest rate that applied for this purpose during the 5-year period ending on the plan termination date.

(B) *Tabular factors.* If, as of the plan termination date, a tabular annuity conversion factor (i.e., a single conversion factor that combines the effect of interest and mortality) is used to convert a participant's accumulated benefit (or a portion thereof) to an annuity and that same fixed tabular annuity conversion factor has been used during the entire 5-year period ending on the plan termination date, then the plan satisfies the requirements of this paragraph (e)(2)(iii) only if that same tabular annuity conversion factor continues to apply after the plan termination date. However, if the tabular

annuity conversion factor used to convert a participant's accumulated benefit (or a portion thereof) to an annuity is not described in the preceding sentence (including any case in which the tabular annuity conversion factor was a fixed conversion factor that changed during the 5-year period ending on the plan termination date), then the plan satisfies the requirements of this paragraph (e)(2)(iii) only if the tabular annuity conversion factor used to convert a participant's accumulated benefit (or a portion thereof) to an annuity for annuity starting dates after the plan termination date is equal to the average of the tabular annuity conversion factors used under the plan for that purpose during the 5-year period ending on the plan termination date.

(C) *Factor applicable where a separate mortality table was not used for entire 5-year period prior to plan termination.* If paragraph (e)(2)(iii)(A) of this section does not apply (including any case in which a separate mortality table was used in conjunction with a separate interest rate to convert a participant's accumulated benefit (or a portion thereof) to an annuity for only a portion of the 5-year period ending on the plan termination date), then the plan is treated as having used a tabular annuity conversion factor to convert a participant's accumulated benefit (or a portion thereof) to an annuity for the entire 5-year period ending on the plan termination date. As a result, the rules of paragraph (e)(2)(iii)(B) of this section apply to determine the annuity conversion factor used for purposes of converting a participant's accumulated benefit (or portion thereof) to an annuity for annuity starting dates after the plan termination date. For this purpose, if a separate mortality table and separate interest rate applied for a portion of the 5-year period, that mortality table and interest rate are used to calculate an annuity conversion factor and that factor is treated as having been the tabular annuity conversion factor that applied for that portion of the 5-year period for purposes of this paragraph (e)(2)(iii).

(D) *Separate application with respect to optional forms.* This paragraph (e)(2)(iii) applies separately with respect to each optional form of benefit on the date of plan termination. For this purpose, the term optional form of benefit has the meaning given that term in §1.411(d)–3(g)(6)(ii), except that a change in the annuity conversion factor used to determine a particular benefit is disregarded in determining whether different optional forms exist. Thus, for example, if, for the entire 5-year period ending on the plan termination date, the plan provides for a mortality table in conjunction with an interest rate to be used to determine annuities other than qualified joint and survivor annuities, but for specified tabular factors to apply to determine annuities that are qualified joint and survivor annuities, then paragraph (e)(2)(iii)(A) of this section applies for purposes of annuities other than qualified joint and survivor annuities and paragraph (e)(2)(iii)(B) of this section applies for purposes of annuities that are qualified joint and survivor annuities. In addition, if the annuity conversion factor used to determine a particular qualified joint and survivor annuity has changed in the 5-year period ending on the plan termination date, the different factors are averaged for purposes of determining the annuity conversion factor that applies after plan termination for that particular qualified joint and survivor annuity.

(iv) *Rules of application*—(A) *Average of interest rates for crediting interest*—(*1*) *In general.* For purposes of determining the average of the interest rates under paragraph (e)(2)(ii) of this section, an interest crediting period is taken into account if the interest crediting date for the interest crediting period is within the 5-year period ending on the plan termination date. The average of the interest rates is determined as the arithmetic average of the annual interest rates used for those interest crediting periods. If the interest crediting periods taken into account are not all the same length, then each rate is weighted to reflect the length of the interest crediting period in which it applied. If the plan provides for the crediting of interest more frequently than annually, then interest credits after the plan termination date must be prorated in accordance with the rules of paragraph (d)(1)(iv)(C) of this section.

(*2*) *Section 411(d)(6) protected accumulated benefit*. In general, the interest rate that was used for each interest crediting period is the ongoing interest crediting rate that was specified under the plan for that period, without regard to any interest rate that was used prior to an amendment changing the interest crediting rate with respect to a section 411(d)(6) protected benefit. However, if, as of the end of the last interest crediting period that ends on or before the plan termination date, the participant's accumulated benefit is based on a section 411(d)(6) protected benefit that results from a prior amendment to change the rate of interest crediting applicable under the plan, then the pre-amendment interest rate is treated as having been used for each interest crediting period after the date of the interest crediting rate change (so that the amendment is disregarded).

(B) *Average annuity conversion rates and factors*—(*1*) *In general*. For purposes of determining average annuity conversion interest rates and average tabular annuity conversion factors under paragraph (e)(2)(iii) of this section, an interest rate or tabular annuity conversion factor is taken into account if the rate or conversion factor applied under the terms of the plan to convert a participant's accumulated benefit (or a portion thereof) to a benefit payable in the form of an annuity during the 5-year period ending on the plan termination date. The average is determined as the arithmetic average of the interest rates or tabular factors used during that period. If the periods in which the rates or factors that are averaged are not all the same length, then each rate or factor is weighted to reflect the length of the period in which it applied.

(*2*) *Section 411(d)(6) protected annuity conversion factors*. In general, the annuity conversion interest rate or tabular annuity conversion factor that was used for each period is the ongoing interest rate or tabular factor that was specified under the plan for that period, without regard to any rate or factor that was used under the plan prior to an amendment changing the rate or factor with respect to a section 411(d)(6) protected benefit. However, if, as of the plan termination date, the participant's annuity benefit for an annuity commencing at that date would be based on a section 411(d)(6) protected benefit that results from a prior amendment to change the rate or factor under the plan, then the pre-amendment rate or factor is treated as having been used after the date of the amendment (so that the amendment is disregarded).

(C) *Blended rates*. If, as of the plan termination date, the plan determines interest credits by applying different rates to two or more different predetermined portions of the accumulated benefit, then the interest crediting rate that applies after the plan termination date is determined separately with respect to each portion under the rules of paragraph (e)(2)(ii) of this section.

(D) *Participants with less than 5 years of interest credits upon plan termination*. If the plan provided for interest credits for any interest crediting period in which, pursuant to the terms of the plan, an individual was not eligible to receive interest credits (including because the individual was not a participant or beneficiary in the relevant interest crediting period), then, for purposes of determining the individual's average interest crediting rate under paragraph (e)(2)(ii) of this section, the individual is treated as though the individual received interest credits in that period using the interest crediting rate that applied in that period under the terms of the plan to a similarly situated participant or beneficiary who was eligible to receive interest credits.

(E) *Plan termination date*—(*1*) *Plans subject to Title IV of ERISA*. In the case of a plan that is subject to Title IV of ERISA, the plan termination date for purposes of this paragraph (e)(2) means the plan's termination date established under section 4048(a) of ERISA.

(*2*) *Other plans*. In the case of a plan that is not subject to Title IV of ERISA, the plan termination date for purposes of this paragraph (e)(2) means the plan's termination date established by the plan administrator, provided that the plan termination date may be no earlier than the date on which the actions necessary to effect the plan

termination—other than the distribution of plan benefits—are taken. However, a plan is not treated as terminated on the plan's termination date if the assets are not distributed as soon as administratively feasible after that date. See Rev. Rul. 89–87 (1989–2 CB 2), (see § 601.601(d)(2)(ii)(*b*) of this chapter).

(v) *Examples*. The following examples illustrate the rules of this paragraph (e)(2). In each case, it is assumed that the plan is terminated in a standard termination.

Example 1. (i) *Facts*. (A) Plan A is a defined benefit plan with a calendar plan year that expresses each participant's accumulated benefit in the form of a hypothetical account balance to which principal credits are made at the end of each calendar quarter and to which interest is credited at the end of each calendar quarter based on the balance at the beginning of the quarter. Interest credits under Plan A are based on a rate of interest fixed at the beginning of each plan year equal to the third segment rate for the preceding December, except that the plan used the rate of interest on 30-year Treasury bonds (instead of the third segment rate) for plan years before 2013. The plan is terminated on March 3, 2017.

(B) The third segment rate credited under Plan A from January 1, 2013, through December 31, 2016, is assumed to be: 6 percent annually for each of the four quarters in 2016; 6.5 percent annually for each of the four quarters in 2015; 6 percent annually for each of the four quarters in 2014; and 5.5 percent annually for each of the four quarters in 2013. The rate of interest on 30-year Treasury bonds credited under Plan A for each of the four quarters in 2012 is assumed to be 4.4 percent annually.

(ii) *Conclusion*. Pursuant to paragraph (e)(2)(ii) of this section, the interest crediting rate used to determine accrued benefits under the plan on and after the date of plan termination is an annual rate of 5.68 percent (which is the arithmetic average of 6 percent, 6.5 percent, 6 percent, 5.5 percent, and 4.4 percent). In accordance with the rules of paragraph (d)(1)(iv)(C) of this section, the quarterly interest crediting rate after the plan termination date is 1.42 percent (5.68 divided by 4).

Example 2. (i) *Facts*. The facts are the same as *Example 1*. Participant S, who terminated employment before January 1, 2017, has a hypothetical account balance of $100,000 when the plan is terminated on March 3, 2017. Participant S commences distribution in the form of a straight life annuity commencing on January 1, 2020. For the entire 5-year period ending on the plan termination date, the plan has provided that the applicable section 417(e) rates for the preceding August are applied on the annuity starting date in order to convert the hypothetical account balance to an annuity. Based on the 5-year averages of the first segment rates, the second segment rates, and the third segment rates as of the plan termination date, and the applicable mortality table for the year 2020, the resulting conversion rate at the January 1, 2020 annuity starting date is 166.67 for a monthly straight life annuity payable to a participant whose age is the age of Participant S on January 1, 2020.

(ii) *Conclusion*. In accordance with the conclusion in *Example 1*, the interest crediting rate after the plan termination date is 1.42 percent for each of the 12 quarterly interest crediting dates in the period from March 3, 2017, through December 31, 2019, so that Participant S's account balance is $118,436 on December 31, 2019. As a result, using the annuity conversion rate of 166.67, the amount payable to Participant S commencing on January 1, 2020 is $711 per month.

Example 3. (i) *Facts*. The facts are the same as *Example 1*. In addition, Participant T commenced participation in Plan A on April 17, 2014.

(ii) *Conclusion*. In accordance with the conclusion in *Example 1* and the rule of paragraph (e)(2)(iv)(D) of this section, the quarterly interest crediting rate used to determine Participant T's accrued benefits under Plan A on and after the date of plan termination is 1.42 percent, which is the same rate that applies to all participants and beneficiaries in Plan A after the termination date (and that would have applied to Participant T if Participant T had participated in the plan during the 5-year period preceding the date of plan termination).

Example 4. (i) *Facts*. (A) Plan B is a defined benefit plan with a calendar plan year that expresses each participant's accumulated benefit in the form of a hypothetical account balance to which principal credits are made at the end of each calendar year and to which interest is credited at the end of each calendar year based on the balance at the end of the preceding year. The plan is terminated on January 27, 2018.

(B) The plan's interest crediting rate for each calendar year during the entire 5-year period ending on the plan termination date is equal to (A) 50 percent of the greater of the rate of interest on 3-month Treasury Bills for the preceding December and an annual rate of 4 percent, plus (B) 50 percent of the rate of return on plan assets. The rate of interest on 3-month Treasury Bills credited under Plan B is assumed to be: 3.4 Percent for 2017; 4 percent for 2016; 4.5 percent for 2015; 3.5 percent for 2014; and 4.2 percent for 2013. Each of these rates applied under Plan B for purposes of determining the interest credits described in clause (A) of this paragraph (i), except that the 4 percent minimum

rate applied for 2017 and 2014. The second segment rate is assumed to be: 6 percent for December 2016; 6 percent for December 2015; 6.5 percent for December 2014; 6 percent for December 2013; and 5.5 percent for December 2012.

(ii) *Conclusion.* Pursuant to paragraph (e)(2)(ii) of this section, the interest crediting rate used to determine accrued benefits under the plan on and after the date of plan termination is 5.07 percent. This number is equal to the sum of 50 percent of 4.14 percent (which is the sum of 4 percent, 4 percent, 4.5 percent, 4 percent, and 4.2 percent, divided by 5), and 50 percent of 6 percent (which is the average second segment rate applicable for the 5 interest crediting periods ending within the 5-year period, as applied pursuant to the substitution rule described in paragraphs (e)(2)(ii)(B) and (C) of this section).

Example 5. (i) *Facts.* The facts are the same as in *Example 4,* except that the plan had credited interest before January 1, 2016, using the rate of return on a specified RIC and had been amended effective January 1, 2016, to base interest credits for all plan years after 2015 on the interest rate formula described in paragraph (i) of *Example 4.* In order to comply with section 411(d)(6), the plan provides that, for each participant or beneficiary who was a participant on December 31, 2015, benefits at any date are based on either the ongoing hypothetical account balance on that date (which is based on the December 31, 2015 balance, with interest credited thereafter at the rate described in the first sentence of paragraph (i) of *Example 4* and taking principal credits after 2015 into account) or a special hypothetical account balance (the pre-2016 balance) on that date, whichever balance is greater. For each participant, the pre-2016 balance is a hypothetical account balance equal to the participant's December 31, 2015 balance, with interest credited thereafter at the RIC rate of return, but with no principal credits after 2015. There are 10 participants for whom the pre-2016 balance exceeds the ongoing hypothetical account balance at the end of 2017 (which is the end of the last interest crediting period that ends on or before the January 27, 2018, plan termination date).

(ii) *Conclusion.* Because Plan B credited interest prior to 2016 using the rate of return on a RIC (a rate described in paragraph (d)(5) of this section), for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan B for all participants during those periods (for the calendar years 2013, 2014, and 2015) is equal to the second segment rate for December of the calendar year preceding each interest crediting period. In addition, because the pre-2016 balances exceeded the ongoing hypothetical account balance for 10 participants in the last interest crediting period prior to plan termination, for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan B for 2016 and 2017 for those participants is equal to the second segment rate for December 2015 and December 2016, respectively. For all other participants, for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan B for 2016 and 2017 is based on the ongoing interest crediting rate (as described in *Example 4*).

(3) *Rules relating to section 411(d)(6)*—(i) *General rule.* The right to future interest credits determined in the manner specified under the plan and not conditioned on future service is a factor that is used to determine the participant's accrued benefit, for purposes of section 411(d)(6). Thus, to the extent that benefits have accrued under the terms of a statutory hybrid plan that entitle the participant to future interest credits, an amendment to the plan to change the interest crediting rate must satisfy section 411(d)(6) if the revised rate under any circumstances could result in interest credits that are smaller as of any date after the applicable amendment date (within the meaning of §1.411(d)–3(g)(4)) than the interest credits that would be provided without regard to the amendment. For additional rules, see §1.411(d)–3(b). Paragraphs (e)(3)(ii) through (e)(3)(vi) of this section set forth special rules that apply regarding the interaction of section 411(d)(6) and changes to a plan's interest crediting rate. The Commissioner may, in guidance of general applicability, prescribe additional rules regarding the interaction of section 411(d)(6) and section 411(b)(5), including changes to a plan's interest crediting rate. See §601.601(d)(2)(ii)(*b*).

(ii) *Adoption of long-term investment grade corporate bond rate.* For purposes of applying section 411(d)(6) and this paragraph (e) to an amendment to change to the interest crediting rate described in paragraph (d)(3) of this section, a plan is not treated as providing interest credits that are smaller as of any date after the applicable amendment date than the interest credits that would be provided using an interest crediting rate described in paragraph (d)(4) of this section merely

because the plan credits interest after the applicable amendment date using the interest crediting rate described in paragraph (d)(3) of this section, provided—

(A) The amendment only applies to interest credits to be credited after the effective date of the amendment;

(B) The effective date of the amendment is at least 30 days after adoption of the amendment;

(C) On the effective date of the amendment, the new interest crediting rate is not lower than the interest crediting rate that would have applied in the absence of the amendment; and

(D) For plan years described in paragraph (f)(2)(i)(B)(*1*) or (f)(2)(i)(B)(*3*) of this section (as applicable), if prior to the amendment the plan used a fixed annual floor in connection with a rate described in paragraph (d)(4)(ii), (iii) or (iv) of this section (as permitted under paragraph (d)(6)(ii) of this section), the floor is retained after the amendment to the maximum extent permissible under paragraph (d)(6)(ii)(A) of this section.

(iii) *Coordination of section 411(d)(6) and market rate of return limitation*—(A) *In general.* An amendment to a statutory hybrid plan that preserves a section 411(d)(6) protected benefit is subject to the rules under paragraph (d) of this section relating to market rate of return. However, in the case of an amendment to change a plan's interest crediting rate for periods after the applicable amendment date from one interest crediting rate (the old rate) that satisfies the requirements of paragraph (d) of this section to another interest crediting rate (the new rate) that satisfies the requirements of paragraph (d) of this section, the plan's effective interest crediting rate is not in excess of a market rate of return for purposes of paragraph (d) of this section merely because the plan provides for the benefit of any participant who is benefiting under the plan (within the meaning of § 1.410(b)–3(a)) on the applicable amendment date to never be less than what it would be if the old rate had continued but without taking into account any principal credits (as defined in paragraph (d)(1)(ii)(D) of this section) after the applicable amendment date.

(B) *Multiple amendments.* A pattern of repeated plan amendments each of which provides for a prospective change in the plan's interest crediting rate with respect to the benefit as of the applicable amendment date will be treated as resulting in the ongoing plan terms providing for an effective interest crediting rate that is in excess of a market rate of return. See § 1.411(d)–4, A–1(c)(1).

(iv) *Change in lookback month or stability period used to determine interest credits*—(A) *Section 411(d)(6) anti-cutback relief.* With respect to a plan using an interest crediting rate described in paragraph (d)(3) or (d)(4) of this section, notwithstanding the general rule of paragraph (e)(3)(i) of this section, if a plan amendment changes the lookback month or stability period used to determine interest credits, the amendment is not treated as reducing accrued benefits in violation of section 411(d)(6) merely on account of this change if the conditions of this paragraph (e)(3)(iv)(A) are satisfied. If the plan amendment is effective on or after the adoption date, any interest credits credited for the one-year period commencing on the date the amendment is effective must be determined using the lookback month and stability period provided under the plan before the amendment or the lookback month and stability period after the amendment, whichever results in the larger interest credits. If the plan amendment is adopted retroactively (that is, the amendment is effective prior to the adoption date), the plan must use the lookback month and stability period resulting in the larger interest credits for the period beginning with the effective date and ending one year after the adoption date.

(B) *Section 411(b)(5)(B)(i)(I) market rate of return relief.* The plan's effective interest crediting rate is not in excess of a market rate of return for purposes of paragraph (d) of this section merely because a plan amendment complies with the requirements of paragraph (e)(3)(iv)(A) of this section. However, a pattern of repeated plan amendments each of which provides for a change in the lookback month or stability period used to determine interest credits will be treated as resulting in the ongoing

plan terms providing for an effective interest crediting rate that is in excess of a market rate of return. See §1.411(d)–4, A–1(c)(1).

(v) *RIC ceasing to exist.* This paragraph (e)(3)(v) applies in the case of a statutory hybrid plan that credits interest using an interest crediting rate equal to the rate of return on a RIC (pursuant to paragraph (d)(5)(iv) of this section) that ceases to exist, whether as a result of a name change, liquidation, or otherwise. In such a case, the plan is not treated as violating section 411(d)(6) provided that the rate of return on the successor RIC is substituted for the rate of return on the RIC that no longer exists, for purposes of crediting interest for periods after the date the RIC ceased to exist. In the case of a name change or merger of RICs, the successor RIC means the RIC that results from the name change or merger involving the RIC that no longer exists. In all other cases, the successor RIC is a RIC selected by the plan sponsor that has reasonably similar characteristics, including characteristics related to risk and rate of return, as the RIC that no longer exists.

(vi) *Transitional amendments needed to satisfy the market rate of return rules*—(A) *In general.* Notwithstanding the requirements of section 411(d)(6), if the requirements set forth in this paragraph (e)(3)(vi) are satisfied, a plan may be amended to change its interest crediting rate with respect to benefits that have already accrued in order to comply with the requirements of section 411(b)(5)(B)(i) and paragraph (d) of this section. A plan amendment is eligible for the treatment provided under this paragraph (e)(3)(vi)(A) to the extent that the amendment modifies an interest crediting rate that does not satisfy the requirements of section 411(b)(5)(B)(i) and paragraph (d) of this section in the manner specified in paragraph (e)(3)(vi)(C) of this section.

(B) *Rules of application*—(*1*) *Multiple noncompliant features.* If a plan's interest crediting rate has more than one noncompliant feature as described in paragraph (e)(3)(vi)(C) of this section, then each noncompliant feature must be addressed separately in the manner specified in paragraph (e)(3)(vi)(C) of this section.

(*2*) *Definition of investment-based rate.* The application of the rules of paragraph (e)(3)(vi)(C) of this section to an interest crediting rate depends on whether the interest crediting rate is an investment-based rate. For purposes of this paragraph (e)(3)(vi), an investment-based rate is a rate based on either a rate of return provided by actual investments (taking into account the return attributable to any change in the value of the underlying investments) or a rate of return for an index that measures the change in the value of investments. A rate is an investment-based rate even if it is based only in part on a rate described in the preceding sentence.

(*3*) *Timing rules for permitted amendments.* The rules under this paragraph (e)(3)(vi) apply only to a plan amendment that is adopted prior to and effective no later than the first day of the first plan year described in paragraph (f)(2)(i)(B)(*1*) or (f)(2)(i)(B)(*3*) of this section, as applicable. In addition, the rules under this paragraph (e)(3)(vi) apply to a plan amendment only with respect to interest credits that are credited for interest crediting periods that begin on or after the applicable amendment date (within the meaning of §1.411(d)–3(g)(4)).

(*4*) *Amendments that provide for greater interest crediting rates.* If a plan is amended in accordance with paragraphs (e)(3)(vi)(C)(*1*) through (*10*) of this section to switch from a noncompliant rate to a compliant rate and is subsequently amended to switch to a second compliant rate that can never be less than the first compliant rate, then the second amendment does not violate section 411(d)(6). If, instead, the plan is amended to switch from the noncompliant rate to the second compliant rate in a single amendment, that amendment also does not violate section 411(d)(6). For example, if it is permitted under paragraph (e)(3)(vi)(C) of this section to first amend the plan to credit interest using the lesser of the current rate and a rate described in paragraph (d)(3) of this section, it is then permissible to amend the plan to credit interest using that rate described in paragraph (d)(3) of this section. In such a case, it is also permissible to amend the plan to switch from

the current rate to a rate described in paragraph (d)(3) of this section in a single amendment.

(*5*) *Cumulative floors, including floors resulting from a prior change in rates with section 411(d)(6) protection.* This paragraph (e)(3)(vi)(B)(*5*) applies to a plan that takes into account a minimum rate of return that applies less frequently than annually. This paragraph (e)(3)(vi)(B)(*5*) also applies to a plan that determines the participant's benefit as of the annuity starting date as the benefit provided by the greatest of two or more account balances (for example, in order to comply with section 411(d)(6) in connection with a prior amendment to change the plan's interest crediting rate). In either case, this paragraph (e)(3)(vi)(B)(*5*) applies with respect to a participant only if the requirements of paragraph (d)(6) of this section are not satisfied with respect to that participant. If this paragraph (e)(3)(vi)(B)(*5*) applies with respect to a participant, the plan must be amended to provide that the benefit for the participant is based solely on the benefit (and the associated interest crediting rate with respect to that benefit) that is greatest for that participant as of the applicable amendment date for the amendment made pursuant to this paragraph (e)(3)(vi). In addition, the plan must be further amended pursuant to the other rules in this paragraph (e)(3)(vi) if the remaining interest crediting rate does not satisfy the requirements of paragraph (d) of this section.

(*6*) *Plans that permit participant direction of interest crediting rates.* This paragraph (e)(3)(vi)(B)(*6*) applies in the case in which a plan permits a participant to choose an interest crediting rate from among a menu of hypothetical investment options and at least one of those hypothetical investment options provides for an interest crediting rate that is not permitted under paragraph (d) of this section (so that the plan fails to satisfy the requirements of paragraph (d) of this section). In such a case, the rules of this paragraph (e)(3)(vi) may be applied separately to correct each impermissible investment option. Alternatively, with respect to such a plan that permitted a participant to choose an interest crediting rate from among a menu of hypothetical investment options on September 18, 2014, pursuant to plan provisions that were adopted on or before September 18, 2014, the entire menu of investment options may be treated as an impermissible investment-based rate for which there is no permitted investment-based rate with similar risk and return characteristics (so that the rule of paragraph (e)(3)(vi)(C)(*7*) of this section does not apply). As a result, plans described in the preceding sentence may be amended to eliminate a participant's ability to choose an interest crediting rate from among a menu of hypothetical investment options in accordance with paragraph (e)(3)(vi)(C)(*9*) of this section.

(C) *Noncompliant feature and amendment to bring plan into compliance—*(*1*) *Timing or other rules related to determining interest credits not satisfied.* If a plan has an underlying interest rate that generally satisfies the rules of paragraph (d) of this section but that does not satisfy the rules relating to how interest credits are determined and credited as set forth in paragraph (d)(1)(iv) of this section, then the plan must be amended either—

(*i*) To correct the aspect of the plan's interest crediting rate that fails to comply with the rules of paragraph (d)(1)(iv) of this section with respect to its underlying interest crediting rate; or

(*ii*) If the plan's interest crediting rate is a variable rate that is not an investment-based rate of return, to provide that the plan's interest crediting rate is the lesser of that variable rate and a rate described in paragraph (d)(3) of this section that satisfies the rules of paragraph (d)(1)(iv) of this section.

(*2*) *Fixed rate in excess of 6 percent.* If a plan's interest crediting rate is a fixed rate in excess of the rate described in paragraph (d)(4)(v) of this section, then the plan must be amended to reduce the interest crediting rate to an annual interest crediting rate of 6 percent.

(*3*) *Bond-based rate with margin exceeding maximum permitted margin.* If a plan's interest crediting rate is a noncompliant rate that consists of an underlying rate described in paragraph (d)(3) or (d)(4) of this section except

that the plan applies a margin that exceeds the maximum permitted margin under paragraph (d)(3) or (d)(4) of this section to the underlying rate, then the plan must be amended either—

(*i*) To reduce the margin to the maximum permitted margin for the underlying rate used by the plan; or

(*ii*) To provide that the plan's interest crediting rate is the lesser of the plan's noncompliant rate and a rate described in paragraph (d)(3) of this section (together with any fixed minimum rate that was part of the noncompliant rate, reduced to the extent necessary to comply with paragraph (d)(6)(ii) of this section).

(*4*) *Bond-based rate with fixed minimum rate applied on an annual or more frequent basis in excess of the highest permitted fixed minimum rate.* If a plan's interest crediting rate is a composite rate that consists of a variable rate described in paragraph (d)(3) or (d)(4) of this section in combination with a fixed minimum rate in excess of the highest permitted fixed minimum rate under paragraph (d)(6)(ii)(A)(*2*) or (B)(*2*) of this section (as applicable), then the plan must be amended in one of the following manners:

(*i*) To reduce the fixed minimum rate to the highest permitted fixed minimum rate that may be used in combination with the plan's variable rate;

(*ii*) To credit interest using an annual interest crediting rate of 6 percent; or

(*iii*) To provide that the plan's interest crediting rate is the lesser of the plan's noncompliant composite rate and a rate described in paragraph (d)(3) of this section (together with a fixed minimum rate of 4 percent).

(*5*) *Greatest of two or more variable bond-based rates.* If a plan's interest crediting rate is a composite rate that is the greatest of two or more variable rates described in paragraph (d)(3) or (d)(4) of this section, then the plan must be amended to provide for an interest crediting rate that is the lesser of the composite rate and a rate described in paragraph (d)(3) of this section.

(*6*) *Other impermissible bond-based rates.* If, after application of the rules of paragraphs (e)(3)(vi)(C)(*1*) through (*5*) of this section, a plan's interest crediting rate is a variable rate that is not an investment-based rate of return and is not described in paragraph (d)(3) or (d)(4) of this section, then the plan must be amended either—

(*i*) To provide for an interest crediting rate based on a variable rate described in paragraph (d)(3) or (d)(4) of this section that has similar duration and quality characteristics as the plan's variable rate, if such a rate can be selected; or

(*ii*) To provide for an interest crediting rate that is the lesser of the plan's variable rate and a rate described in paragraph (d)(3) of this section.

(*7*) *Impermissible investment-based rate that can be replaced with a permissible rate that has similar risk and return characteristics.* If a plan's interest crediting rate is an investment-based rate of return that is not described in paragraph (d)(5) of this section and a permitted investment-based rate described in paragraph (d)(5)(ii)(A), (d)(5)(ii)(B), or (d)(5)(iv) of this section that has similar risk and return characteristics as the plan's impermissible investment-based rate can be selected, then the plan must be amended to provide for an interest crediting rate based on such a permitted investment-based rate.

(*8*) *Investment-based rate with an annual or more frequent minimum rate that is either a fixed rate or a non-investment based variable rate.* If a plan's interest crediting rate is an investment-based rate of return that would be described in paragraph (d)(5) of this section except that the plan uses an annual or more frequent minimum rate that is either a fixed rate or a non-investment based variable rate in conjunction with the investment-based rate, then the plan must be amended either—

(*i*) To credit interest using that investment-based rate of return described in paragraph (d)(5) of this section without the minimum rate and eliminating any reduction (or other adjustment) to the investment-based rate; or

(*ii*) To provide that the plan's interest crediting rate is a rate described in paragraph (d)(3) of this section (together with any fixed minimum rate, reduced to the extent necessary to comply with paragraph (d)(6)(ii) of this section).

(*9*) *Other impermissible investment-based rates.* If, after application of the rules of paragraphs (e)(3)(vi)(C)(*1*), (*7*), and (*8*) of this section, a plan's interest crediting rate is an investment-based rate that is not described in paragraph (d)(5) of this section, then the plan must be amended either—

(*i*) To provide for an interest crediting rate that is an investment-based rate that is described in paragraph (d)(5) of this section and that is otherwise similar to the plan's impermissible investment-based rate but without the risk and return characteristics of the impermissible investment-based rate that caused it to be impermissible (generally requiring the use of a rate that is less volatile than the plan's impermissible investment-based rate but is otherwise similar to that rate); or

(*ii*) To provide that the plan's interest crediting rate is a rate described in paragraph (d)(3) of this section with a fixed minimum rate of 4 percent.

(D) *Examples.* The following examples illustrate the application of the rules of this paragraph (e)(3)(vi). Each plan has a plan year that is the calendar year, and all amendments are adopted on October 1, 2016, and become effective for interest crediting periods beginning on or after January 1, 2017. Except as otherwise provided, the interest crediting rate under the plan satisfies the timing and other rules related to crediting interest under paragraph (d)(1)(iv) of this section.

Example 1. (i) *Facts.* A plan determines interest credits for a plan year using the average yield on 30-year Treasury Constant Maturities for the last week of the preceding plan year (which is an impermissible lookback period for this purpose pursuant to paragraph (d)(1)(iv)(B) of this section because it is not a month).

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(*1*) of this section, the plan must be amended in one of two manners. It may be amended to determine interest credits for a plan year using the average yield on 30-year Treasury Constant Maturities for a lookback month that complies with the requirements of paragraph (d)(1)(iv)(B) of this section. Alternatively, the plan may be amended to cap the existing rate so that it cannot exceed a third segment rate described in paragraph (d)(3) of this section for a period that complies with the requirements of paragraph (d)(1)(iv)(B) of this section.

Example 2. (i) *Facts.* A plan determines interest credits for a plan year using the average yield on 30-year Treasury Constant Maturities for the last week of the preceding plan year, plus 50 basis points.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(B)(*1*) of this section, the plan must be amended to correct both the impermissible lookback period and the excess margin. Accordingly, pursuant to paragraph (e)(3)(vi)(C)(*1*) and (*3*) of this section, the plan may be amended to determine interest credits for a plan year using the average yield on 30-year Treasury Constant Maturities (with no margin) for a period that complies with the requirements of paragraph (d)(1)(iv)(B) of this section. Alternatively, the plan may be amended to cap the existing rate so that it cannot exceed a third segment rate described in paragraph (d)(3) of this section for a period that complies with the requirements of paragraph (d)(1)(iv)(B) of this section.

Example 3. (i) *Facts.* A plan credits interest for a plan year using the rate of return on plan assets for the preceding plan year.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(*1*) of this section, the plan must be amended to determine interest credits for each plan year using the rate of return on plan assets for that plan year.

Example 4. (i) *Facts.* A plan credits interest using the average yield on 30-year Treasury Constant Maturities for December of the preceding plan year with a minimum rate of 5.5 percent per year.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(*4*) of this section, the plan must be amended to change the plan's interest crediting rate. The new interest crediting rate under the plan may be the average yield on 30-year Treasury Constant Maturities for December of the preceding plan year with a minimum rate of 5 percent per year. Alternatively, the new interest crediting rate under the plan may be an annual interest crediting rate of 6 percent. As another alternative, the existing noncompliant composite rate may be capped so that it cannot exceed a third segment rate described in paragraph (d)(3) of this section, with a minimum rate of 4 percent as a floor on the entire resulting rate.

Example 5. (i) *Facts.* A plan credits interest using the greater of the unadjusted yield on 30-year Treasury Constant Maturities and the yield on 1-year Treasury Constant Maturities plus 100 basis points.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(*5*) of this section, the plan must be amended to cap the existing composite ''greater-of'' rate so that the composite rate cannot exceed a third segment rate described in paragraph (d)(3) of this section.

Example 6. (i) *Facts.* A plan credits interest using a broad-based index that measures the

yield to maturity on a group of intermediate-term investment grade corporate bonds.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(*6*) of this section, the plan must be amended in one of two manners. The plan may be amended to credit interest using a second segment rate described in paragraph (d)(4)(iv) of this section. Alternatively, the plan may be amended to cap the existing rate so that it cannot exceed a third segment rate described in paragraph (d)(3) of this section.

Example 7. (i) *Facts.* A plan credits interest using the rate of return for a broad-based index that measures the yield to maturity on a group of short-term non-investment grade corporate bonds.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(*6*)(*ii*) of this section, the plan must be amended to cap the existing rate so that it cannot exceed a third segment rate described in paragraph (d)(3) of this section.

Example 8. (i) *Facts.* A plan credits interest using the rate of return for the S&P 500 index. To bring the plan into compliance with the market rate of return rules, the plan sponsor amends the plan to credit interest based on the rate of return on a RIC that is designed to track the rate of return on the S&P 500 index.

(ii) *Conclusion.* The amendment satisfies the rule of paragraph (e)(3)(vi)(C)(*7*) of this section.

Example 9. (i) *Facts.* A plan credits interest based on the rate of return on a collective trust that holds a portfolio of equity investments, which provides a rate of return that is reasonably expected to be not significantly more volatile than the broad U.S. equities market or a similarly broad international equities market. To bring the plan into compliance with the market rate of return rules, the plan sponsor amends the plan to credit interest based on the actual rate of return on the assets within a specified subset of the plan's assets that is invested in the collective trust and that satisfies the requirements of paragraph (d)(5)(ii)(B) of this section.

(ii) *Conclusion.* The amendment satisfies the rule of paragraph (e)(3)(vi)(C)(*7*) of this section.

Example 10. (i) *Facts.* A plan credits interest for a plan year using the rate of return on a RIC that has most of its investments concentrated in the semiconductor industry.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(*9*) of this section, the plan must be amended in one of two manners. The plan may be amended to provide for an interest crediting rate that is an investment-based rate that is described in paragraph (d)(5) of this section and that is similar to the plan's impermissible investment-based rate except to the extent that the risk and return characteristics of the impermissible investment-based rate caused it to be impermissible. Thus, the plan may be amended to provide for an interest crediting rate based on the rate of return on a RIC that is invested in a broader sector of the market than the semiconductor industry (such as the overall technology sector of the market), provided that the sector in which the RIC is invested is broad enough that the volatility requirements of paragraph (d)(5)(iv) of this section are satisfied. Alternatively, the plan may be amended to provide that the plan's interest crediting rate is a third segment rate described in paragraph (d)(3) of this section with a fixed minimum rate of 4 percent.

Example 11. (i) *Facts.* A plan was amended in 2014 to change its interest crediting rate for all interest crediting periods after the applicable amendment date of the amendment. The amendment changed the rate from the yield on 30-year Treasury Constant Maturities to the rate of return on aggregate plan assets under paragraph (d)(5)(ii)(A) of this section. The amendment also provided for section 411(d)(6) protection with respect to the account balance as of the applicable amendment date (by providing that the account balance after the applicable amendment date will never be smaller than the account balance as of the applicable amendment date credited with interest using the yield on 30-year Treasury Constant Maturities).

(ii) *Conclusions.* (A) *Participants benefiting under the plan.* With respect to those participants who were benefiting under the plan as of the applicable amendment date of the amendment described in paragraph (i) of this *Example 11*, the requirements of paragraph (e)(3)(iii) of this section (which provides a special market rate of return rule to permit certain changes in rates for participants benefiting under the plan) are satisfied. Accordingly, no amendment is required under this paragraph (e)(3)(vi) with respect to those participants.

(B) *Participants not benefiting under the plan.* With respect to those participants who were not benefiting under the plan as of the applicable amendment date of the amendment described in paragraph (i) of this *Example 11*, the requirements of paragraph (e)(3)(iii) of this section are not satisfied and, accordingly, the ''greater-of'' rate resulting from the section 411(d)(6) protection does not satisfy the requirements of paragraph (d)(6) of this section. As a result, pursuant to paragraph (e)(3)(vi)(B)(*5*) of this section, it must be determined on a participant-by-participant basis which account balance provides the benefit that is greater as of the applicable amendment date for the amendment made pursuant to this paragraph (e)(3)(iv) (the transitional amendment). If, as of the applicable amendment date for the transitional amendment, the account balance credited with interest after the change in rates

using the yield on 30-year Treasury Constant Maturities is greater, then the plan must be amended to provide that the participant's benefit is based solely on that account balance credited with interest using the yield on 30-year Treasury Constant Maturities. On the other hand, if, as of the applicable amendment date for the transitional amendment, the account balance using the rate of return on aggregate plan assets is greater, then the plan must be amended to provide that the participant's benefit is based solely on that account balance credited with interest at the rate of return on aggregate plan assets.

(vii) *Plan termination amendments*. A plan amendment with an applicable amendment date on or before the first day of the first plan year described in paragraph (f)(2)(i)(B)(*1*) or (*3*) of this section (as applicable) is not treated as reducing accrued benefits in violation of section 411(d)(6) merely because the amendment changes the rules that apply upon plan termination in order to satisfy the requirements of paragraph (e)(2) of this section.

(4) *Actuarial increases after normal retirement age*. A statutory hybrid plan is not treated as providing an effective interest crediting rate that is in excess of a market rate of return for purposes of paragraph (d) of this section merely because the plan provides that the participant's benefit, as of each annuity starting date after normal retirement age, is equal to the greater of—

(i) The benefit based on the accumulated benefit determined using an interest crediting rate that is not in excess of a market rate of return under paragraph (d) of this section; and

(ii) The benefit that satisfies the requirements of section 411(a)(2).

(5) *Plans that permit participant direction of interest crediting rates*. [Reserved]

(f) *Effective/applicability date*—(1) *Statutory effective/applicability dates*—(i) *In general*. Except as provided in paragraph (f)(1)(iii) of this section, section 411(b)(5) applies for periods beginning on or after June 29, 2005.

(ii) *Conversion amendments*. The requirements of section 411(b)(5)(B)(ii), 411(b)(5)(B)(iii), and 411(b)(5)(B)(iv) apply to a conversion amendment (as defined in paragraph (c)(4) of this section) that both is adopted on or after June 29, 2005, and takes effect on or after June 29, 2005.

(iii) *Market rate of return*—(A) *Plans in existence on June 29, 2005*—(*1*) *In general*. In the case of a plan that was in existence on June 29, 2005 (regardless of whether the plan was a statutory hybrid plan on that date), section 411(b)(5)(B)(i) applies to plan years that begin on or after January 1, 2008.

(*2*) *Exception for plan sponsor election*. Notwithstanding paragraph (f)(1)(iii)(A)(*1*) of this section, a plan sponsor of a plan that was in existence on June 29, 2005 (regardless of whether the plan was a statutory hybrid plan on that date) may elect to have the requirements of section 411(a)(13)(B) and section 411(b)(5)(B)(i) apply for any period on or after June 29, 2005, and before the first plan year beginning after December 31, 2007. In accordance with section 1107 of the PPA '06, an employer is permitted to adopt an amendment to make this election as late as the last day of the first plan year that begins on or after January 1, 2009 (January 1, 2011, in the case of a governmental plan as defined in section 414(d)) if the plan operates in accordance with the election.

(B) *Plans not in existence on June 29, 2005*. In the case of a plan not in existence on June 29, 2005, section 411(b)(5)(B)(i) applies to the plan on and after the later of June 29, 2005, and the date the plan becomes a statutory hybrid plan.

(iv) *Collectively bargained plans*—(A) *In general*. Notwithstanding paragraph (f)(1)(iii) of this section, in the case of a collectively bargained plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified on or before August 17, 2006, the requirements of section 411(b)(5)(B)(i) do not apply to plan years that begin before the earlier of—

(*1*) The later of—

(*i*) The date on which the last of those collective bargaining agreements terminates (determined without regard to any extension thereof on or after August 17, 2006); or

(*ii*) January 1, 2008; or

(*2*) January 1, 2010.

(B) *Treatment of plans with both collectively bargained and non-collectively bargained employees*. In the case of a plan

with respect to which a collective bargaining agreement applies to some, but not all, of the plan participants, the plan is considered a collectively bargained plan for purposes of this paragraph (f)(1)(iv) if it is considered a collectively bargained plan under the rules of § 1.436–1(a)(5)(ii)(B).

(2) *Effective/applicability date of regulations*—(i) *In general*—(A) *General effective date*. Except as provided in paragraph (f)(2)(i)(B) of this section, this section applies to plan years that begin on or after January 1, 2011.

(B) *Special effective date*—(*1*) *In general*. Except as otherwise provided in this paragraph (f)(2)(i)(B), paragraphs (d)(1)(iii), (d)(1)(iv)(D) and (E), (d)(1)(vi), (d)(2)(ii) and (v), (d)(5)(ii)(B), (d)(5)(iv), (d)(6), (e)(2), (e)(3)(iii), (iv) and (v), and (e)(4) of this section apply to plan years that begin on or after January 1, 2017 (or an earlier date as elected by the taxpayer).

(*2*) *Transitional amendments*. Paragraphs (e)(3)(vi) and (vii) of this section apply to plan amendments made on or after September 18, 2014 (or an earlier date as elected by the taxpayer).

(*3*) *Collectively bargained plans*. In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified on or before November 13, 2015, that constitutes a collectively bargained plan under the rules of § 1.436–1(a)(5)(ii)(B), the paragraphs referenced in paragraph (f)(2)(i)(B)(*1*) of this section apply to plan years that begin on or after the later of—

(*i*) January 1, 2017; and

(*ii*) The earlier of January 1, 2019; and the date on which the last of those collective bargaining agreements terminates (determined without regard to any extension thereof on or after November 13, 2015).

(ii) *Conversion amendments*. With respect to a conversion amendment (within the meaning of paragraph (c)(4) of this section), where the effective date of the conversion amendment (as defined in paragraph (c)(4)(vi) of this section) is on or after the statutory effective date set forth in paragraph (f)(1)(ii) of this section, the requirements of paragraph (c)(2) of this section apply only to a participant who has an hour of service on or after the regulatory effective date set forth in paragraph (f)(2)(i) of this section.

(iii) *Reliance before regulatory effective date*. For the periods after the statutory effective date set forth in paragraph (f)(1) of this section and before the regulatory effective date set forth in paragraph (f)(2)(i) of this section, the safe harbor and other relief of section 411(b)(5) apply and the market rate of return and other requirements of section 411(b)(5) must be satisfied. During these periods, a plan is permitted to rely on the provisions of this section for purposes of applying the relief and satisfying the requirements of section 411(b)(5).

[T.D. 9505, 75 FR 64137, Oct. 19, 2010, as amended by T.D. 9505, Dec. 28, 2010; T.D. 9693, 79 FR 56460, Sept. 19, 2014; T.D. 9743, 80 FR 70684, Nov. 16, 2015]

§ 1.411(c)–1 Allocation of accrued benefits between employer and employee contributions.

(a) *Accrued benefit derived from employer contributions*. For purposes of section 411 and the regulations thereunder, under section 411(c)(1), an employee's accrued benefit derived from employer contributions under a plan as of any applicable date is the excess, if any, of—

(1) The total accrued benefit under the plan provided for the employee as of such date, over

(2) The accrued benefit provided for the employee, derived from contributions made by the employee under the plan as of such date.

For computation of accrued benefit derived from employee contributions to a defined contribution plan or from voluntary employee contributions to a defined benefit plan, see paragraph (b) of this section. For computation of accrued benefit derived from mandatory employee contributions to a defined benefit plan, see paragraph (c) of this section.

(b) *Accrued benefit derived from employee contribution to defined contribution plan, etc.* For purposes of section 411 and the regulations thereunder, under section 411(c)(2)(A) the accrued benefit derived from employee contributions to a defined contribution plan is determined under paragraph (b)

(1) or (2) of this section, whichever applies. Under section 411(d)(5), the accrued benefit derived from voluntary employee contributions to a defined benefit plan is determined under paragraph (b)(1) of this section.

(1) *Separate accounts maintained.* If a separate account is maintained with respect to an employee's contributions and all income, expenses, gains, and losses attributable thereto, the accrued benefit determined under this subparagraph as of any applicable date is the balance of such account as of such date.

(2) *Separate accounts not maintained.* If a separate account is not maintained with respect to an employee's contributions and the income, expenses, gains, and losses attributable thereto, the accrued benefit determined under this subparagraph is the employee's total accrued benefit determined under the plan multiplied by a fraction—

(i) The numerator of which is the total amount of the employee's contributions under the plan less withdrawals, and

(ii) The denominator of which is the sum of (A) the amount described in paragraph (b)(2)(i) of this section, and (B) the total contributions made under the plan by the employer on behalf of the employee less withdrawals.

For purposes of this subparagraph, contributions include all amounts which are contributed to the plan even if such amounts are used to provide ancillary benefits, such as incidental life insurance, health insurance, or death benefits, and withdrawals include only amounts distributed to the employee and do not reflect the cost of any death benefits under the plan.

(c) *Accrued benefit derived from mandatory employee contributions to a defined benefit plan*—(1) *General rule.* In the case of a defined benefit plan (as defined in section 414(j)) the accrued benefit derived from contributions made by an employee under the plan as of any applicable date is an annual benefit, in the form of a single life annuity (without ancillary benefits) commencing at normal retirement age, equal to the amount of the employee's accumulated contributions (determined under paragraph (c)(3) of this section) multiplied by the appropriate conversion factor (determined under paragraph (c)(2) of this section). Paragraph (e) of this section provides rules for actuarial adjustments where the benefit is to be determined in a form other than the form described in this paragraph.

(2) *Appropriate conversion factor.* For purposes of this paragraph, the term ''appropriate conversion factor'' means the factor necessary to convert an amount equal to the accumulated contributions to a single life annuity (without ancillary benefits) commencing at normal retirement age and shall be 10 percent for a normal retirement age of 65 years. For other normal retirement ages the appropriate conversion factor shall be the factor as determined by the Commissioner.

(3) *Accumulated contributions.* For purposes of section 411(c) and this section, the term ''accumulated contributions'' means the total of—

(i) All mandatory contributions made by the employee (determined under paragraph (c)(4) of this section),

(ii) Interest (if any) on such contributions, computed at the rate provided by the plan to the end of the last plan year to which section 411(a)(2) does not apply (by reason of the applicable effective date), and

(iii) Interest on the sum of the amounts determined under paragraphs (c)(3)(i) and (ii) of this section compounded annually at the rate of 5 percent per annum from the beginning of the first plan year to which section 411(a)(2) applies (by reason of the applicable effective date) to the date on which the employee would attain normal retirement age.

For example, if under section 1017 of the Employee Retirement Income Security Act of 1974, section 411(a)(2) of the Code applies for plan years beginning after December 31, 1975, and for plan years beginning before 1975, the plan provided for 3 percent interest on employee contributions, an employee's accumulated contributions would be computed by crediting interest at the rate provided by the plan (3 percent) for plan years beginning before 1976 and by crediting interest at the rate of 5 percent (or another rate prescribed under section 411(c)(2)(D)) thereafter.

Section 1017 of the Employee Retirement Income Security Act of 1974 and § 1.411(a)–2 provide the effective dates for the application of section 411(a)(2).

(4) *Mandatory contributions.* For purposes of section 411(c) and this section the term ''mandatory contributions'' means amounts contributed to the plan by the employee which are required as a condition of his employment, as a condition of his participation in the plan, or as a condition of obtaining benefits (or additional benefits) under the plan attributable to employer contributions. For example, if the benefit derived from employer contributions depends upon a specified level of employee contributions, employee contributions up to that level would be treated as mandatory contributions. Mandatory contributions, otherwise satisfying the requirements of this subparagraph, include amounts contributed to the plan which are used to provide ancillary benefits such as incidental life insurance, health insurance, or death benefits.

(d) *Limitation on accrued benefit.* The accrued benefit derived from mandatory employee contributions under a defined benefit plan (determined under paragraph (c) of this section) shall not exceed the greater of—

(1) The accrued benefit of the employee under the plan, or

(2) The accrued benefit derived from employee contributions determined without regard to any interest under section 411(c)(2)(C) (ii) and (iii) and under paragraphs (c)(3) (ii) and (iii) of this section.

(e) *Actuarial adjustments for defined benefit plans*—(1) *Accrued benefit.* In the case of a defined benefit plan (as defined in section 414(j)) if an employee's accrued benefit is to be determined as an amount other than an annual benefit commencing at normal retirement age, such benefit (determined under section 411(c)(1) and paragraph (a) of this section) shall be the actuarial equivalent of such benefit, as determined by the Commissioner.

(2) *Accrued benefit derived from employee contributions.* In the case of a defined benefit plan (as defined in section 414(j) if the accrued benefit derived from mandatory contributions made by an employee is to be determined with respect to a benefit other than an annual benefit in the form of a single life annuity (without ancillary benefits) commencing at normal retirement age, such benefit shall be the actuarial equivalent of such benefit (determined under section 411(c)(2)(B) and paragraph (c) of this section) as determined by the Commissioner.

(f) *Suspension of benefits, etc.*—(1) *Suspensions.* No adjustment to an accrued benefit is required on account of any suspension of benefits if such suspension is permitted under section 203(a)(3)(B) of the Employee Retirement Income Security Act of 1974 (88 Stat. 855) (Code section 411(a)(3)(B)).

(2) *Employment after retirement.* No actuarial adjustment to an accrued benefit is required on account of employment after normal retirement age. For example, if a plan with a normal retirement age of 65 provides a benefit of $400 a month payable at age 65 the same $400 benefit (with no upward adjustment) could be paid to an employee who retires at age 68.

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42338, Aug. 23, 1977]

§ 1.411(d)–1 Coordination of vesting and discrimination requirements. [Reserved]

§ 1.411(d)–2 Termination or partial termination; discontinuance of contributions.

(a) *General rule*—(1) *Required nonforfeitability.* A plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) unless the plan provides that—

(i) Upon the termination or partial termination of the plan, or

(ii) In addition, in the case of a plan to which section 412 (relating to minimum funding standards) does not apply, upon the complete discontinuance of contributions under the plan,

the rights of each affected employee to benefits accrued to the date of such termination or partial termination (or, in the case of a plan to which section 412 does not apply, discontinuance), to the extent funded, or the rights of each employee to the amounts credited to his account at such time, are nonforfeitable (within the meaning of § 1.411(a)–4.

(2) *Required allocation.* (i) A plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) unless the plan provides for the allocation of any previously unallocated funds to the employes covered by the plan upon the termination or partial termination of the plan (or, in the case of a plan to which section 412 does not apply, upon the complete discontinuance of contributions under the plan). Such provision may be incorporated in the plan at its inception or by an amendment made prior to the termination or partial termination of the plan for the discontinuance of contributions thereunder. In the case of a defined contribution plan under which unallocated forfeitures are held in a suspense account in order to satisfy the requirements of section 415, this subdivision shall not require such plan to provide for allocations from the suspense account to the extent that such allocations would result in annual additions to participants' accounts in excess of amounts permitted under section 415 for the year for which such allocations would be made.

(ii) Any provision for the allocation of unallocated funds which is found by the Secretary of Labor or the Pension Benefit Guaranty Corporation (whichever is appropriate) to satisfy the requirements of section 4044 or section 403(d)(1) of the Employee Retirement Income Security Act of 1974 is acceptable if it specifies the method to be used and does not conflict with the provisions of section 401(a)(4) of the Internal Revenue Code of 1954 and the regulations thereunder. Any allocation of funds required by paragraph (1), (2), (3), or (4)(A) of section 4044(a) of such Act shall be deemed not to result in discrimination prohibited by section 401(a)(4) of the Code (see, however, paragraph (e) of this section). Notwithstanding the preceding sentence, in the case of a plan which establishes subclasses or categories pursuant to section 4044(b)(6) of such Act, the allocation of funds by the use of such subclasses or categories shall not be deemed not to result in discrimination prohibited by the Code. The allocation of unallocated funds may be in cash or in the form of other benefits provided under the plan. However, the allocation of the funds contributed by the employer among the employees need not necessarily benefit all the employees covered by the plan.

(iii) Paragraphs (a)(2) (i) and (ii) of this section do not require the allocation of amounts to the account of any employee if such amounts are not required to be used to satisfy the liabilities with respect to employees and their beneficiaries under the plan (see section 401(a)(2)).

(b) *Partial termination*—(1) *General rule.* Whether or not a partial termination of a qualified plan occurs (and the time of such event) shall be determined by the Commissioner with regard to all the facts and circumstances in a particular case. Such facts and circumstances include: the exclusion, by reason of a plan amendment or severance by the employer, of a group of employees who have previously been covered by the plan; and plan amendments which adversely affect the rights of employees to vest in benefits under the plan.

(2) *Special rule.* If a defined benefit plan ceases or decreases future benefit accruals under the plan, a partial termination shall be deemed to occur if, as a result of such cessation or decrease, a potential reversion to the employer, or employers, maintaining the plan (determined as of the date such cessation or decrease is adopted) is created or increased. If no such reversion is created or increased, a partial termination shall be deemed not to occur by reason of such cessation or decrease. However, the Commissioner may determine that a partial termination of such a plan occurs pursuant to subparagraph (1) of this paragraph for reasons other than such cessation or decrease.

(3) *Effect of partial termination.* If a termination of a qualified plan occurs, the provisions of section 411(d)(3) apply only to the part of the plan that is terminated.

(c) *Termination*—(1) *Application.* This paragraph applies to a plan other than a plan described in section 411(e)(1) (relating to governmental, certain church plans, etc.).

(2) *Plans subject to termination insurance.* For purposes of this section, a plan to which title IV of the Employee Retirement Income Security Act of

1974 applies is considered terminated on a particular date if, as of that date—

(i) The plan is voluntarily terminated by the plan administrator under section 4041 of the Employee Retirement Income Security Act of 1974, or

(ii) The Pension Benefit Guaranty Corporation terminates the plan under section 4042 of the Employee Retirement Income Security Act of 1974.

For purposes of this subparagraph, the particular date of termination shall be the date of termination determined under section 4048 of such Act.

(3) *Other plans*. In the case of a plan not described in paragraph (c)(2) of this section, a plan is considered terminated on a particular date if, as of that date, the plan is voluntarily terminated by the employer, or employers, maintaining the plan.

(d) *Complete discontinuance*—(1) *General rule*. For purposes of this section, a complete discontiuance of contributions under the plan is contrasted with a suspension of contributions under the plan which is merely a temporary cessation of contributions by the employer. A complete discontinuance of contributions may occur although some amounts are contributed by the employer under the plan if such amounts are not substantial enough to reflect the intent on the part of the employer to continue to maintain the plan. The determination of whether a complete discontinuance of contributions under the plan has occurred will be made with regard to all the facts and circumstances in the particular case, and without regard to the amount of any contributions made under the plan by employees. Among the factors to be considered in determining whether a suspension constitutes a discontinuance are:

(i) Whether the employer may merely be calling an actual discontinuance of contributions a suspension of such contributions in order to avoid the requirement of full vesting as in the case of a discontinuance, or for any other reason;

(ii) Whether contributions are recurring and substantial; and

(iii) Whether there is any reasonable probability that the lack of contributions will continue indefinitely.

(2) *Time of discontinuance*. In any case in which a suspension of a profit-sharing plan maintained by a single employer is considered a discontinuance, the discontinuance becomes effective not later than the last day of the taxable year of the employer following the last taxable year of such employer for which a substantial contribution was made under the profit-sharing plan. In the case of a profit-sharing plan maintained by more than one employer, the discontinuance becomes effective not later than the last day of the plan year following the plan year within which any employer made a substantial contribution under the plan.

(e) *Contributions or benefits which remain forfeitable*. Under section 411 (d) (2) and (3), section 411(a) and this section do not apply to plan benefits which may not be provided for designated employees in the event of early termination of the plan under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to preclude the discrimination prohibited by section 401(a)(4). Accordingly, in such a case, plan benefits may be required to be reallocated without regard to this section. See § 1.401–4(c).

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42339, Aug. 23, 1977]

§ 1.411(d)–3 Section 411(d)(6) protected benefits.

(a) *Protection of accrued benefits*—(1) *General rule*. Under section 411(d)(6)(A), a plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) if a plan amendment decreases the accrued benefit of any plan participant, except as provided in section 412(d)(2) (section 412(c)(8) for plan years beginning before January 1, 2008), section 4281 of the Employee Retirement Income Security Act of 1974 as amended (ERISA), or other applicable law (see, for example, sections 418D and 418E of the Internal Revenue Code, and section 1107 of the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780, 1063)). For purposes of this section, a plan amendment includes

any changes to the terms of a plan, including changes resulting from a merger, consolidation, or transfer (as defined in section 414(l)) or a plan termination. The protection of section 411(d)(6) applies to a participant's entire accrued benefit under the plan as of the applicable amendment date, without regard to whether the entire accrued benefit was accrued before a participant's severance from employment or whether any portion was the result of an increase in the accrued benefit of the participant pursuant to a plan amendment adopted after the participant's severance from employment.

(2) *Plan provisions taken into account*—(i) *Direct or indirect reduction in accrued benefit*. For purposes of determining whether a participant's accrued benefit is decreased, all of the amendments to the provisions of a plan affecting, directly or indirectly, the computation of accrued benefits are taken into account. Plan provisions indirectly affecting the computation of accrued benefits include, for example, provisions relating to years of service and compensation.

(ii) *Amendments effective with the same applicable amendment date*. In determining whether a reduction in a participant's accrued benefit has occurred, all plan amendments with the same applicable amendment date are treated as one amendment. Thus, if two amendments have the same applicable amendment date and one amendment, standing alone, increases participants' accrued benefits and the other amendment, standing alone, decreases participants' accrued benefits, the amendments are treated as one amendment and will only violate section 411(d)(6) if, for any participant, the net effect is to decrease participants' accrued benefit as of that applicable amendment date.

(iii) *Multiple amendments*—(A) *General rule*. A plan amendment violates the requirements of section 411(d)(6) if it is one of a series of plan amendments that, when taken together, have the effect of reducing or eliminating a section 411(d)(6) protected benefit in a manner that would be prohibited by section 411(d)(6) if accomplished through a single amendment.

(B) *Determination of the time period for combining plan amendments*. For purposes of applying the rule in paragraph (a)(2)(iii)(A) of this section, generally only plan amendments adopted within a 3-year period are taken into account.

(3) *Application of section 411(a) nonforfeitability provisions with respect to section 411(d)(6) protected benefits*—(i) *In general*. The rules of this paragraph (a) apply to a plan amendment that decreases a participant's accrued benefits, or otherwise places greater restrictions or conditions on a participant's rights to section 411(d)(6) protected benefits, even if the amendment merely adds a restriction or condition that is permitted under the vesting rules in section 411(a)(3) through (11). However, such an amendment does not violate section 411(d)(6) to the extent it applies with respect to benefits that accrue after the applicable amendment date. See section 411(a)(10) and § 1.411(a)–8 for additional rules relating to changes in a plan's vesting schedule.

(ii) *Exception for changes in a plan's vesting computation period*. Notwithstanding paragraph (a)(3)(i) of this section, a plan amendment that satisfies the applicable requirements under 29 CFR 2530.203–2(c) (rules relating to vesting computation periods) does not fail to satisfy the requirements of section 411(d)(6) merely because the plan amendment changes the plan's vesting computation period.

(4) *Examples*. The following examples illustrate the application of this paragraph (a):

Example 1. (i) *Facts*. Plan A provides an annual benefit of 2% of career average pay times years of service commencing at normal retirement age (age 65). Plan A is amended on November 1, 2006, effective as of January 1, 2007, to provide for an annual benefit of 1.3% of final pay times years of service, with final pay computed as the average of a participant's highest 3 consecutive years of compensation. As of January 1, 2007, Participant M has 16 years of service, M's career average pay is $37,500, and the average of M's highest 3 consecutive years of compensation is $67,308. Thus, Participant M's accrued benefit as of the applicable amendment date is increased from $12,000 per year at normal retirement age (2% times $37,500 times 16 years of service) to $14,000 per year at normal retirement age (1.3% times $67,308 times 16 years of service). As of January 1, 2007, Participant N has 6 years of service, N's career

average pay is $50,000, and the average of N's highest 3 consecutive years of compensation is $51,282. Participant N's accrued benefit as of the applicable amendment date is decreased from $6,000 per year at normal retirement age (2% times $50,000 times 6 years of service) to $4,000 per year at normal retirement age (1.3% times $51,282 times 6 years of service).

(ii) *Conclusion*. While the plan amendment increases the accrued benefit of Participant M, the plan amendment fails to satisfy the requirements of section 411(d)(6)(A) because the amendment decreases the accrued benefit of Participant N below the level of the accrued benefit of Participant N immediately before the applicable amendment date.

Example 2. (i) *Facts*. The facts are the same as Example 1, except that Plan A includes a provision under which Participant N's accrued benefit cannot be less than what it was immediately before the applicable amendment date (so that Participant N's accrued benefit could not be less than $6,000 per year at normal retirement age).

(ii) *Conclusion*. The amendment does not violate the requirements of section 411(d)(6)(A) with respect to Participant M (whose accrued benefit has been increased) or with respect to Participant N (although Participant N would not accrue any benefits until the point in time at which the new formula amount would exceed the amount payable under the minimum provision, approximately 3 years after the amendment becomes effective).

Example 3. (i) *Facts*. Employer N maintains Plan C, a qualified defined benefit plan under which an employee becomes a participant upon completion of 1 year of service and is vested in 100% of the employer-derived accrued benefit upon completion of 5 years of service. Plan C provides that a former employee's years of service prior to a break in service will be reinstated upon completion of 1 year of service after being rehired. Plan C has participants who have fewer than 5 years of service and who are accordingly 0% vested in their employer-derived accrued benefits. On December 31, 2007, effective January 1, 2008, Plan C is amended, in accordance with section 411(a)(6)(D), to provide that any nonvested participant who has at least 5 consecutive 1-year breaks in service and whose number of consecutive 1-year breaks in service exceeds his or her number of years of service before the breaks will have his or her pre-break service disregarded in determining vesting under the plan.

(ii) *Conclusion*. Under paragraph (a)(3) of this section, the plan amendment does not satisfy the requirements of this paragraph (a), and thus violates section 411(d)(6), because the amendment places greater restrictions or conditions on the rights to section 411(d)(6) protected benefits, as of January 1, 2008, for participants who have fewer than 5 years of service, by restricting the ability of those participants to receive further vesting protections on benefits accrued as of that date.

Example 4. (i) *Facts*. (A) Employer O sponsors Plan D, a qualified profit sharing plan under which each employee has a nonforfeitable right to a percentage of his or her employer-derived accrued benefit based on the following table:

Completed years of service	Nonforfeitable percentage
Fewer than 3	0
3	20
4	40
5	60
6	80
7	100

(B) In January 2006, Employer O acquires Company X, which maintains Plan E, a qualified profit sharing plan under which each employee who has completed 5 years of service has a nonforfeitable right to 100% of the employer-derived accrued benefit. In 2007, Plan E is merged into Plan D. On the effective date for the merger, Plan D is amended to provide that the vesting schedule for participants of Plan E is the 7-year graded vesting schedule of Plan D. In accordance with section 411(a)(10)(A), the plan amendment provides that any participant of Plan E who had completed 5 years of service prior to the amendment is fully vested. In addition, as required under section 411(a)(10)(B), the amendment provides that any participant in Plan E who has at least 3 years of service prior to the amendment is permitted to make an irrevocable election to have the vesting of his or her nonforfeitable right to the employer-derived accrued benefit determined under either the 5-year cliff vesting schedule or the 7-year graded vesting schedule. Participant G, who has an account balance of $10,000 on the applicable amendment date, is a participant in Plan E with 2 years of service as of the applicable amendment date. As of the date of the merger, Participant G's nonforfeitable right to G's employer-derived accrued benefit is 0% under both the 7-year graded vesting schedule of Plan D and the 5-year cliff vesting schedule of Plan E.

(ii) *Conclusion*. Under paragraph (a)(3) of this section, the plan amendment does not satisfy the requirements of this paragraph (a) and violates section 411(d)(6), because the amendment places greater restrictions or conditions on the rights to section 411(d)(6) protected benefits with respect to G and any participant who has fewer than 5 years of service and who elected (or was made subject to) the new vesting schedule. A method of avoiding a section 411 (d)(6) violation with respect to account balances attributable to

benefits accrued as of the applicable amendment date and earnings thereon would be for Plan D to provide for the vested percentage of G and each other participant in Plan E to be no less than the greater of the vesting percentages under the two vesting schedules (for example, for G and each other participant in Plan E to be 20% vested upon completion of 3 years of service, 40% vested upon completion of 4 years of service, and fully vested upon completion of 5 years of service) for those account balances and earnings.

(b) *Protection of section 411(d)(6)(B) protected benefits*—(1) *General rule—(i) Prohibition against plan amendments eliminating or reducing section 411(d)(6)(B) protected benefits.* Except as provided in this section, a plan is treated as decreasing an accrued benefit if it is amended to eliminate or reduce a section 411(d)(6)(B) protected benefit as defined in paragraph (g)(15) of this section. This paragraph (b)(1) applies to participants who satisfy (either before or after the plan amendment) the preamendment conditions for a section 411(d)(6)(B) protected benefit.

(ii) *Contingent benefits.* The rules of paragraph (b)(1)(i) of this section apply to participants who satisfy (either before or after the plan amendment) the preamendment conditions for the section 411(d)(6)(B) protected benefit even if the condition on which the eligibility for the section 411(d)(6)(B) protected benefit depends is an unpredictable contingent event (*e.g.*, a plant shutdown).

(iii) *Application of general rules in paragraph (a) of this section to section 411(d)(6)(B) protected benefits.* For purposes of determining whether a participant's section 411(d)(6)(B) protected benefit is eliminated or reduced, the rules of paragraph (a) of this section apply to section 411(d)(6)(B) protected benefits in the same manner as they apply to accrued benefits described in section 411(d)(6)(A). As an example of the application of paragraph (a)(2)(ii) of this section to section 411(d)(6)(B) protected benefits, if there are two amendments with the same applicable amendment date and one amendment increases accrued benefits and the other amendment decreases the early retirement factors that are used to determine the early retirement annuity, the amendments are treated as one amendment and only violate section 411(d)(6) if, after the two amendments, the net dollar amount of any early retirement annuity with respect to the accrued benefit of any participant as of the applicable amendment date is lower than it would have been without the two amendments. As an example of the application of paragraph (a)(2)(iii) of this section to section 411(d)(6)(B) protected benefits, a series of amendments made within a 3-year period that, when taken together, have the effect of reducing or eliminating early retirement benefits or retirement-type subsidies in a manner that adversely affects the rights of any participant in a more than *de minimis* manner violates section 411(d)(6)(B) even if each amendment would be permissible pursuant to paragraphs (c), (d), or (f) of this section.

(2) *Permissible elimination of section 411(d)(6)(B) protected benefits—(i) In general.* A plan is permitted to be amended to eliminate a section 411(d)(6)(B) protected benefit if the elimination is in accordance with this section or § 1.411(d)–4.

(ii) *Increases in payment amounts do not eliminate an optional form of benefit.* An amendment is not treated as eliminating an optional form of benefit or eliminating or reducing an early retirement benefit or retirement-type subsidy under the plan, if, effective after the plan amendment, there is another optional form of benefit available to the participant under the plan that is of inherently equal or greater value (within the meaning of § 1.401(a)(4)–4(d)(4)(i)(A)). Thus, for example, a change in the method of calculating a joint and survivor annuity from using a 90% adjustment factor on account of the survivorship payment at particular ages for a participant and a spouse to using a 91% adjustment factor at the same ages is not treated as an elimination of an optional form of benefit. Similarly, a plan that offers a subsidized qualified joint and survivor annuity option for married participants under which the amount payable during the participant's lifetime is not less than the amount payable under the plan's straight life annuity is permitted to be amended to eliminate the straight life annuity option for married participants.

(3) *Permissible elimination of benefits that are not section 411(d)(6) protected benefits*—(i) *In general.* Section 411(d)(6) does not provide protection for benefits that are ancillary benefits, other rights and features, or any other benefits that are not described in section 411(d)(6). See §1.411(d)–4, Q&A–1(d). However, a plan may not be amended to recharacterize a retirement-type benefit as an ancillary benefit. Thus, for example, a plan amendment to recharacterize any portion of an early retirement subsidy as a social security supplement that is an ancillary benefit violates section 411(d)(6).

(ii) *No protection for future benefit accruals.* Section 411(d)(6) only protects benefits that accrue before the applicable amendment date. Thus, a plan is permitted to be amended to eliminate or reduce an early retirement benefit, a retirement-type subsidy, or an optional form of benefit with respect to benefits that accrue after the applicable amendment date without violating section 411(d)(6). However, section 4980F(e) of the Internal Revenue Code and section 204(h) of ERISA require notice of an amendment to an applicable pension plan that either provides for a significant reduction in the rate of future benefit accrual or that eliminates or significantly reduces an early retirement benefit or a retirement-type subsidy. See §54.4980F–1 of this chapter generally, and see §54.4980F–1, Q&A–7(b) and Q&A–8(c) of this chapter, with respect to the circumstances under which such notice is required for a reduction in an early retirement benefit or retirement-type subsidy.

(4) *Examples.* The following examples illustrate the application of this paragraph (b):

Example 1. (i) *Facts involving amendments to an early retirement subsidy.* Plan A provides an annual benefit of 2% of career average pay times years of service commencing at normal retirement age (age 65). Plan A is amended on November 1, 2006, effective as of January 1, 2007, to provide for an annual benefit of 1.3% of final pay times years of service, with final pay computed as the average of a participant's highest 3 consecutive years of compensation. Participant M is age 50, M has 16 years of service, M's career average pay is $37,500, and the average of M's highest 3 consecutive years of compensation is $67,308. Thus, M's accrued benefit as of the effective date of the amendment is increased from $12,000 per year at normal retirement age (2% times $37,500 times 16 years of service) to $14,000 per year at normal retirement age (1.3% times $67,308 times 16 years of service). (These facts are similar to the facts in *Example 1* in paragraph (a)(4) of this section.) Before the amendment, Plan A permitted a former employee to commence distribution of benefits as early as age 55 and, for a participant with at least 15 years of service, actuarially reduced the amount payable in the form of a straight life annuity commencing before normal retirement age by 3% per year from age 60 to age 65 and by 7% per year from age 55 through age 59. Thus, before the amendment, the amount of M's early retirement benefit that would be payable for commencement at age 55 was $6,000 per year ($12,000 per year minus 3% for 5 years and minus 7% for 5 more years). The amendment also alters the actuarial reduction factor so that, for a participant with at least 15 years of service, the amount payable in a straight life annuity commencing before normal retirement age is reduced by 6% per year. As a result, the amount of M's early retirement benefit at age 55 becomes $5,600 per year after the amendment ($14,000 minus 6% for 10 years).

(ii) *Conclusion.* The straight life annuity payable under Plan A at age 55 is an optional form of benefit that includes an early retirement subsidy. The plan amendment fails to satisfy the requirements of section 411(d)(6)(B) because the amendment decreases the optional form of benefit payable to Participant M below the level that Participant M was entitled to receive immediately before the effective date of the amendment. If instead Plan A had included a provision under which M's straight life annuity payable at any age could be not be less than what it was immediately before the amendment (so that M's straight life annuity payable at age 55 could not be less than $6,000 per year), then the amendment would not fail to satisfy the requirements of section 411(d)(6)(B) with respect to M's straight life annuity payable at age 55 (although the straight life annuity payable to M at age 55 would not increase until the point in time at which the new formula amount with the new actuarial reduction factors exceeds the amount payable under the minimum provision, approximately 14 months after the amendment becomes effective).

Example 2. (i) *Facts involving plant shutdown benefits.* Plan B permits participants who have a severance from employment before normal retirement age (age 65) to commence distributions at any time after age 55 with the amount payable to be actuarially reduced using reasonable actuarial assumptions regarding interest and mortality specified in the plan, but provides that the annual reduction for any participant who has at

least 20 years of service and who has a severance from employment after age 55 is only 3% per year (which is a smaller reduction than would apply under reasonable actuarial reductions). Plan B also provides 2 plant shutdown benefits to participants who have a severance of employment as a result of a plant shutdown. First, the favorable 3% per year actuarial reduction applies for commencement of benefits after age 55 and before age 65 for any participant who has at least 10 years of service and who has a severance from employment as a result of a plant shutdown. Second, all participants who have at least 20 years of service and who have a severance from employment after age 55 (and before normal retirement age at age 65) as a result of a plant shutdown will receive supplemental payments. Under the supplemental payments, an additional amount equal to the participant's estimated old-age insurance benefit under the Social Security Act is payable until age 65. The supplemental payments are not a QSUPP, as defined in §1.401(a)(4)–12, because the plan's terms do not state that the supplement is treated as an early retirement benefit that is protected under section 411(d)(6).

(ii) *Conclusion with respect to plant shutdown benefits.* The benefits payable with the 3% annual reduction are retirement-type benefits. The excess of the actuarial present value of the early retirement benefit using the 3% annual reduction over the actuarial present value of the normal retirement benefit is a retirement-type subsidy and the right to receive payments of the benefit at age 55 is an early retirement benefit. These conclusions apply not only with respect to the rights that apply to participants who have at least 20 years of service, but also to participants with at least 10 years of service who have a severance from employment as a result of a plant shutdown. Thus, the right to receive benefits based on a 3% annual reduction for participants with at least 10 years of service at the time of a plant shutdown is an early retirement benefit that provides a retirement-type subsidy and is a section 411(d)(6)(B) protected benefit (even though no plant shutdown has occurred). Therefore, a plan amendment cannot eliminate this benefit with respect to benefits accrued before the applicable amendment date, even before the occurrence of the plant shutdown. Because the plan provides that the supplemental payments cannot exceed the OASDI benefit under the Social Security Act, the supplemental payments constitute a social security supplement (but not a QSUPP as defined in §1.401(a)(4)–12), which is an ancillary benefit that is not a section 411(d)(6)(B) protected benefit and accordingly is not taken into account in determining whether a prohibited reduction has occurred.

Example 3. (i) *Facts.* Plan C, a multiemployer defined benefit plan in which participation is limited to electricians in the construction industry, provides that a participant may elect to commence distributions only if the participant is not currently employed by a participating employer and provides that, if the participant has a specified number of years of service and attains a specified age, the distribution is without any actuarial reduction for commencement before normal retirement age. Since the plan's inception, Plan C has provided for suspension of pension benefits during periods of disqualifying employment (ERISA section 203(a)(3)(B) service). Before 2007, the plan defined disqualifying employment to include any job as an electrician in the particular industry and geographic location to which Plan C applies. This definition of disqualifying employment did not cover a job as an electrician supervisor. In 2005, Participant E, having rendered the specified number of years of service and attained the specified age to retire with a fully subsidized early retirement benefit, retires from E's job as an electrician with Employer Y and starts a position with Employer Z as an electrician supervisor. Employer Z is not a participating employer in Plan C but is an employer in the same industry and geographic location as Employer Y. When E left service with Employer Y, E's position as an electrician supervisor was not disqualifying employment for purposes of Plan C's suspension of pension benefit provision, and E elected to commence benefit payments in 2005. In 2006, effective January 1, 2007, Plan C is amended to expand the definition of disqualifying employment to include any job (including supervisory positions) as an electrician in the same industry and geographic location to which Plan C applies. The plan's definition of disqualifying employment satisfies the requirements of section 411(a)(3)(B). On January 1, 2007, E's pension benefits are suspended because of E's disqualifying employment as an electrician supervisor.

(ii) *Conclusion.* Under paragraphs (a)(3) and (b)(1) of this section, the 2007 plan amendment violates section 411(d)(6), because the amendment places greater restrictions or conditions on a participant's rights to section 411(d)(6) protected benefits to the extent it applies with respect to benefits that accrued before January 1, 2007. The result would be the same even if the amendment did not apply to former employees and instead applied only to participants who were actively employed at the time of the applicable amendment.

(c) *Permissible elimination of optional forms of benefit that are redundant*—(1) *General rule.* Except as otherwise provided in paragraph (c)(5) of this section, a plan is permitted to be amended

to eliminate an optional form of benefit for a participant with respect to benefits accrued before the applicable amendment date if—

(i) The optional form of benefit is redundant with respect to a retained optional form of benefit, within the meaning of paragraph (c)(2) of this section;

(ii) The plan amendment is not applicable with respect to an optional form of benefit with an annuity commencement date that is earlier than the number of days in the maximum QJSA explanation period (as defined in paragraph (g)(9) of this section) after the date the amendment is adopted; and

(iii) The requirements of paragraph (e) of this section are satisfied in any case in which either:

(A) The retained optional form of benefit for the participant does not commence on the same annuity commencement date as the optional form of benefit that is being eliminated; or

(B) As of the date the amendment is adopted, the actuarial present value of the retained optional form of benefit for the participant is less than the actuarial present value of the optional form of benefit that is being eliminated.

(2) *Similar types of optional forms of benefit are redundant*—(i) *General rule.* An optional form of benefit is redundant with respect to a retained optional form of benefit if, after the amendment becomes applicable—

(A) There is a retained optional form of benefit available to the participant that is in the same family of optional forms of benefit, within the meaning of paragraphs (c)(3) and (4) of this section, as the optional form of benefit being eliminated; and

(B) The participant's rights with respect to the retained optional form of benefit are not subject to materially greater restrictions (such as conditions relating to eligibility, restrictions on a participant's ability to designate the person who is entitled to benefits following the participant's death, or restrictions on a participant's right to receive an in-kind distribution) than applied to the optional form of benefit being eliminated.

(ii) *Special rule for core options.* An optional form of benefit that is a core option as defined in paragraph (g)(5) of this section may not be eliminated as a redundant benefit under the rules of this paragraph (c) unless the retained optional form of benefit and the eliminated core option are identical except for differences described in paragraph (c)(3)(ii) of this section. Thus, for example, a particular 10-year term certain and life annuity may not be eliminated by plan amendment unless the retained optional form of benefit is another 10-year term certain and life annuity.

(3) *Family of optional forms of benefit*—(i) *In general.* Paragraph (c)(4) of this section describes certain families of optional forms of benefits. Not every optional form of benefit that is offered under a plan necessarily fits within a family of optional forms of benefit as described in paragraph (c)(4) of this section. Each optional form of benefit that is not included in any particular family of optional forms of benefit listed in paragraph (c)(4) of this section is in a separate family of optional forms of benefit with other optional forms of benefit that would be identical to that optional form of benefit but for differences that are disregarded under paragraph (c)(3)(ii) of this section.

(ii) *Certain differences among optional forms of benefit*—(A) *Differences in actuarial factors and annuity starting dates.* The determination of whether two optional forms of benefit are within a family of optional forms of benefit is made without regard to actuarial factors or annuity starting dates. Thus, any optional forms of benefit that are part of the same generalized optional form (within the meaning of paragraph (g)(8) of this section) are in the same family of optional forms of benefit. For example, if a plan has a single-sum distribution option for some participants that is calculated using a 5% interest rate and a specific mortality table (but no less than the minimum present value as determined under section 417(e)) and another single-sum distribution option for other participants that is calculated using the applicable interest rate as defined in section 417(e)(3)(A)(ii)(II) and the applicable mortality table as defined in section 417(e)(3)(A)(ii)(I), both single-sum distribution options are part of the same

generalized optional form and thus in the same family of optional forms of benefit under the rules of paragraph (c)(3)(i) of this section. However, differences in actuarial factors and annuity starting dates are taken into account for purposes of the requirements in paragraph (e)(3) of this section.

(B) *Differences in pop-up provisions and cash refund features for joint and contingent options.* The determination of whether two optional forms of benefit are within a family of optional forms of benefit relating to joint and contingent families (as described in paragraph (c)(4)(i) and (ii) of this section) is made without regard to the following features—

(*1*) Pop-up provisions (under which payments increase upon the death of the beneficiary or another event that causes the beneficiary not to be entitled to a survivor annuity);

(*2*) Cash refund features (under which payment is provided upon the death of the last annuitant in an amount that is not greater than the excess of the present value of the annuity at the annuity starting date over the total of payments before the death of the last annuitant); or

(*3*) Term-certain provisions for optional forms of benefit within a joint and contingent family.

(C) *Differences in social security leveling features, refund of employee contributions features, and retroactive annuity starting date features.* The determination of whether 2 optional forms of benefit are within a family of optional forms of benefit is made without regard to social security leveling features, refund of employee contributions features, or retroactive annuity starting date features. But see paragraph (c)(5) of this section for special rules relating to social security leveling, refund of employee contributions, and retroactive annuity starting date features in optional forms of benefit.

(4) *List of families.* The following are families of optional forms of benefit for purposes of this paragraph (c):

(i) *Joint and contingent options with continuation percentages of 50% to 100%.* An optional form of benefit is within the 50% or more joint and contingent family if it provides a life annuity to the participant and a survivor annuity to an individual that is at least 50% and no more than 100% of the annuity payable during the joint lives of the participant and the participant's survivor.

(ii) *Joint and contingent options with continuation percentages less than 50%.* An optional form of benefit is within the less than 50% joint and contingent family if it provides a life annuity to the participant and a survivor annuity to an individual that is less than 50% of the annuity payable during the joint lives of the participant and the participant's survivor.

(iii) *Term certain and life annuity options with a term of 10 years or less.* An optional form of benefit is within the 10 years or less term certain and life family if it is a life annuity with a guarantee that payments will continue to the participant's beneficiary for the remainder of a fixed period that is 10 years or less if the participant dies before the end of the fixed period.

(iv) *Term certain and life annuity options with a term longer than 10 years.* An optional form of benefit is within the longer than 10 years term certain and life family if it is a life annuity with a guarantee that payments will continue to the participant's beneficiary for the remainder of a fixed period that is in excess of 10 years if the participant dies before the end of the fixed period.

(v) *Level installment payment options over a period of 10 years or less.* An optional form of benefit is within the 10 years or less installment family if it provides for substantially level payments to the participant for a fixed period of at least 2 years and not in excess of 10 years with a guarantee that payments will continue to the participant's beneficiary for the remainder of the fixed period if the participant dies before the end of the fixed period.

(vi) *Level installment payment options over a period of more than 10 years.* An optional form of benefit is within the more than 10 years installment family if it provides for substantially level payments to the participant for a fixed period that is in excess of 10 years with a guarantee that payments will continue to the participant's beneficiary for the remainder of the fixed period if the participant dies before the end of the fixed period.

(5) *Special rules for certain features included in optional forms of benefit.* For purposes of applying this paragraph (c), to the extent an optional form of benefit that is being eliminated includes either a social security leveling feature or a refund of employee contributions feature, the retained optional form of benefit must also include that feature, and, to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature or a refund of employee contributions feature, the retained optional form of benefit must not include that feature. For purposes of applying this paragraph (c), to the extent an optional form of benefit that is being eliminated does not include a retroactive annuity starting date feature, the retained optional form of benefit must not include the feature.

(6) *Separate application of redundancy rules for bifurcated benefits.* If a plan permits the participant to make different distribution elections with respect to two or more separate portions of the participant's benefit, the rules of this paragraph (c) are permitted to be applied separately to each such portion of the participant's benefit as if that portion were the participant's entire benefit. Thus, for example, if one set of distribution elections applies to a portion of the participant's accrued benefit and another set of distribution elections applies to the other portion of the participant's accrued benefit, then with respect to one portion of the participant's benefit, the determination of whether any optional form of benefit is within a family of optional forms of benefit is permitted to be made disregarding elections that apply to the other portion of the participant's benefit. Similarly, if a participant can elect to receive any portion of the accrued benefit in a single sum and the remainder pursuant to a set of distribution elections, the rules of this paragraph (c) are permitted to be applied separately to the set of distribution elections that apply to the portion of the participant's accrued benefit that is not payable in a single sum (for example, for the portion of a participant's benefit that is not paid in a single sum, the determination of whether any optional form of benefit is within a family of optional forms of benefit is permitted to be made disregarding the fact that the other portion of the participant's benefit is paid in a single sum).

(d) *Permissible elimination of noncore optional forms of benefit where core options are offered*—(1) *General rule.* Except as otherwise provided in paragraph (d)(2) of this section, a plan is permitted to be amended to eliminate an optional form of benefit for a participant with respect to benefits accrued before the applicable amendment date if—

(i) After the amendment becomes applicable, each of the core options described in paragraph (g)(5) of this section is available to the participant with respect to benefits accrued before and after the amendment;

(ii) The plan amendment is not applicable with respect to an optional form of benefit with an annuity commencement date that is earlier than 4 years after the date the amendment is adopted; and

(iii) The requirements of paragraph (e) of this section are satisfied in any case in which either:

(A) One or more of the core options are not available commencing on the same annuity commencement date as the optional form of benefit that is being eliminated; or

(B) As of the date the amendment is adopted, the actuarial present value of the benefit payable under any core option with the same annuity commencement date is less than the actuarial present value of benefits payable under the optional form of benefit that is being eliminated.

(2) *Special rules*—(i) *Treatment of certain features included in optional forms of benefit.* For purposes of applying this paragraph (d), to the extent an optional form of benefit that is being eliminated includes either a social security leveling feature or a refund of employee contributions feature, at least one of the core options must also be available with that feature, and, to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature or a refund of employee contributions feature, each of the core options must be available without that

feature. For purposes of applying this paragraph (d), to the extent an optional form of benefit that is being eliminated does not include a retroactive annuity starting date feature, each of the core options must be available without that feature.

(ii) *Eliminating the most valuable option for a participant with a short life expectancy*. For purposes of applying this paragraph (d), if the most valuable option for a participant with a short life expectancy (as defined in paragraph (g)(5)(iii) of this section) is eliminated, then, after the plan amendment, an optional form of benefit that is identical, except for differences described in paragraph (c)(3)(ii) of this section, must be available to the participant. However, such a plan amendment cannot eliminate a refund of employee contributions feature from the most valuable option for a participant with a short life expectancy.

(iii) *Single-sum distributions*. A plan amendment is not treated as satisfying this paragraph (d) if it eliminates an optional form of benefit that includes a single-sum distribution that applies with respect to at least 25% of the participant's accrued benefit as of the date the optional form of benefit is eliminated. But see §1.411(d)–4, Q&A–2(b)(2)(v), relating to involuntary single-sum distributions for benefits with a present value not in excess of the maximum dollar amount in section 411(a)(11).

(iv) *Application of multiple amendment rule to core option rule*. Notwithstanding paragraph (a)(2)(iii)(B) of this section, if a plan is amended to eliminate an optional form of benefit using the core options rule in this paragraph (d), then the employer must wait 3 years after the first annuity commencement date for which the optional form of benefit is no longer available before making any changes to the core options offered under the plan (other than a change that is not treated as an elimination under paragraph (b)(2)(ii) of this section). Thus, for example, if a plan amendment eliminates an optional form of benefit for a participant using the core options rule under this paragraph (d), with an adoption date of January 1, 2006 and an effective date of January 1, 2010, the plan would not be permitted to be amended to make changes to the core options offered under the plan (and the core options would continue to apply with respect to the participant's accrued benefit) until January 1, 2013.

(v) *Special rule for joint and contingent annuity core option*. If a plan offers joint and contingent annuities under which a participant is entitled to a life annuity with a survivor annuity for the individual designated by the participant (including a non-spousal contingent annuitant) with continuation percentage options of both 50% and 100% (after adjustments permitted under paragraph (g)(5)(ii) of this section to comply with applicable law), the plan is permitted to treat both of these options as core options for purposes of this paragraph (d), in lieu of a 75% joint and contingent annuity. Thus, such a plan is permitted to use the rules of this paragraph (d) if the plan satisfies all of the requirements of this paragraph (d) (taking into account the modification rule in paragraph (g)(5)(ii) of this section) other than the requirement of offering a 75% joint and contingent annuity as described in paragraph (g)(5)(i)(B) of this section.

(e) *Permissible plan amendments under paragraphs (c) and (d) eliminating or reducing section 411(d)(6)(B) protected benefits that are burdensome and of de minimis value*—(1) *In general*. A plan amendment that, pursuant to paragraph (c)(1)(iii) or (d)(1)(iii) of this section, is required to satisfy this paragraph (e) satisfies this paragraph (e) if—

(i) The amendment eliminates section 411(d)(6)(B) protected benefits that create significant burdens or complexities for the plan and its participants as described in paragraph (e)(2) of this section; and

(ii) The amendment does not adversely affect the rights of any participant in a more than *de minimis* manner as described in paragraph (e)(3) of this section.

(2) *Plan amendments eliminating section 411(d)(6)(B) protected benefits that create significant burdens and complexities*—(i) *Facts and circumstances analysis*—(A) *In general*. The determination of whether a plan amendment eliminates section 411(d)(6)(B) protected benefits that create significant burdens

or complexities for the plan and its participants is based on facts and circumstances.

(B) *Early retirement benefits.* In the case of an amendment that eliminates an early retirement benefit, relevant factors include whether the annuity starting dates under the plan considered in the aggregate are burdensome or complex (*e.g.*, the number of categories of early retirement benefits, whether the terms and conditions applicable to the plan's early retirement benefits are difficult to summarize in a manner that is concise and readily understandable to the average plan participant, and whether those different early retirement benefits were added to the plan as a result of a plan merger, transfer, or consolidation), and whether the effect of the plan amendment is to reduce the number of categories of early retirement benefits.

(C) *Retirement-type subsidies and actuarial factors.* In the case of a plan amendment eliminating a retirement-type subsidy or changing the actuarial factors used to determine optional forms of benefit, relevant factors include whether the actuarial factors used for determining optional forms of benefit available under the plan considered in the aggregate are burdensome or complex (*e.g.*, the number of different retirement-type subsidies and other actuarial factors available under the plan, whether the terms and conditions applicable to the plan's retirement-type subsidies are difficult to summarize in a manner that is concise and readily understandable to the average plan participant, whether the plan is eliminating one or more generalized optional forms, whether the plan is replacing a complex optional form of benefit that contains a retirement-type subsidy with a simpler form, and whether the different retirement-type subsidies and other actuarial factors were added to the plan as a result of a plan merger, transfer, or consolidation), and whether the effect of the plan amendment is to reduce the number of categories of retirement-type subsidies or other actuarial factors.

(D) *Example.* The following example illustrates the application of this paragraph (e)(2)(i):

Example. (i) *Facts.* Plan A is a defined benefit plan under which employees may select a distribution in the form of a straight life annuity, a straight life annuity with cost-of-living increases, a 50% qualified joint and survivor annuity with a pop-up provision, or a 10-year term certain and life annuity. On January 15, 2007, Plan A is amended, effective June 1, 2007, to eliminate the 50% qualified joint and survivor annuity with a pop-up provision as described in paragraph (c)(3)(ii)(B)(*1*) of this section and replace it with a 50% qualified joint and survivor annuity without the pop-up provision (and using the same actuarial factor).

(ii) *Conclusion.* Plan A satisfies the requirements of paragraph (e)(2)(i)(B) of this section because, based on the relevant facts and circumstances (*e.g.*, the amendment replaces a complex optional form of benefit with a simpler form), the amendment eliminates section 411(d)(6)(B) protected benefits that create significant burdens and complexities. Accordingly, the plan amendment is permitted to eliminate the pop-up provision, provided that the plan amendment satisfies all the other applicable requirements in paragraph (c) or (d) of this section. For example, the plan amendment must not eliminate the most valuable option for a participant with a short life expectancy (as defined in paragraph (g)(5)(iii) of this section) and the plan amendment must not adversely affect the rights of any participant in a more than *de minimis* manner, taking into account the actuarial factors for the joint and survivor annuity with the pop-up provision and the joint and survivor annuity without the pop-up provision, as described in paragraph (e)(3) of this section.

(ii) *Presumptions for certain amendments*—(A) *Presumption for amendments eliminating certain annuity starting dates.* If the annuity starting dates under the plan considered in the aggregate are burdensome or complex, then elimination of any one of the annuity starting dates is presumed to eliminate section 411(d)(6)(B) protected benefits that create significant burdens or complexities for the plan and its participants. However, if the effect of a plan amendment with respect to a set of optional forms of benefit is merely to substitute one set of annuity starting dates for another set of annuity starting dates, without any reduction in the number of different annuity starting dates, then the plan amendment does not satisfy the requirements of this paragraph (e)(2).

(B) *Presumption for amendments changing certain actuarial factors.* If the actuarial factors used for determining benefit distributions available under a generalized optional form considered in the aggregate are burdensome or complex, then replacing some of the actuarial factors for the generalized optional form is presumed to eliminate section 411(d)(6)(B) protected benefits that create significant burdens or complexities for the plan and its participants. However, if the effect is merely to substitute one set of actuarial factors for another set of actuarial factors, without any reduction in the number of different actuarial factors or the complexity of those factors, then the plan amendment does not satisfy the requirements of this paragraph (e)(2) unless the change of actuarial factors is merely to replace one or more of the plan's actuarial factors for determining optional forms of benefit with new actuarial factors that are more accurate (*e.g.*, reflecting more recent mortality experience or more recent market rates of interest).

(iii) *Restrictions against creating burdens or complexities.* See paragraphs (a)(2)(iii) and (b)(1)(iii) of this section for general rules applicable to multiple amendments. In accordance with these rules, a plan amendment does not eliminate a section 411(d)(6)(B) protected benefit that creates burdens and complexities for a plan and its participants if, less than 3 years earlier, a plan was previously amended to add another retirement-type subsidy in order to facilitate the elimination of the original retirement-type subsidy, even if the elimination of the other subsidy would not adversely affect the rights of any plan participant in a more than *de minimis* manner as provided in paragraph (e)(3) of this section.

(3) *Elimination of early retirement benefits or retirement-type subsidies that are de minimis*—(i) *Rules for retained optional forms of benefit under paragraph (c) of this section.* For purposes of paragraph (c) of this section, the elimination of an optional form of benefit does not adversely affect the rights of any participant in a more than *de minimis* manner if—

(A) The retained optional form of benefit described in paragraph (c) of this section has substantially the same annuity commencement date as the optional form of benefit that is being eliminated, as described in paragraph (e)(4) of this section; and

(B) Either the actuarial present value of the benefit payable in the optional form of benefit that is being eliminated does not exceed the actuarial present value of the benefit payable in the retained optional form of benefit by more than a *de minimis* amount, as described in paragraph (e)(5) of this section, or the amendment satisfies the requirements of paragraph (e)(6) of this section relating to a delayed effective date.

(ii) *Rules for core options under paragraph (d) of this section.* For purposes of paragraph (d) of this section, the elimination of an optional form of benefit does not adversely affect the rights of any participant in a more than *de minimis* manner if, with respect to each of the core options—

(A) The core option is available after the amendment with substantially the same annuity commencement date as the optional form of benefit that is being eliminated, as described in paragraph (e)(4) of this section; and

(B) Either the actuarial present value of the benefit payable in the optional form of benefit that is being eliminated does not exceed the actuarial present value of the benefit payable under the core option by more than a *de minimis* amount, as described in paragraph (e)(5) of this section, or the amendment satisfies the requirements of paragraph (e)(6) of this section.

(4) *Definition of substantially the same annuity starting dates.* For purposes of applying paragraphs (e)(3)(i)(A) and (ii)(A) of this section, annuity starting dates are considered substantially the same if they are within 6 months of each other.

(5) *Definition of de minimis difference in actuarial present value.* For purposes of applying paragraph (e)(3)(i)(B) and (ii)(B) of this section, a difference in actuarial present value between the optional form of benefit being eliminated and the retained optional form of benefit or core option is not more than a *de minimis* amount if, as of the date the

amendment is adopted, the difference between the actuarial present value of the eliminated optional form of benefit and the actuarial present value of the retained optional form of benefit or core option is not more than the greater of—

(i) 2% of the present value of the retirement-type subsidy (if any) under the eliminated optional form of benefit prior to the amendment; or

(ii) 1% of the greater of the participant's compensation (as defined in section 415(c)(3)) for the prior plan year or the participant's average compensation for his or her high 3 years (within the meaning of section 415(b)(1)(B) and (b)(3)).

(6) *Delayed effective date*—(i) *General rule*. For purposes of applying paragraph (e)(3)(i)(B) and (ii)(B) of this section, an amendment that eliminates an optional form of benefit satisfies the requirements of this paragraph (e)(6) if the elimination of the optional form of benefit is not applicable to any annuity commencement date before the end of the expected transition period for that optional form of benefit.

(ii) *Determination of expected transition period*—(A) *General rule*. The expected transition period for a plan amendment eliminating an optional form of benefit is the period that begins when the amendment is adopted and ends when it is reasonable to expect, with respect to a section 411(d)(6)(B) protected benefit (*i.e.*, not taking into account benefits that accrue in the future), that the form being eliminated would be subsumed by another optional form of benefit after taking into account expected future benefit accruals.

(B) *Determination of expected transition period using conservative actuarial assumptions*. The expected transition period for a plan amendment eliminating an optional form of benefit must be determined in accordance with actuarial assumptions that are reasonable at the time of the amendment and that are conservative (*i.e.*, reasonable actuarial assumptions that are likely to result in the longest period of time until the eliminated optional form of benefit would be subsumed). For this purpose, actuarial assumptions are not treated as conservative unless they include assumptions that a participant's compensation will not increase and that future benefit accruals will not exceed accruals in recent periods.

(C) *Effect of subsequent amendments reducing future benefit accruals on the expected transition period*. If, during the expected transition period for a plan amendment eliminating an optional form of benefit, the plan is subsequently amended to reduce the rate of future benefit accrual (or otherwise to lengthen the expected transition period), thus that subsequent plan amendment must provide that the elimination of the optional form of benefit is void or must provide for the effective date for elimination of the optional form of benefit to be further extended to a new expected transition period that satisfies this paragraph (e)(6) taking into account the subsequent amendment.

(iii) *Applicability of the delayed effective date rule limited to employees who continue to accrue benefits through the end of expected transition period*. An amendment eliminating an optional form of benefit under this paragraph (e)(6) must be limited to participants who continue to accrue benefits under the plan through the end of the expected transition period. Thus, for example, the plan amendment may not apply to any participant who has a severance from employment during the expected transition period.

(iv) *Special rule for section 204(h) notice*. See § 54.4980F–1(b), Q&A–8(c) of this chapter for a special rule relating to this paragraph (e)(6).

(f) *Utilization test*—(1) *General rule*. A plan is permitted to be amended to eliminate all of the optional forms of benefit that comprise a generalized optional form (as defined in paragraph (g)(8) of this section) for a participant with respect to benefits accrued before the applicable amendment date if—

(i) None of the optional forms of benefit being eliminated is a core option, within the meaning of paragraph (g)(5) of this section;

(ii) The plan amendment is not applicable with respect to an optional form of benefit with an annuity commencement date that is earlier than the number of days in the maximum Qualified Joint and Survivor Annuity explanation period (as defined in paragraph

(g)(9) of this section) after the date the amendment is adopted;

(iii) During the look-back period—

(A) The generalized optional form has been available to at least the applicable number of participants who are taken into account under paragraph (f)(3) and (4) of this section; and

(B) No participant has elected any optional form of benefit that is part of the generalized optional form with an annuity commencement date that is within the look-back period.

(2) *Look-back period*—(i) *In general*. For purposes of this paragraph (f), the look-back period is the period that includes—

(A) The portion of the plan year in which such plan amendment is adopted that precedes the date of adoption (the pre-adoption period); and

(B) The 2 plan years immediately preceding the pre-adoption period.

(ii) *Special look-back period rules*—(A) *12-month plan year*. In the look-back period, at least 1 of the plan years must be a 12-month plan year.

(B) *Permitted 3-month exclusion in the pre-adoption period*. A plan is permitted to exclude from the look-back period the calendar month in which the amendment is adopted and the preceding 1 or 2 calendar months to the extent those preceding months are contained within the pre-adoption period.

(C) *Permission to extend the look-back period*. In order to have a look-back period that satisfies the minimum applicable number of participants requirement in paragraph (f)(1)(iii)(A) of this section, the look-back period described in paragraph (f)(2)(i)(B) of this section is permitted to be expanded, so as to include the 3, 4, or 5 plan years immediately preceding the plan year in which the amendment is adopted. Thus, in determining the look-back period, a plan is permitted to substitute the 3, 4, or 5 plan years immediately preceding the pre-adoption period for the 2 plan years described in paragraph (f)(2)(i)(B) of this section. However, if a plan does not satisfy the minimum applicable number of participants requirement of paragraph (f)(1)(iii)(A) of this section using the pre-adoption period and the immediately preceding 5 plan years, the plan is not permitted to be amended in accordance with the utilization test in this paragraph (f).

(3) *Participants taken into account*. A participant is taken into account for purposes of this paragraph (f) only if the participant was eligible to elect to commence payment of an optional form of benefit that is part of the generalized optional form being eliminated with an annuity commencement date that is within the look-back period. However, a participant is not taken into account if the participant—

(i) Did not elect any optional form of benefit with an annuity commencement date that was within the look-back period;

(ii) Elected an optional form of benefit that included a single-sum distribution that applied with respect to at least 25% of the participant's accrued benefit;

(iii) Elected an optional form of benefit that was only available during a limited period of time and that contained a retirement-type subsidy where the subsidy that is part of the generalized optional form being eliminated was not extended to any optional form of benefit with the same annuity commencement date; or

(iv) Elected an optional form of benefit with an annuity commencement date that was more than 10 years before normal retirement age.

(4) *Determining the applicable number of participants*. For purposes of applying the rules in this paragraph (f), the applicable number of participants is 50 participants. However, notwithstanding paragraph (f)(3)(ii) of this section, a plan is permitted to take into account any participant who elected an optional form of benefit that included a single-sum distribution that applied with respect to at least 25% of the participant's accrued benefit, but only if the applicable number of participants is increased to 1,000 participants.

(5) *Default elections*. For purposes of this paragraph (f), an election includes the payment of an optional form of benefit that applies in the absence of an affirmative election.

(g) *Definitions and use of terms*. The definitions in this paragraph (g) apply for purposes of this section.

(1) *Actuarial present value*. The term *actuarial present value* means actuarial

present value (within the meaning of § 1.401(a)(4)–12) determined using reasonable actuarial assumptions.

(2) *Ancillary benefit*. The term *ancillary benefit* means—

(i) A social security supplement under a defined benefit plan (other than a QSUPP as defined in § 1.401(a)(4)–12);

(ii) A benefit payable under a defined benefit plan in the event of disability (to the extent that the benefit exceeds the benefit otherwise payable), but only if the total benefit payable in the event of disability does not exceed the maximum qualified disability benefit, as defined in section 411(a)(9);

(iii) A life insurance benefit;

(iv) A medical benefit described in section 401(h);

(v) A death benefit under a defined benefit plan other than a death benefit which is a part of an optional form of benefit; or

(vi) A plant shutdown benefit or other similar benefit in a defined benefit plan that does not continue past retirement age and does not affect the payment of the accrued benefit, but only to the extent that such plant shutdown benefit, or other similar benefit (if any), is permitted in a qualified pension plan (see § 1.401–1(b)(1)(i)).

(3) *Annuity commencement date*. The term *annuity commencement date* generally means the annuity starting date, except that, in the case of a retroactive annuity starting date under section 417(a)(7), *annuity commencement date* means the date of the first payment of benefits pursuant to a participant election of a retroactive annuity starting date, as defined in § 1.417(e)–1(b)(3)(iv).

(4) *Applicable amendment date*. The term *applicable amendment date*, with respect to a plan amendment, means the later of the effective date of the amendment or the date the amendment is adopted.

(5) *Core options*—(i) *General rule*. With respect to a plan, the term *core options* means—

(A) A straight life annuity generalized optional form under which the participant is entitled to a level life annuity with no benefit payable after the participant's death;

(B) A 75% joint and contingent annuity generalized optional form under which the participant is entitled to a life annuity with a survivor annuity for any individual designated by the participant (including a non-spousal contingent annuitant) that is 75% of the amount payable during the participant's life (but see paragraph (d)(2)(v) of this section for a special rule relating to the joint and contingent annuity core option);

(C) A 10-year term certain and life annuity generalized optional form under which the participant is entitled to a life annuity with a guarantee that payments will continue to any person designated by the participant for the remainder of a fixed period of 10 years if the participant dies before the end of the 10-year period; and

(D) The most valuable option for a participant with a short life expectancy (as defined in paragraph (g)(5)(iii) of this section).

(ii) *Modification of core options to satisfy other requirements*. An annuity does not fail to be a core option (*e.g.*, a joint and contingent annuity described in paragraph (g)(5)(i)(B) of this section or a 10-year term certain and life annuity described in paragraph (g)(5)(i)(C) of this section) as a result of differences to comply with applicable law, such as limitations on death benefits to comply with the incidental benefit requirement of § 1.401–1(b)(1)(i) or on account of the spousal consent rules of section 417.

(iii) *Most valuable option for a participant with a short life expectancy*—(A) *General definition*. Except as provided in paragraph (g)(5)(iii)(B) of this section, *most valuable option for a participant with a short life expectancy* means, for an annuity starting date, the optional form of benefit that is reasonably expected to result in payments that have the largest actuarial present value in the case of a participant who dies shortly after the annuity starting date, taking into account both payments due to the participant prior to the participant's death and any payments due after the participant's death. For this purpose, a plan is permitted to assume that the spouse of the participant is the same age as the participant. In addition, a plan is permitted to assume that the optional form of benefit that

is the most valuable option for a participant with a short life expectancy when the participant is age 70½ also is the most valuable option for a participant with a short life expectancy at all older ages, and that the most valuable option for a participant with a short life expectancy at age 55 is the most valuable option for a participant with a short life expectancy at all younger ages.

(B) *Safe harbor hierarchy*—(*1*) A plan is permitted to treat a single-sum distribution option with an actuarial present value that is not less than the actuarial present value of any optional form of benefit eliminated by the plan amendment as the most valuable option for a participant with a short life expectancy for all of a participant's annuity starting dates if such single-sum distribution option is available at all such dates, without regard to whether the option was available before the plan amendment.

(*2*) If the plan before the amendment does not offer a single-sum distribution option as described in paragraph (g)(5)(iii)(B)(*1*) of this section, a plan is permitted to treat a joint and contingent annuity with a continuation percentage that is at least 75% and that is at least as great as the highest continuation percentage available before the amendment as the most valuable option for a participant with a short life expectancy for all of a participant's annuity starting dates if such joint and contingent annuity is available at all such dates, without regard to whether the option was available before the plan amendment.

(*3*) If the plan before the amendment offers neither a single-sum distribution option as described in paragraph (g)(5)(iii)(B)(*1*) of this section nor a joint and contingent annuity with a continuation percentage as described in paragraph (g)(5)(iii)(B)(*2*) of this section, a plan is permitted to treat a term certain and life annuity with a term certain period no less than 15 years as the most valuable option for a participant with a short life expectancy for each annuity starting date if such 15-year term certain and life annuity is available at all annuity starting dates, without regard to whether the option was available before the plan amendment.

(6) *Definitions of types of section 411(d)(6)(B) protected benefits*—(i) *Early retirement benefit*. The term *early retirement benefit* means the right, under the terms of a plan, to commence distribution of a retirement-type benefit at a particular date after severance from employment with the employer and before normal retirement age. Different early retirement benefits result from differences in terms relating to timing.

(ii) *Optional form of benefit*—(A) *In general*. The term *optional form of benefit* means a distribution alternative (including the normal form of benefit) that is available under the plan with respect to an accrued benefit or a distribution alternative with respect to a retirement-type benefit. Different optional forms of benefit exist if a distribution alternative is not payable on substantially the same terms as another distribution alternative. The relevant terms include all terms affecting the value of the optional form, such as the method of benefit calculation and the actuarial factors or assumptions used to determine the amount distributed. Thus, for example, different optional forms of benefit may result from differences in terms relating to the payment schedule, timing, commencement, medium of distribution (*e.g.*, in cash or in kind), election rights, differences in eligibility requirements, or the portion of the benefit to which the distribution alternative applies. Likewise, differences in the normal retirement ages of employees or in the form in which the accrued benefit of employees is payable at normal retirement age under a plan are taken into account in determining whether a distribution alternative constitutes one or more optional forms of benefit.

(B) *Death benefits*. If a death benefit is payable after the annuity starting date for a specific optional form of benefit and the same death benefit would not be provided if another optional form of benefit were elected by a participant, then that death benefit is part of the specific optional form of benefit and is thus protected under section 411(d)(6). A death benefit is not treated as part of a specific optional form of benefit merely because the

same benefit is not provided to a participant who has received his or her entire accrued benefit prior to death. For example, a $5,000 death benefit that is payable to all participants except any participant who has received his or her accrued benefit in a single-sum distribution is not part of a specific optional form of benefit.

(iii) *Retirement-type benefit*. The term *retirement-type benefit* means—

(A) The payment of a distribution alternative with respect to an accrued benefit; or

(B) The payment of any other benefit under a defined benefit plan (including a QSUPP as defined in §1.401(a)(4)–12) that is permitted to be in a qualified pension plan, continues after retirement, and is not an ancillary benefit.

(iv) *Retirement-type subsidy*. The term *retirement-type subsidy* means the excess, if any, of the actuarial present value of a retirement-type benefit over the actuarial present value of the accrued benefit commencing at normal retirement age or at actual commencement date, if later, with both such actuarial present values determined as of the date the retirement-type benefit commences. Examples of retirement-type subsidies include a subsidized early retirement benefit and a subsidized qualified joint and survivor annuity.

(v) *Subsidized early retirement benefit or early retirement subsidy*. The terms *subsidized early retirement benefit* or *early retirement subsidy* mean the right, under the terms of a plan, to commence distribution of a retirement-type benefit at a particular date after severance from employment with the employer and before normal retirement age where the actuarial present value of the optional forms of benefit available to the participant under the plan at that annuity starting date exceeds the actuarial present value of the accrued benefit commencing at normal retirement age (with such actuarial present values determined as of the annuity starting date). Thus, an early retirement subsidy is an early retirement benefit that provides a retirement-type subsidy.

(7) *Eliminate; elimination; reduce; reduction*. The terms *eliminate* or *elimination* when used in connection with a section 411(d)(6)(B) protected benefit mean to eliminate or the elimination of an optional form of benefit or an early retirement benefit and to reduce or a reduction in a retirement-type subsidy. The terms *reduce* or *reduction* when used in connection with a retirement-type subsidy mean to reduce or a reduction in the amount of the subsidy. For purposes of this section, an *elimination* includes a *reduction* and a *reduction* includes an *elimination*.

(8) *Generalized optional form*. The term *generalized optional form* means a group of optional forms of benefit that are identical except for differences due to the actuarial factors that are used to determine the amount of the distributions under those optional forms of benefit and the annuity starting dates.

(9) *Maximum QJSA explanation period*. The term *maximum QJSA explanation period* means the maximum number of days before an annuity starting date for a qualified joint and survivor annuity for which a written explanation relating to the qualified joint and survivor annuity would satisfy the timing requirements of section 417(a)(3) and §1.417(e)–1(b)(3)(ii).

(10) *Other right and feature*. The term *other right or feature* has the meaning set forth at §1.401(a)(4)–4(e)(3)(ii).

(11) *Refund of employee contributions feature*. The term *refund of employee contributions features* means a feature with respect to an optional form of benefit that provides for employee contributions and interest thereon to be paid in a single sum at the annuity starting date with the remainder to be paid in another form beginning on that date.

(12) *Retirement; retirement age*. For purposes of this section, the date of *retirement* means the annuity starting date. Thus, *retirement age* means a participant's age at the annuity starting date.

(13) *Retroactive annuity starting date feature*. The term *retroactive annuity starting date* feature means a feature with respect to an optional form of benefit under which the annuity starting date for the distribution occurs on or before the date the written explanation required by section 417(a)(3) is provided to the participant.

(14) *Section 411(d)(6) protected benefit*. The term *section 411(d)(6) protected benefit* means the accrued benefit of a participant as of the applicable amendment date described in section 411(d)(6)(A) and any section 411(d)(6)(B) protected benefit.

(15) *Section 411(d)(6)(B) protected benefit*. The term *section 411(d)(6)(B) protected benefit* means the portion of an early retirement benefit, a retirement-type subsidy, or an optional form of benefit attributable to benefits accrued before the applicable amendment date.

(16) *Social security leveling feature*. The term *social security leveling feature* means a feature with respect to an optional form of benefit commencing prior to a participant's expected commencement of social security benefits that provides for a temporary period of higher payments which is designed to result in an approximately level amount of income when the participant's estimated old age benefits from Social Security are taken into account.

(h) *Examples*. The following examples illustrate the application of paragraphs (c) through (g) of this section:

Example 1. (i) *Facts involving elimination of optional forms of benefit as redundant*. Plan C is a defined benefit plan under which employees may elect to commence distributions at any time after the later of termination of employment or attainment of age 55. At each potential annuity commencement date, Plan C permits employees to select, with spousal consent where required, a straight life annuity or any of a number of actuarially equivalent alternative forms of payment, including a straight life annuity with cost-of-living increases and a joint and contingent annuity with the participant having the right to select any beneficiary and any continuation percentage from 1% to 100%, subject to modification to the extent necessary to satisfy the requirements of the incidental benefit requirement of §1.401–1(b)(1)(i). The amount of any alternative payment is determined as the actuarial equivalent of the straight life annuity payable at the same age using reasonable actuarial assumptions. On June 2, 2006, Plan C is amended to delete all continuation percentages for joint and contingent options other than 25%, 50%, 75%, or 100%, effective with respect to annuity commencement dates that are on or after January 1, 2007.

(ii) *Conclusion*—(A) *Categorization of family members under the redundancy rule*. The optional forms of benefit described in paragraph (i) of this *Example 1* are members of 4 families: a straight life annuity; a straight life annuity with cost-of-living increases; joint and contingent options with continuation percentages of less than 50%; and joint and contingent options with continuation percentages of 50% or more. The amendment does not affect either of the first 2 families, but affects the 2 families relating to joint and contingent options.

(B) *Conclusion for elimination of optional forms of benefit as redundant*. The amendment satisfies the requirements of paragraph (c) of this section. First, the eliminated optional forms of benefit are redundant with respect to the retained optional forms of benefit because each eliminated joint and contingent annuity option with a continuation percentage of less than 50% is redundant with respect to the 25% continuation option and each eliminated joint and contingent annuity option with a continuation percentage of 50% or higher is redundant with respect to any one of the retained 50%, 75%, or 100% continuation options. In addition, to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature, return of employee contribution feature, or retroactive annuity starting date feature, the retained optional form of benefit does not include that feature. Second, the amendment is not effective with respect to annuity commencement dates before September 1, 2006, as required under paragraph (c)(1)(ii) of this section. Third, the plan amendment does not eliminate any available core option, including the most valuable option for a participant with a short life expectancy, treating a joint and contingent annuity with a 100% continuation percentage as this optional form of benefit pursuant to paragraph (g)(5)(iii)(B)(2) of this section. Finally, the amendment need not satisfy the requirements of paragraph (e) of this section because the retained optional forms of benefit are available on the same annuity commencement dates and have the same actuarial present value as the optional forms of benefit that are being eliminated.

Example 2. (i) *Facts involving elimination of optional forms of benefit as redundant if additional restrictions are imposed*. The facts are the same as *Example 1*, except that the plan amendment also restricts the class of beneficiaries that may be elected under the 4 retained joint and contingent annuities to the employee's spouse.

(ii) *Conclusion*. The amendment fails to satisfy the requirements of paragraph (c)(2)(i)(B) of this section because the retained joint and contingent annuities have materially greater restrictions on the beneficiary designation than did the eliminated joint and contingent annuities. Thus, the joint and contingent annuities being eliminated are not redundant with respect to the retained joint and contingent annuities. In addition, the amendment fails to satisfy the

requirements of the core option rules in paragraph (d) of this section because the amendment fails to be limited to annuity commencement dates that are at least 4 years after the date the amendment is adopted, the amendment fails to include the core option in paragraph (g)(5)(i)(B) of this section because the participant does not have the right to designate any beneficiary, and the amendment fails to include the core option described in paragraph (g)(5)(i)(C) of this section because the plan does not provide a 10-year term certain and life annuity.

Example 3. (i) *Facts involving elimination of a social security leveling feature and a period certain annuity as redundant.* Plan D is a defined benefit plan under which participants may elect to commence distributions in the following actuarially equivalent forms, with spousal consent if applicable: a straight life annuity; a 50%, 75%, or 100% joint and contingent annuity; a 5-year, 10-year, or a 15-year term certain and life annuity; and an installment refund annuity (*i.e.*, an optional form of benefit that provides a period certain, the duration of which is based on the participant's age), with the participant having the right to select any beneficiary. In addition, each annuity offered under the plan, if payable to a participant who is less than age 65, is available both with and without a social security leveling feature. The social security leveling feature provides for an assumed commencement of social security benefits at any age selected by the participant between age 62 and 65. Plan D is amended on June 2, 2006, effective as of January 1, 2007, to eliminate the installment refund form of benefit and to restrict the social security leveling feature to an assumed social security commencement age of 65.

(ii) *Conclusion.* The amendment satisfies the requirements of paragraph (c) of this section. First, the installment refund annuity option is redundant with respect to the 15-year certain and life annuity (except for advanced ages where, because of shorter life expectancies, the installment refund annuity option is redundant with respect to the 5-year certain and life annuity and also redundant with respect to the 10-year certain and life annuity). Second, with respect to restricting the social security leveling feature to an assumed social security commencement age of 65, under paragraph (c)(3)(ii)(C) of this section, straight life annuities with social security leveling features that have different social security commencement ages are treated as members of the same family as straight life annuities without social security leveling features. To the extent an optional form of benefit that is being eliminated includes a social security leveling feature, the retained optional form of benefit must also include that feature, but it is permitted to have a different assumed age for commencement of social security benefits. Third, to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature, a return of employee contribution feature, or retroactive annuity starting date feature, the retained optional form of benefit must not include that feature. Fourth, the plan amendment does not eliminate any available core option, including the most valuable option for a participant with a short life expectancy, treating a joint and contingent annuity with a 100% continuation percentage as this optional form of benefit pursuant to paragraph (g)(5)(iii)(B)(*2*) of this section. Fifth, the amendment is not effective with respect to annuity commencement dates before September 1, 2006, as required under paragraph (c)(1)(ii) of this section. The amendment need not satisfy the requirements of paragraph (e) of this section because the retained optional forms of benefit are available on the same annuity commencement dates and have the same actuarial present value as the optional forms of benefit that are being eliminated.

Example 4. (i) *Facts involving elimination of noncore options.* Employer N sponsors Plan E, a defined benefit plan that permits every participant to elect payment in the following actuarially equivalent optional forms of benefit (Plan E's uniformly available options), with spousal consent if applicable: a straight life annuity; a 50%, 75%, or 100% joint and contingent annuity with no restrictions on designation of beneficiaries; and a 5-, 10-, or 15-year term certain and life annuity. In addition, each can be elected in conjunction with a social security leveling feature, with the participant permitted to select a social security commencement age from age 62 to age 67. None of Plan E's uniformly available options include a single-sum distribution. The plan has been in existence for over 30 years, during which time Employer N has acquired a large number of other businesses, including merging over 20 defined benefit plans of acquired entities into Plan E. Many of the merged plans offered optional forms of benefit that were not among Plan E's uniformly available options, including some plans funded through insurance products, often offering all of the insurance annuities that the insurance carrier offers, and with some of the merged plans offering single-sum distributions. In particular, under the XYZ acquisition that occurred in 1990, the XYZ acquired plan offered a single-sum distribution option that was frozen at the time of the acquisition. On April 1, 2006, each single-sum distribution option applies to less than 25% of the XYZ participants' accrued benefits. Employer N has generally, but not uniformly, followed the practice of limiting the optional forms of benefit for an acquired unit to an employee's service before the date of the merger, and

has uniformly followed this practice with respect to each of the early retirement subsidies in the acquired unit's plan. As a result, as of April 1, 2007, Plan E includes a large number of generalized optional forms which are not members of families of optional forms of benefit identified in paragraph (c)(4) of this section, but there are no participants who are entitled to any early retirement subsidies because any subsidies have been subsumed by the actuarially reduced accrued benefit. Plan E is amended in April of 2007 to eliminate all of the optional forms of benefit that Plan E offers other than Plan E's uniformly available options, except that the amendment does not eliminate any single-sum distribution option except with respect to XYZ participants and permits any commencement date that was permitted under Plan E before the amendment. Plan E also eliminates the single-sum distribution option for XYZ participants. Further, each of Plan E's uniformly available options has an actuarial present value that is not less than the actuarial present value of any optional form of benefit offered before the amendment. The amendment is effective with respect to annuity commencement dates that are on or after May 1, 2011.

(ii) *Conclusion.* The amendment satisfies the requirements of paragraph (d) of this section. First, Plan E, as amended, does not eliminate any single-sum distribution option as provided in paragraph (d)(2)(iii) of this section except for single-sum distribution options that apply to less than 25% of a plan participant's accrued benefit as of the date the option is eliminated (May 1, 2011). Second, Plan E, as amended, includes each of the core options as defined in paragraph (g)(5) of this section, including offering the most valuable option for a participant with a short life expectancy (treating the 100% joint and contingent annuity as this benefit, under paragraph (g)(5)(iii)(B)(*2*) of this section). The 100% joint and contingent annuity option (and not the grandfathered single-sum distribution option) is the most valuable option for a participant with a short life expectancy because the grandfathered single-sum distribution option is not available with respect to a participant's entire accrued benefit. In addition, as required under paragraph (d)(2) of this section, to the extent an optional form of benefit that is being eliminated includes either a social security leveling feature or a refund of employee contributions feature, at least one of the core options is available with that feature and, to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature or a refund of employee contributions feature, each of the core options is available without that feature. Third, the amendment is not effective with respect to annuity commencement dates that are less than 4 years after the date the amendment is adopted. Finally, the amendment need not satisfy the requirements of paragraph (e) of this section because the retained optional forms of benefit are available on the same annuity commencement date and have the same actuarial present value as the optional forms of benefit that are being eliminated. The conclusion that the amendment satisfies the requirements of paragraph (d) of this section assumes that no amendments are made to change the core options before May 1, 2014.

Example 5. (i) *Facts involving reductions in actuarial present value.* (A) Plan F is a defined benefit plan providing an accrued benefit of 1% of the average of a participant's highest 3 consecutive years' pay times years of service, payable as a straight life annuity beginning at the normal retirement age at age 65. Plan F permits employees to elect to commence actuarially reduced distributions at any time after the later of termination of employment or attainment of age 55. At each potential annuity commencement date, Plan F permits employees to select, with spousal consent, either a straight life annuity, a joint and contingent annuity with the participant having the right to select any beneficiary and a continuation percentage of 50%, 66 2/3%, 75%, or 100%, or a 10-year certain and life annuity with the participant having the right to select any beneficiary, subject to modification to the extent necessary to satisfy the requirements of the incidental benefit requirement of §1.401–1(b)(1)(i). The amount of any joint and contingent annuity and the 10-year certain and life annuity is determined as the actuarial equivalent of the straight life annuity payable at the same age using reasonable actuarial assumptions. The plan covers employees at 4 divisions, one of which, Division X, was acquired on January 1, 1999. The plan provides for distributions before normal retirement age to be actuarially reduced, but, if a participant retires after attainment of age 55 and completion of 10 years of service, the applicable early retirement reduction factor is 3% per year for the years between age 65 and 62 and 6% per year for the ages from 62 to 55 for all employees at any division, except for employees who were in Division X on January 1, 1999, for whom the early retirement reduction factor for retirement after age 55 and 10 years of service is 5% for each year before age 65. On June 2, 2006, effective January 1, 2007, Plan F is amended to change the early retirement reduction factors for all employees of Division X to be the same as for other employees, effective with respect to annuity commencement dates that are on or after January 1, 2008, but only with respect to participants who are employees on or after January 1, 2008 and only if Plan F continues accruals at the current rate through January 1, 2008 (or the effective date of the change in reduction factors is delayed to reflect the

change in the accrual rate). For purposes of this *Example 5*, it is assumed that an actuarially equivalent early retirement factor would have a reduction shown in column 4 of the following table, which compares the reduction factors for Division X before and after the amendment:

Age (1)	Old division X factor (as a %) (2)	New factor (as a %) (3)	Actuarially equivalent factor (as a %) (4)	Column 3 minus column 2 (5)
65	NA	NA	NA	NA
64	95	97	91.1	+ 2
63	90	94	83.2	+ 4
62	85	91	76.1	+ 5
61	80	85	69.8	+ 5
60	75	79	64.1	+ 4
59	70	73	59.0	+ 3
58	65	67	54.3	+ 2
57	60	61	50.1	+ 1
56	55	55	46.3	0
55	50	49	42.8	-1

(B) On January 1, 2007, the employee with the largest number of years of service is Employee E, who is age 54 and has 20 years of service. For 2006, Employee E's compensation is $80,000 and E's highest 3 consecutive years of pay on January 1, 2007 is $75,000. Employee E's accrued benefit as of the January 1, 2007 effective date of the amendment is a life annuity of $15,000 per year at normal retirement age (1% times $75,000 times 20 years of service) and E's early retirement benefit commencing at age 55 has a present value of $91,397 as of January 1, 2007. It is assumed for purposes of this example that the longest expected transition period for any active employee does not exceed 5 months (20 years and 5 months, times 1% times 49% exceeds 20 years times 1% times 50%). Finally, it is assumed for purposes of this example that the amendment reduces optional forms of benefit which are burdensome or complex.

(ii) *Conclusion concerning application of section 411(d)(6)(B).* The amendment reducing the early retirement factors has the effect of eliminating the existing optional forms of benefit (where the amount of the benefit is based on preamendment early retirement factors in any case where the new factors result in a smaller amount payable) and adding new optional forms of benefit (where the amount of benefit is based on the different early retirement factors). Accordingly, the elimination must satisfy the requirements of paragraph (c) or (d) of this section if the amount payable at any date is less than would have been payable under the plan before the amendment.

(iii) *Conclusion concerning application of redundancy rules.* The amendment satisfies the requirements of paragraph (c)(1)(i) and (ii) of this section (see paragraphs (iv) through (vi) of this *Example 5* below for the requirements of paragraph (c)(1)(iii) of this section). First, with respect to each eliminated optional form of benefit (*i.e.*, with respect to each optional form of benefit with the Old Division X Factor), after the amendment there is a retained optional form of benefit that is in the same family of optional forms of benefit (*i.e.*, the optional form of benefit with the New Factor). Second, the amendment is not effective with respect to annuity commencement dates that are less than the time period required under paragraph (c)(1)(ii) of this section. Third, to the extent that the plan amendment eliminates the most valuable option for a participant with a short life expectancy, the retained optional form of benefit is identical except for differences in actuarial factors.

(iv) *Conclusion concerning application of the requirements under paragraph (e) of this section.* The plan amendment must satisfy the requirements of paragraph (e) of this section because, as of the December 2, 2006 adoption date, the actuarial present value of the early retirement subsidy is less than the actuarial present value of the early retirement subsidy being eliminated. The plan amendment satisfies the requirements under paragraph (e)(1)(i) and (2) of this section because the amendment eliminates optional forms of benefit that create significant burdens or complexities for the plan and its participants. See below for the *de minimis* requirement under paragraph (e)(1)(ii) and (3) of this section.

(v) *Conclusion concerning application of de minimis rules under paragraph (e)(5) of this section.* In order to satisfy the requirements under paragraph (e)(1)(ii) and (3) of this section, the amendment must satisfy the requirements of either paragraph (e)(5) or paragraph (e)(6) of this section. The amendment does not satisfy the requirements of paragraph (e)(5) of this section because the reduction in the actuarial present value is more than a *de minimis* amount under paragraph

(e)(5) of this section. For example, for Employee E, the amount of the joint and contingent annuity payable at age 55 is reduced from $7,500 (50% of $15,000) to $7,350 (49% of $15,000) and the reduction in present value as a result of the amendment is $1,828 ($91,397—$89,569). In this case, the retirement-type subsidy at age 55 is the excess of the present value of the 50% early retirement benefit over the present value of the deferred payment of the accrued benefit, or $13,921 ($97,269—$83,348) and the present value at age 54 of the retirement-type subsidy is $13,081. The reduction in present value is more than the greater of 2% of the present value of the retirement-type subsidy and 1% of E's compensation because the reduction in present value exceeds $800 (the greater of $262, which is 2% of the present value of the retirement-type subsidy for the benefit being eliminated, and $800, which is 1% of E's compensation of $80,000).

(vi) *Conclusion involving application of de minimis rules under paragraph (e)(6) of this section relating to expected transition period.* The amendment satisfies the requirements of paragraph (e)(6) of this section and, thus, satisfies the requirements of paragraph (c) of this section, including the requirement in paragraph (c)(1)(iii) of this section that paragraph (e) of this section be satisfied. First, as assumed under the facts above, the amendment reduces optional forms of benefit that are burdensome or complex. Second, the plan amendment is not effective for annuity commencement dates before January 1, 2008, and that date is not earlier than the longest expected transition period for any participant in Plan F on the date of the amendment. Third, the amendment does not apply to any participant who has a severance from employment during the transition period. If, however, a later plan amendment reduces accruals under Plan F, the initial plan amendment will no longer satisfy the requirements of paragraph (e)(6) of this section (and must be voided) unless, as part of the later amendment, the expected transition period is extended to reflect the reduction in accruals under Plan F.

Example 6. (i) *Facts involving elimination of noncore options using utilization test*—(A) *In general.* Plan G is a calendar year defined benefit plan under which participants may elect to commence distributions after termination of employment in the following actuarially equivalent forms, with spousal consent, if applicable: a straight life annuity; a 50%, 75%, or 100% joint and contingent annuity; or a 5-year, 10-year, or a 15-year term certain and life annuity. A participant is permitted to elect a single-sum distribution if the present value of the participant's nonforfeitable accrued benefit is not greater than $5,000. The annuities offered under the plan are generally available both with and without a social security leveling feature. The social security leveling feature provides for an assumed commencement of social security benefits at any age selected by the participant between the ages of 62 and 67. Under Plan G, the normal retirement age is defined as age 65.

(B) *Utilization test.* In 2007, the plan sponsor of Plan G, after reviewing participants' benefit elections, determines that, during the period from January 1, 2005, through June 30, 2007, no participant has elected a 5-year term certain and life annuity with a social security leveling option. During that period, Plan G has made the 5-year term certain and life annuity with a social security leveling option available to 142 participants who were at least age 55 and who elected optional forms of benefit with an annuity commencement dates during that period. In addition, during that period, 20 of the 142 participants elected a single-sum distribution and there was no retirement-type subsidy available for a limited period of time. Plan G, in accordance with paragraph (f)(1) of this section, is amended on September 15, 2007, effective as of January 1, 2008, to eliminate all 5-year term certain and life annuities with a social security leveling option for all annuity commencement dates on or after January 1, 2008.

(ii) *Conclusion.* The amendment satisfies the requirements of paragraph (f) of this section. First, the 5-year term certain and life annuity with a social security leveling option is not a core option as defined in paragraph (g)(5) of this section. Second, the plan amendment is not applicable with respect to an optional form of benefit with an annuity commencement date that is earlier than the number of days in the maximum QJSA explanation period after the date the amendment is adopted. Third, the 5-year term certain and life annuity with a social security leveling option has been available to at least 50 participants who are taken into account for purposes of paragraph (f) of this section during the look-back period. Fourth, during the look-back period, no participant elected any optional form that is part of the generalized optional form being eliminated (for example, the 5-year term and life annuity with a social security leveling option).

(i) [Reserved]

(j) *Effective dates*—(1) *General effective date.* Except as otherwise provided in this paragraph (j), the rules of this section apply to amendments adopted on or after August 12, 2005.

(2) *Effective date for rules relating to contingent event benefits.* Paragraph (b)(1)(ii) of this section applies to amendments adopted after December 31, 2005.

(3) *Effective dates for rules relating to section 411(a) nonforfeitability provisions*—(i) *Application of suspension of*

benefit rules to section 411(d)(6) protected benefits. With respect to a plan amendment that places greater restrictions or conditions on a participant's rights to section 411(d)(6) protected benefits by adding or modifying a plan provision relating to suspension of benefit payments during a period of employment or reemployment, the rules provided in paragraph (a)(3) of this section apply to periods beginning on or after June 7, 2004.

(ii) *Application of section 411(a) nonforfeitability provisions to section 411(d)(6) protected benefits*. With respect to a plan amendment that places greater restrictions or conditions on a participant's rights to section 411(d)(6) protected benefits other than a plan amendment described in paragraph (j)(3)(i) of this section, the rules provided in paragraph (a)(3) of this section apply to plan amendments adopted after August 9, 2006.

(4) *Effective date for change to redundancy rule regarding bifurcation of benefits*. The rules provided in paragraph (c)(6) of this section are applicable for amendments adopted after August 9, 2006.

(5) *Effective date for rules relating to utilization test*. The rules provided in paragraph (f) of this section are applicable for amendments adopted after December 31, 2006.

[T.D. 9219, 70 FR 47116, Aug. 12, 2005, as amended by T.D. 9280, 71 FR 45383, Aug. 9, 2006; 71 FR 55108, Sept. 21, 2006; T.D. 9472, 74 FR 61276, Nov. 24, 2009]

§ 1.411(d)–4 Section 411(d)(6) protected benefits.

Q–1: What are ''section 411(d)(6) protected benefits''?

A–1: (a) *In general*. The term ''section 411(d)(6) protected benefit'' includes any benefit that is described in one or more of the following categories—

(1) Benefits described in section 411(d)(6)(A),

(2) Early retirement benefits (as defined in §1.411(d)–3(g)(6)(i)) and retirement-type subsidies (as defined in §1.411(d)–3(g)(6)(iv)), and

(3) Optional forms of benefit described in section 411(d)(6)(B)(ii).

Such benefits, to the extent they have accrued, are subject to the protection of section 411(d)(6) and, where applicable, the definitely determinable requirement of section 401(a) (including section 401(a)(25)) and cannot, therefore, be reduced, eliminated, or made subject to employer discretion except to the extent permitted by regulations.

(b) *Optional forms of benefit*—(1) *In general*. The term *optional form of benefit* has the same meaning as in §1.411(d)–3(g)(6)(ii). Under this definition, different optional forms of benefit exist if a distribution alternative is not payable on substantially the same terms as another distribution alternative. Thus, for example, different optional forms of benefit may result from differences in terms relating to the payment schedule, timing, commencement, medium of distribution (*e.g.*, in cash or in kind), election rights, differences in eligibility requirements, or the portion of the benefit to which the distribution alternative applies.

(2) *Examples*. The following examples illustrate the meaning of the term ''optional form of benefit.'' Other issues, such as the requirement that the optional forms satisfy section 401(a)(4), are not addressed in these examples and no inferences are intended with respect to such requirements. Assume that the distribution forms, including those not described in these examples, provided under the plan in each of the following examples are identical in all respects not described.

Example 1. A plan permits each participant to receive his benefit under the plan as a single sum distribution; a level monthly distribution schedule over 15 years; a single life annuity; a joint and 50 percent survivor annuity; a joint and 75 percent survivor annuity; a joint and 50 percent survivor annuity with a benefit increase for the participant if the beneficiary dies before a specified date; and joint and 50 percent survivor annuity with a 10 year certain feature. Each of these benefit distribution options is an optional form of benefit (without regard to whether the values of these options are actuarially equivalent).

Example 2. A plan permits each participant who is employed by division A to receive his benefit in a single sum distribution payable upon termination from employment and each participant who is employed by division B in a single sum distribution payable upon termination from employment on or after the attainment of age 50. This plan provides two single sum optional forms of benefit.

Example 3. A plan permits each participant to receive his benefit in a single life annuity

that commences in the month after the participant's termination from employment or in a single life annuity that commences upon the completion of five consecutive one year breaks in service. These are two optional forms of benefit.

Example 4. A profit-sharing plan permits each participant who is employed by division A to receive an in-service distribution upon the satisfaction of objective criteria set forth in the plan designed to determine whether the participant has a heavy and immediate financial need, and each participant who is employed by division B to receive an in-service distribution upon the satisfaction of objective criteria set forth in the plan designed to determine whether the participant has a heavy and immediate financial need attributable to extraordinary medical expenses. These in-service distribution options are two optional forms of benefits.

Example 5. A profit-sharing plan permits each participant who is employed by division A to receive an in-service distribution up to $5,000 and each participant who is employed by division B to receive an in-service distribution of up to his total benefit. These in-service distribution options differ as to the portion of the accrued benefit that may be distributed in a particular form and are, therefore, two optional forms of benefit.

Example 6. A profit-sharing plan provides for a single sum distribution on termination of employment. The plan is amended in 1991 to eliminate the single sum optional form of benefit with respect to benefits accrued after the date of amendment. This single sum optional form of benefit continues to be a single optional form of benefit although, over time, the percentage of various employees' accrued benefits that are potentially payable under this single sum may vary because the form is only available with respect to benefits accrued up to and including the date of the amendment.

Example 7. A profit-sharing plan permits each participant to receive a single sum distribution of his benefit in cash or in the form of a specified class of employer stock. This plan provides two single sum distribution optinal forms of benefit.

Example 8. A stock bonus plan permits each participant to receive a single sum distribution of his benefit in cash or in the form of the property in which such participant's benefit was invested prior to the distribution. This plan's single sum distribution option provides two optional forms of benefit.

Example 9. A defined benefit plan provides for an early retirement benefit payable upon termination of employment after attainment of age 55 and either after ten years of service or, if earlier, upon plan termination to employees of Division A and provides for an identical early retirement benefit payable on the same terms with the exception of payment on plan termination to employees of Division B. The plan provides for two optional forms of benefit.

Example 10. A profit-sharing plan provides for loans secured by an employee's account balance. In the event of default on such a loan, there is an execution on such account balances. Such execution is a distribution of the employee's accrued benefits under the plan. A distribution of an accrued benefit contingent on default under a plan loan secured by such accrued benefits is an optional form of benefit under the plan.

(c) *Plan terms*—(1) *General rule.* Generally, benefits described in section 411(d)(6)(A), early retirement benefits, retirement-type subsidies, and optional forms of benefit are section 411(d)(6) protected benefits only if they are provided under the terms of a plan. However, if an employer establishes a pattern of repeated plan amendments providing for similar benefits in similar situations for substantially consecutive, limited periods of time, such benefits will be treated as provided under the terms of the plan, without regard to the limited periods of time, to the extent necessary to carry out the purposes of section 411(d)(6) and, where applicable, the definitely determinable requirement of section 401(a), including section 401(a)(25). A pattern of repeated plan amendments providing that a particular optional form of benefit is available to certain named employees for a limited period of time is within the scope of this rule and may result in such optional form of benefit being treated as provided under the terms of the plan to all employees covered under the plan without regard to the limited period of time and the limited group of named employees.

(2) *Effective date.* The provisions of paragraph (c)(1)of this Q&A-1 are effective as of July 11, 1988. Thus, patterns or repeated plan amendments adopted and effective before July 11, 1988 will be disregarded in determining whether such amendments have created an ongoing optional form of benefit under the plan.

(d) *Benefits that are not section 411(d)(6) protected benefits.* The following benefits are examples of items that are not section 411(d)(6) protected benefits:

(1) Ancillary life insurance protection;

(2) Accident or health insurance benefits;

(3) Social security supplements described in section 411(a)(9), except qualified social security supplements as defined in §1.401(a)(4)–12;

(4) The availability of loans (other than the distribution of an employee's accrued benefit upon default under a loan);

(5) The right to make after-tax employee contributions or elective deferrals described in section 402(g)(3);

(6) The right to direct investments;

(7) The right to a particular form of investment (e.g., investment in employer stock or securities or investment in certain types of securities, commercial paper, or other investment media);

(8) The allocation dates for contributions, forfeitures, and earnings, the time for making contributions (but not the conditions for receiving an allocation of contributions or forfeitures for a plan year after such conditions have been satisfied), and the valuation dates for account balances;

(9) Administrative procedures for distributing benefits, such as provisions relating to the particular dates on which notices are given and by which elections must be made; and

(10) Rights that derive from administrative and operational provisions, such as mechanical procedures for allocating investment experience among accounts in defined contribution plans.

Q–2: To what extent may section 411(d)(6) protected benefits under a plan be reduced or eliminated?

A–2:

(a) *Reduction or elimination of section 411(d)(6) protected benefits*—(1) *In general.* A plan is not permitted to be amended to eliminate or reduce a section 411(d)(6) protected benefit that has already accrued, except as provided in §1.411(d)–3 or this section. This is generally the case even if such elimination or reduction is contingent upon the employee's consent. However, a plan may be amended to eliminate or reduce section 411(d)(6) protected benefits with respect to benefits not yet accrued as of the later of the amendment's adoption date or effective date without violating section 411(d)(6).

(2) *Selection of optional forms of benefit*—(i) *General rule.* A plan may treat a participant as receiving his entire nonforfeitable accrued benefit under the plan if the participant receives his benefit in an optional form of benefit in an amount determined under the plan that is at least the actuarial equivalent of the employee's nonforfeitable accrued benefit payable at normal retirement age under the plan. This is true even though the participant could have elected to receive an optional form of benefit with a greater actuarial value than the value of the optional form received, such as an optional form including retirement-type subsidies, and without regard to whether such other, more valuable optional form could have commenced immediately or could have become available only upon the employee's future satisfaction of specified eligibility conditions.

(ii) *Election of an optional form.* Except as provided in paragraph (a)(2)(iii) of this Q&A–2, a plan does not violate section 411(d)(6) merely because an employee's election to receive a portion of his nonforfeitable accrued benefit in one optional form of benefit precludes the employee from receiving that portion of his benefit in another optional form of benefit. Such employee retains all 411(d)(6) protected rights with respect to the entire portion of such employee's nonforfeitable accrued benefit for which no distribution election was made. For purposes of this rule, an elective transfer of an otherwise distributable benefit is treated as the selection of an optional form of benefit. See Q&A–3 of this section.

(iii) *Buy-back rule.* Notwithstanding paragraph (a)(2)(ii) of this Q&A–2, an employee who received a distribution of his nonforfeitable benefit from a plan that is required to provide a repayment opportunity to such employee if he returns to service within the applicable period pursuant to the requirements of section 411(a)(7) and who, upon subsequent reemployment, repays the full amount of such distribution in accordance with section 411(a)(7)(C) must be reinstated in the full array of section 411(d)(6) protected benefits that existed with respect to such benefit prior to distribution.

(iv) *Examples*. The rules in this paragraph (a)(2) can be illustrated by the following examples:

Example 1. Defined benefit plan X provides, among its optional forms of benefit, for a subsidized early retirement benefit payable in the form of an annuity and available to employees who terminate from employment on or after their 55th birthdays. In addition plan X provides for a single sum distribution available on termination from employment or termination of the plan. The single sum distribution is determined on the basis of the present value of the accrued normal retirement benefit and does not take the early retirement subsidy into account. Plan X is terminated December 31, 1991. Employees U, age 47, V, age 55, and W, age 47, all continue in the service of the employer. Employees X, age 47, Y, age 55 and Z, age 47, terminate from employment with the employer during 1991. Employees U and V elect to take the single sum optional form of distribution at the time of plan termination. Employees X and Y elect to take the single sum distribution on termination from employment with the employer. The elimination of the subsidized early retirement benefit with respect to employees U, V, X and Y does not result in a violation of section 411(d)(6). This is the result even though employees U and X had not yet satisfied the conditions for the subsidized early retirement benefit. Because employees W and Z have not selected an optional form of benefit, they continue to have a 411(d)(6) protected right to the full array of section 411(d)(6) protected benefits provided under the plan, including the single sum distribution form and the subsidized early retirement benefit.

Example 2. A partially vested employee receives a single sum distribution of the present value of his entire nonforfeitable benefit on account of separation from service under a defined benefit plan providing for a repayment provision. Upon reemployment with the employer such employee makes repayment in the required amount in accordance with section 411(a)(7). Such employee may, upon subsequent termination of employment, elect to take such repaid benefits in any optional form provided under the plan as of the time of the employee's initial separation from service. If the plan was amended prior to such repayment, to eliminate the single sum optional form of benefit with respect to benefits accrued after the date of the amendment, such participant has a 411(d)(6) protected right to take distribution of the repaid benefit in the form of a single sum distribution.

(3) *Certain transactions*—(i) *Plan mergers and benefit transfers*. The prohibition against the reduction or elimination of section 411(d)(6) protected benefits already accrued applies to plan mergers, spinoffs, transfers, and transactions amending or having the effect of amending a plan or plans to transfer plan benefits. Thus, for example, if plan A, a profit-sharing plan that provides for distribution of plan benefits in annual installments over ten or twenty years, is merged with plan B, a profit-sharing plan that provides for distribution of plan benefits in annual installments over life expectancy at time of retirement, the merged plan must retain the ten or twenty year installment option for participants with respect to benefits already accrued under plan A as of the merger and the installments over life expectancy for participants with benefits already accrued under plan B. Similarly, for example, if an employee's benefit under a defined contribution plan is transferred to another defined contribution plan (whether or not of the same employer), the optional forms of benefit available with respect to the employee's benefit accrued under the transferor plan may not be eliminated or reduced except as otherwise permitted under this regulation. See Q&A–3 of this section with respect to the transfer of benefits between and among defined benefit and defined contribution plans.

(ii) *Annuity contracts*—(A) *General rule*. The right of a participant to receive a benefit in the form of cash payments from the plan and the right of a participant to receive that benefit in the form of the distribution of an annuity contract that provides for cash payments that are identical in all respects to the cash payments from the plan except with respect to the source of the payments are not separate optional forms of benefit. Therefore, for example, if a plan includes an optional form of benefit under which benefits are distributed in the medium of an annuity contract that provides for cash payments, that optional form of benefit may be modified by a plan amendment that substitutes cash payments from the plan for the annuity contract, where those cash payments from the plan are identical to the cash payments payable from the annuity contract in all respects except with respect to the source of the payments. The protection provided by section 411(d)(6) may not

be avoided by the use of annuity contracts. Thus, section 411(d)(6) protected benefits already accrued may not be eliminated or reduced merely because a plan uses annuity contracts to provide such benefits, without regard to whether the plan, a participant, or a beneficiary of a participant holds the contract or whether such annuity contracts are purchased as a result of the termination of the plan. However, to the extent that an annuity contract constitutes payment of benefits in a particular optional form elected by the participant, the plan does not violate section 411(d)(6) merely because it provides that other optional forms are no longer available with respect to such participant. See paragraph (a)(2) of this Q&A–2.

(B) *Examples.* The provisions of this paragraph (a)(3)(ii) can be illustrated by the following examples:

Example 1. A profit-sharing plan that is being terminated satisfies section 411(d)(6) only if the plan makes available to participants annuity contracts that provide for all section 411(d)(6) protected benefits under the plan that may not otherwise be reduced or eliminated pursuant to this Q&A–2. Thus, if such a plan provided for a single sum distribution upon attainment of early retirement age, and a provision for payment in the form of 10 equal annual installments, the plan would satisfy section 411(d)(6) only if the participants had the opportunity to elect to have their benefits provided under an annuity contract that provided for the same single sum distribution upon the attainment of the participant's early retirement age and the same 10 year installment optional form of benefit.

Example 2. A defined benefit plan permits each participant who separates from service on or after age 62 to receive a qualified joint and survivor annuity or a single life annuity commencing 45 days after termination from employment. For a participant who separates from service before age 62, payments under these optional forms of benefit commence 45 days after the participant's 62nd birthday. Under the plan, a participant is to elect among these optional forms of benefit during the 90-day period preceding the annuity starting date. However, during such period, a participant may defer both benefit commencement and the election of a particular benefit form to any later date, subject to section 401(a)(9). In January 1990, the employer decides to terminate the plan as of July 1, 1990. The plan will fail to satisfy section 411(d)(6) unless the optional forms of benefit provided under the plan are preserved under the annuity contract purchased on plan termination. Thus, such annuity contract must provide a participant the same optional benefit commencement rights that the plan provided. In addition, such contract must provide the same election rights with respect to such benefit options. This is the case even if, for example, in conjunction with the termination, the employer amended the plan to permit participants to elect a qualified joint and survivor annuity, single life annuity, or single sum distribution commencing on July 1, 1990.

(4) *Benefits payable to a spouse or beneficiary.* Section 411(d)(6) protected benefits may not be eliminated merely because they are payable with respect to a spouse or other beneficiary.

(b) *Section 411(d)(6) protected benefits that may be eliminated or reduced only as permitted by the Commissioner*—(1) *In general.* The Commissioner may, consistent with the provisions of this section, provide for the elimination or reduction of section 411(d)(6) protected benefits that have already accrued only to the extent that such elimination or reduction does not result in the loss to plan participants of either a valuable right or an employer-subsidized optional form of benefit where a similar optional form of benefit with a comparable subsidy is not provided or to the extent such elimination or reduction is necessary to permit compliance with other requirements of section 401(a) (e.g., sections 401(a)(4), 401(a)(9) and 415). The Commissioner may exercise this authority only through the publication of revenue rulings, notices, and other documents of general applicability.

(2) *Section 411(d)(6) protected benefits that may be eliminated or reduced.* The elimination or reduction of certain section 411(d)(6) protected benefits that have already accrued in the following situations does not violate section 411(d)(6). The rules with respect to permissible eliminations and reductions provided in this paragraph (b)(2) generally are effective January 30, 1986; however, the rules of paragraphs (b)(2)(iii) (A) and (B) and (b)(2)(viii) of this Q&A–2 are effective for plan amendments that are adopted and effective on or after September 6, 2000. These exceptions create no inference with respect to whether any other applicable requirements are satisfied (for

example, requirements imposed by section 401(a)(9) and section 401(a)(14)).

(i) *Change in statutory requirement.* A plan may be amended to eliminate or reduce a section 411(d)(6) protected benefit if the following three requirements are met: the amendment constitutes timely compliance with a change in law affecting plan qualification; there is an exercise of section 7805(b) relief by the Commissioner; and the elimination or reduction is made only to the extent necessary to enable the plan to continue to satisfy the requirements for qualified plans. In general, the elimination or reduction of a section 411(d)(6) protected benefit will not be treated as necessary if it is possible through other modifications to the plan (e.g., by expanding the availability of an optional form of benefit to additional employees) to satisfy the applicable qualification requirement.

(ii) *Joint and survivor annuity.* A plan that provides a range of three or more actuarially equivalent joint and survivor annuity options may be amended to eliminate any of such options, other than the options with the largest and smallest optional survivor payment percentages, even if the effect of such amendment is to change which of the options is the qualified joint and survivor annuity under section 417. Thus, for example, if a money purchase pension plan provides three joint and survivor annuity options with survivor payments of 50%, 75% and 100%, respectively, that are uniform with respect to age and are actuarially equivalent, then the employer may eliminate the option with the 75% survivor payment, even if this option had been the qualified joint and survivor annuity under the plan.

(iii) *In-kind distributions*—(A) *In-kind distributions payable under defined contribution plans in the form of marketable securities other than employer securities.* If a defined contribution plan includes an optional form of benefit under which benefits are distributed in the form of marketable securities, other than securities of the employer, that optional form of benefit may be modified by a plan amendment that substitutes cash for the marketable securities as the medium of distribution. For purposes of this paragraph (b)(2)(iii)(A) and paragraph (b)(2)(iii)(B) of this Q&A–2, the term *marketable securities* means marketable securities as defined in section 731(c)(2), and the term *securities of the employer* means securities of the employer as defined in section 402(e)(4)(E)(ii).

(B) *Amendments to defined contribution plans to specify medium of distribution.* If a defined contribution plan includes an optional form of benefit under which benefits are distributable to a participant in a medium other than cash, the plan may be amended to limit the types of property in which distributions may be made to the participant to the types of property specified in the amendment. For this purpose, the types of property specified in the amendment must include all types of property (other than marketable securities that are not securities of the employer) that are allocated to the participant's account on the effective date of the amendment and in which the participant would be able to receive a distribution immediately before the effective date of the amendment if a distributable event occurred. In addition, a plan amendment may provide that the participant's right to receive a distribution in the form of specified types of property is limited to the property allocated to the participant's account at the time of distribution that consists of property of those specified types.

(C) *In-kind distributions after plan termination.* If a plan includes an optional form of benefit under which benefits are distributed in specified property, that optional form of benefit may be modified for distributions after plan termination by substituting cash for the specified property as the medium of distribution to the extent that, on plan termination, an employee has the opportunity to receive the optional form of benefit in the form of the specified property. This exception is not available, however, if the employer that maintains the terminating plan also maintains another plan that provides an optional form of benefit under which benefits are distributed in the specified property.

(D) *Examples.* The following examples illustrate the application of this paragraph (b)(2)(iii):

Example 1. (i) An employer maintains a profit-sharing plan under which participants may direct the investment of their accounts. One investment option available to participants is a fund invested in common stock of the employer. The plan provides that the participant has the right to a distribution in the form of cash upon termination of employment. In addition, the plan provides that, to the extent a participant's account is invested in the employer stock fund, the participant may receive an in-kind distribution of employer stock upon termination of employment. On October 18, 2000, the plan is amended, effective on January 1, 2001, to remove the fund invested in employer common stock as an investment option under the plan and to provide for the stock held in the fund to be sold. The amendment permits participants to elect how the sale proceeds are to be reallocated among the remaining investment options, and provides for amounts not so reallocated as of January 1, 2001, to be allocated to a specified investment option.

(ii) The plan does not fail to satisfy section 411(d)(6) solely on account of the plan amendment relating to the elimination of the employer stock investment option, which is not a section 411(d)(6) protected benefit. See paragraph (d)(7) of Q&A–1 of this section. Moreover, because the plan did not provide for distributions of employer securities except to the extent participants' accounts were invested in the employer stock fund, the plan is not required operationally to offer distributions of employer securities following the amendment. In addition, the plan would not fail to satisfy section 411(d)(6) on account of a further plan amendment, effective after the plan has ceased to provide for an employer stock fund investment option (and participants' accounts have ceased to be invested in employer securities), to eliminate the right to a distribution in the form of employer stock. See paragraph (b)(2)(iii)(B) of this Q&A–2.

Example 2. (i) An employer maintains a profit-sharing plan under which a participant, upon termination of employment, may elect to receive benefits in a single-sum distribution either in cash or in kind. The plan's investments are limited to a fund invested in employer stock, a fund invested in XYZ mutual funds (which are marketable securities), and a fund invested in shares of PQR limited partnership (which are not marketable securities).

(ii) The following alternative plan amendments would not cause the plan to fail to satisfy section 411(d)(6):

(A) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership. See paragraph (b)(2)(iii)(A) of this Q&A–2.

(B) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership, and that also provides that only participants with employer stock allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of employer stock, and that only participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of shares of PQR limited partnership. To comply with the plan amendment, the plan administrator retains a list of participants with employer stock allocated to their accounts as of the effective date of the amendment, and a list of participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment. See paragraphs (b)(2)(iii) (A) and (B) of this Q&A–2.

(C) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership to the extent that those assets are allocated to the participant's account at the time of the distribution. See paragraphs (b)(2)(iii) (A) and (B) of this Q&A–2.

(D) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership, and that provides that only participants with employer stock allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of employer stock, and that only participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of shares of PQR limited partnership, and that further provides that the distribution of that stock or those shares is available only to the extent that those assets are allocated to those participants' accounts at the time of the distribution. To comply with the plan amendment, the plan administrator retains a list of participants with employer stock allocated to their accounts as of the effective date of the amendment, and a list of participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment. See paragraphs (b)(2)(iii) (A) and (B) of this Q&A–2.

Example 3. (i) An employer maintains a stock bonus plan under which a participant, upon termination of employment, may elect to receive benefits in a single-sum distribution in employer stock. This is the only plan maintained by the employer under which distributions in employer stock are available.

The employer decides to terminate the stock bonus plan.

(ii) If the plan makes available a single-sum distribution in employer stock on plan termination, the plan will not fail to satisfy section 411(d)(6) solely because the optional form of benefit providing a single-sum distribution in employer stock on termination of employment is modified to provide that such distribution is available only in cash. See paragraph (b)(2)(iii)(C) of this Q&A–2.

(iv) *Coordination with diversification requirement.* A tax credit employee stock ownership plan (as defined in section 409(a)) or an employee stock ownership plan (as defined in section 4975(e)(7)) may be amended to provide that a distribution is not available in employer securities to the extent that an employee elects to diversify benefits pursuant to section 401(a)(28).

(v) *Involuntary distributions.* A plan may be amended to provide for the involuntary distribution of an employee's benefit to the extent such involuntary distribution is permitted under sections 411(a)(11) and 417(e). Thus, for example, an involuntary distribution provision may be amended to require that an employee who terminates from employment with the employer receive a single sum distribution in the event that the present value of the employee's benefit is not more than $3,500, by substituting the cash-out limit in effect under §1.411(a)–11(c)(3)(ii) for $3,500, without violating section 411(d)(6). In addition, for example, the employer may amend the plan to reduce the involuntary distribution threshold from the cash-out limit in effect under §1.411(a)–11(c)(3)(ii) to any lower amount and to eliminate the involuntary single sum option for employees with benefits between the cash-out limit in effect under §1.411(a)–11(c)(3)(ii) and such lower amount without violating section 411(d)(6). This rule does not permit a plan provision permitting employer discretion with respect to optional forms of benefit for employees the present value of whose benefit is less than the cash-out limit in effect under §1.411(a)–11(c)(3)(ii).

(vi) *Distribution exception for certain profit-sharing plans*—(A) *In general.* If a defined contribution plan that is not subject to section 412 and does not provide for an annuity option is terminated, the plan may be amended to provide for the distribution of a participant's accrued benefit upon termination in a single sum optional form without the participant's consent. The preceding sentence does not apply if the employer maintains any other defined contribution plan (other than an employee stock ownership plan as defined in section 4975(e)(7)).

(B) *Examples.* The provisions of this paragraph (b)(2)(vi) can be illustrated by the following examples:

Example 1. Employer X maintains a defined contribution plan that is not subject to section 412. The plan provides for distribution in the form of equal installments over five years or equal installments over twenty years. X maintains no other defined contribution plans. X terminates its defined contribution plan after amending the plan to provide for the distribution of all participants' accrued benefits in the form of single sum distributions, without obtaining participant consent. Pursuant to the rule in this paragraph (b)(2)(iv), this amendment does not violate the requirements of section 411(d)(6).

Example 2. Corporations X and Y are members of controlled group employer XY. Both X and Y maintain defined contribution plans. X's plan, which is not subject to section 412, covers only employees working for X. Y's plan, which is subject to section 412, covers only employees working for Y. X terminates its defined contribution plan. Because employer XY maintains another defined contribution plan, plan X may not provide for the distribution of participants' accrued benefits upon termination without a participants' consent.

(vii) *Distribution of benefits on default of loans.* Notwithstanding that the distribution of benefits arising from an execution on an account balance used to secure a loan on which there has been a default is an optional form of benefit, a plan may be amended to eliminate or change a provision for loans, even if such loans would be secured by an employee's account balance.

(viii) *Provisions for transfer of benefits between and among defined contribution plans and defined benefit plans.* A plan may be amended to eliminate provisions permitting the transfer of benefits between and among defined contribution plans and defined benefit plans.

(ix) *De minimis change in the timing of an optional form of benefit.* A plan may

be amended to modify an optional form of benefit by changing the timing of the availability of such optional form if, after the change, the optional form is available at a time that is within two months of the time such optional form was available before the amendment. To the extent the optional form of benefit is available prior to termination of employment, six months may be substituted for two months in the prior sentence. Thus, for example, a plan that makes in-service distributions available to employees once every month may be amended to make such in-service distributions available only once every six months. This exception to section 411(d)(6) relates only to the timing of the availability of the optional form of benefit. Other aspects of an optional form of benefit may not be modified and the value of such optional form may not be reduced merely because of an amendment permitted by this exception.

(x) *Amendment of hardship distribution standards.* A qualified cash or deferred arrangement that permits hardship distributions under §1.401(k)–1(d)(3) may be amended to specify or modify nondiscriminatory and objective standards for determining the existence of an immediate and heavy financial need, the amount necessary to meet the need, or other conditions relating to eligibility to receive a hardship distribution. For example, a plan will not be treated as violating section 411(d)(6) merely because it is amended to specify or modify the resources an employee must exhaust to qualify for a hardship distribution or to require employees to provide additional statements or representations to establish the existence of a hardship. A qualified cash or deferred arrangement may also be amended to eliminate hardship distributions. The provisions of this paragraph also apply to profit-sharing or stock bonus plans that permit hardship distributions, whether or not the hardship distributions are limited to those described in §1.401(k)–1(d)(3).

(xi) *Section 415 benefit limitations.* Accrued benefits under a plan as of the first day of the first limitation year beginning after December 31, 1986, that exceed the benefit limitations under section 415 (b) or (e), effective on the first day of the plan's first limitation year beginning after December 31, 1986, because of a change in the terms and conditions of the plan made after May 5, 1986, or the establishment of a plan after that date, may be reduced to the level permitted under section 415 (b) or (e).

(xii) *Prohibited payment option under single-employer defined benefit plan of plan sponsor in bankruptcy.* A single-employer plan that is covered under section 4021 of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)), as amended (ERISA), may be amended, effective for a plan amendment that is both adopted and effective after November 8, 2012, to eliminate an optional form of benefit that includes a prohibited payment described in section 436(d)(5), provided that the following conditions are satisfied on the applicable amendment date (as defined in §1.411(d)–3(g)(4)):

(A) The enrolled actuary of the plan has certified that the plan's adjusted funding target attainment percentage (as defined in section 436(j)(2)) for the plan year that contains the applicable amendment date is less than 100 percent.

(B) The plan is not permitted to pay any prohibited payment, due to application of the requirements of section 436(d)(2) of the Internal Revenue Code and section 206(g)(3)(B) of ERISA, because the plan sponsor is a debtor in a bankruptcy case (that is, a case under title 11, United States Code, or under similar Federal or State law).

(C) The court overseeing the bankruptcy case has issued an order, after notice to the affected parties (as defined in section 4001(a)(21) of ERISA) and a hearing, within the meaning of 11 U.S.C. 102(1), finding that the adoption of the amendment eliminating that optional form of benefit is necessary to avoid a distress termination of the plan pursuant to section 4041(c) of ERISA or an involuntary termination of the plan pursuant to section 4042 of ERISA before the plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed).

(D) The Pension Benefit Guaranty Corporation has issued a determination that—

(*1*) The adoption of the amendment eliminating that optional form of benefit is necessary to avoid a distress or involuntary termination of the plan before the plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed); and

(*2*) The plan is not sufficient for guaranteed benefits within the meaning of section 4041(d)(2) of ERISA.

(c) *Multiple amendments*—(1) *General rule*. A plan amendment violates the requirements of section 411(d)(6) if it is one of a series of plan amendments that, when taken together, have the effect of reducing or eliminating a section 411(d)(6) protected benefit in a manner that would be prohibited by section 411(d)(6) if accomplished through a single amendment.

(2) *Determination of time period for combining plan amendments*. For purposes of paragraph (c)(1) of this Q&A–2, generally only plan amendments adopted within a 3-year period are taken into account. But see Q&A–1(c)(1) of this section for rules relating to repeated plan amendments.

(d) *ESOP and stock bonus plan exception*—(1) *In general*. Subject to the limitations in paragraph (d)(2) of this Q&A–2, a tax credit employee stock ownership plan (as defined in section 409(a)) or an employee stock ownership plan (as defined in section 4975(e)(7)) will not be treated as violating the requirements of section 411(d)(6) merely because of any of the circumstances described in paragraphs (d)(1)(i) through (d)(1)(iv) of this Q&A–2. In addition, a stock bonus plan that is not an employee stock ownership plan will not be treated as violating the requirements of section 411(d)(6) merely because of any of the circumstances described in paragraphs (d)(1)(ii) and (d)(1)(iv) of this Q&A–2.

(i) *Single sum or installment optional forms of benefit*. The employer eliminates, or retains the discretion to eliminate, with respect to all participants, a single sum optional form or installment optional form with respect to benefits that are subject to section 409(h)(1)(B), provided such elimination or retention of discretion is consistent with the distribution and payment requirements otherwise applicable to such plans (e.g., those required by section 409).

(ii) *Employer becomes substantially employee-owned or is an S corporation*. The employer eliminates, or retains the discretion to eliminate, with respect to all participants, optional forms of benefit by substituting cash distributions for distributions in the form of employer stock with respect to benefits subject to section 409(h) in the circumstances described in paragraph (d)(1)(ii)(A) or (B) of this Q&A–2, but only if the employer otherwise meets the requirements of section 409(h)(2)—

(A) The employer becomes substantially employee-owned; or

(B) For taxable years of the employer beginning after December 31, 1997, the employer is an S corporation as defined in section 1361.

(iii) *Employer securities become readily tradable*. The employer eliminates, or retains the discretion to eliminate, with respect to all participants, in cases in which the employer securities become readily tradable, optional forms of benefit by substituting distributions in the form of employer securities for distributions in cash with respect to benefits that are subject to section 409(h).

(iv) *Employer securities cease to be readily tradable or certain sales*. The employer eliminates, or retains the discretion to eliminate, with respect to all participants, optional forms of benefit by substituting cash distributions for distributions in the form of employer stock with respect to benefits that are subject to section 409(h) in the following circumstances:

(A) The employer stock ceases to be readily tradable;

(B) The employer stock continues to be readily tradable but there is a sale of substantially all of the stock of the employer or a sale of substantially all of the assets of a trade or business of the employer and, in either situation, the purchasing employer continues to maintain the plan.

In the situation described in paragraph (d)(1)(iv)(B) of this Q&A–2, the employer may also substitute distributions in the purchasing employer's stock for distributions in the form of employer stock of the predecessor employer.

(2) *Limitations on ESOP and stock bonus plan exceptions*—(i) *Nondiscrimination requirement.* Plan amendments and the retention and exercise of discretion permitted under the exceptions in paragraph (d)(1) must meet the nondiscrimination requirements of section 401(a)(4).

(ii) *ESOP investment requirement.* Except as provided in paragraph (d)(2)(iii) of this Q&A–2, benefits provided by employee stock ownership plans will not be eligible for the exceptions in paragraph (d)(1) of this Q&A–2 unless the benefits have been held in a tax credit employee stock ownership plan (as defined in section 409 (a)) or an employee stock ownership plan (as defined in section 4975 (e)(7)) subject to section 409 (h) for the five-year period prior to the exercise of employer discretion or any amendment affecting such benefits and permitted under paragraph (d)(1) of this Q&A–2. For purposes of the preceding sentence, if benefits held under an employee stock ownership plan are transferred to a plan that is an employee stock ownership plan at the time of transfer, then the consecutive periods under the transferor and transferee employee stock ownership plans may be aggregated for purposes of meeting the five-year requirement. If the benefits are held in an employee stock ownership plan throughout the entire period of their existence, and such total period of existence is less than five years, then such lesser period may be substituted for the five year requirement.

(3) *Effective date.* The provisions of this paragraph (d) are effective beginning with the first day of the first plan year commencing on or after January 1, 1989. Prior to this effective date the reduction or elimination of a section 411(d)(6) protected benefit by a tax credit employee stock ownership plan (as defined in section 409(a)) or an employee stock ownership plan (as defined in section 4975(e)(7)) will not be treated as violating the requirements of section 411(d)(6) if such reduction or elimination reflects a reasonable interpretation of the statutory language of section 411(d)(6)(C).

(4) *Additional exceptions and requirements.* The Commissioner may, in revenue rulings, notices or other documents of general applicability, prescribe such additional rules and exceptions, consistent with the purposes of this section, as may be necessary or appropriate.

(e) *Permitted plan amendments affecting alternative forms of payment under defined contribution plans*—(1) *General rule.* A defined contribution plan does not violate the requirements of section 411(d)(6) merely because the plan is amended to eliminate or restrict the ability of a participant to receive payment of accrued benefits under a particular optional form of benefit for distributions with annuity starting dates after the date the amendment is adopted if, after the plan amendment is effective with respect to the participant, the alternative forms of payment available to the participant include payment in a single-sum distribution form that is otherwise identical to the optional form of benefit that is being eliminated or restricted.

(2) *Otherwise identical single-sum distribution.* For purposes of this paragraph (e), a single-sum distribution form is otherwise identical to an optional form of benefit that is eliminated or restricted pursuant to paragraph (e)(1) of this Q&A–2 only if the single-sum distribution form is identical in all respects to the eliminated or restricted optional form of benefit (or would be identical except that it provides greater rights to the participant) except with respect to the timing of payments after commencement. For example, a single-sum distribution form is not otherwise identical to a specified installment form of benefit if the single-sum distribution form is not available for distribution on the date on which the installment form would have been available for commencement, is not available in the same medium of distribution as the installment form, or imposes any condition of eligibility that did not apply to the installment form. However, an otherwise identical distribution form need not retain rights or features of the optional form of benefit that is eliminated or restricted to the extent that those rights or features would not be protected from elimination or restriction under section 411(d)(6) or this section.

(3) *Example*. The following example illustrates the application of this paragraph (e):

Example. (i) P is a participant in Plan M, a qualified profit-sharing plan with a calendar plan year that is invested in mutual funds. The distribution forms available to P under Plan M include a distribution of P's vested account balance under Plan M in the form of distribution of various annuity contract forms (including a single life annuity and a joint and survivor annuity). The annuity payments under the annuity contract forms begin as of the first day of the month following P's severance from employment (or as of the first day of any subsequent month, subject to the requirements of section 401(a)(9)). P has not previously elected payment of benefits in the form of a life annuity, and Plan M is not a direct or indirect transferee of any plan that is a defined benefit plan or a defined contribution plan that is subject to section 412. Distributions on the death of a participant are made in accordance with plan provisions that comply with section 401(a)(11)(B)(iii)(I). On September 2, 2005, Plan M is amended so that, effective for payments that begin on or after November 1, 2005, P is no longer entitled to any distribution in the form of the distribution of an annuity contract. However, after the amendment is effective, P is entitled to receive a single-sum cash distribution of P's vested account balance under Plan M payable as of the first day of the month following P's severance from employment (or as of the first day of any subsequent month, subject to the requirements of section 401(a)(9)).

(ii) Plan M does not violate the requirements of section 411(d)(6) (or section 401(a)(11)) merely because, as of November 1, 2005, the plan amendment has eliminated P's option to receive a distribution in any of the various annuity contract forms previously available.

(4) *Effective date*. This paragraph (e) is applicable on January 25, 2005.

Q–3 Does the transfer of benefits between and among defined benefit plans and defined contribution plans (or similar transactions) violate the requirements of section 411(d)(6)?

A–3 (a) *Transfers and similar transactions*—(1) *General rule*. Section 411(d)(6) protected benefits may not be eliminated by reason of transfer or any transaction amending or having the effect of amending a plan or plans to transfer benefits. Thus, for example, except as otherwise provided in this section, an employer who maintains a money purchase pension plan that provides for a single sum optional form of benefit may not establish another plan that does not provide for this optional form of benefit and transfer participants' account balances to such new plan.

(2) *Defined benefit feature and separate account feature*. The defined benefit feature of an employee's benefit under a defined benefit plan and the separate account feature of an employee's benefit under a defined contribution plan are section 411(d)(6) protected benefits. Thus, for example, the elimination of the defined benefit feature of an employee's benefit under a defined benefit plan, through transfer of benefits from a defined benefit plan to a defined contribution plan or plans, will violate section 411(d)(6).

(3) *Waiver prohibition*. In general, except as provided in paragraph (b) of this Q&A–3, a participant may not elect to waive section 411(d)(6) protected benefits. Thus, for example, the elimination of the defined benefit feature of a participant's benefit under a defined benefit plan by reason of a transfer of such benefits to a defined contribution plan pursuant to a participant election, at a time when the benefit is not distributable to the participant, violates section 411(d)(6).

(4) *Direct rollovers*. A direct rollover described in Q&A–3 of §1.401(a)(31)–1 that is paid to a qualified plan is not a transfer of assets and liabilities that must satisfy the requirements of section 414(l), and is not a transfer of benefits for purposes of applying the requirements under section 411(d)(6) and paragraph (a)(1) of this Q&A–3. Therefore, for example, if such a direct rollover is made to another qualified plan, the receiving plan is not required to provide, with respect to amounts paid to it in a direct rollover, the same optional forms of benefit that were provided under the plan that made the direct rollover. See §1.401(a)(31)–1, Q&A–14.

(b) *Elective transfers of benefits between defined contribution plans*—(1) *General rule*. A transfer of a participant's entire benefit between qualified defined contribution plans (other than any direct rollover described in Q&A–3 of §1.401(a)(31)–1) that results in the elimination or reduction of section 411(d)(6) protected benefits does not

violate section 411(d)(6) if the following requirements are met—

(i) *Voluntary election.* The plan from which the benefits are transferred must provide that the transfer is conditioned upon a voluntary, fully-informed election by the participant to transfer the participant's entire benefit to the other qualified defined contribution plan. As an alternative to the transfer, the participant must be offered the opportunity to retain the participant's section 411(d)(6) protected benefits under the plan (or, if the plan is terminating, to receive any optional form of benefit for which the participant is eligible under the plan as required by section 411(d)(6)).

(ii) *Types of plans to which transfers may be made.* To the extent the benefits are transferred from a money purchase pension plan, the transferee plan must be a money purchase pension plan. To the extent the benefits being transferred are part of a qualified cash or deferred arrangement under section 401(k), the benefits must be transferred to a qualified cash or deferred arrangement under section 401(k). To the extent the benefits being transferred are part of an employee stock ownership plan as defined in section 4975(e)(7), the benefits must be transferred to another employee stock ownership plan. Benefits transferred from a profit-sharing plan other than from a qualified cash or deferred arrangement, or from a stock bonus plan other than an employee stock ownership plan, may be transferred to any type of defined contribution plan.

(iii) *Circumstances under which transfers may be made.* The transfer must be made either in connection with an asset or stock acquisition, merger, or other similar transaction involving a change in employer of the employees of a trade or business (*i.e.*, an acquisition or disposition within the meaning of §1.410(b)–2(f)) or in connection with the participant's change in employment status to an employment status with respect to which the participant is not entitled to additional allocations under the transferor plan.

(2) *Applicable qualification requirements.* A transfer described in this paragraph (b) is a transfer of assets or liabilities within the meaning of section 414(l)(1) and, thus, must satisfy the requirements of section 414(l). In addition, this paragraph (b) only provides relief under section 411(d)(6); a transfer described in this paragraph must satisfy all other applicable qualification requirements. Thus, for example, if the survivor annuity requirements of sections 401(a)(11) and 417 apply to the plan from which the benefits are transferred, as described in this paragraph (b), but do not otherwise apply to the receiving plan, the requirements of sections 401(a)(11) and 417 must be met with respect to the transferred benefits under the receiving plan. In addition, the vesting provisions under the receiving plan must satisfy the requirements of section 411(a)(10) with respect to the amounts transferred.

(3) *Status of elective transfer as other right or feature.* A right to a transfer of benefits from a plan pursuant to the elective transfer rules of this paragraph (b) is an other right or feature within the meaning of §1.401(a)(4)–4(e)(3), the availability of which is subject to the nondiscrimination requirements of section 401(a)(4) and §1.401(a)(4)–4. However, for purposes of applying the rules of §1.401(a)(4)–4, the following conditions are to be disregarded in determining the employees to whom the other right or feature is available—

(i) A condition restricting the availability of the transfer to benefits of participants who are transferred to a different employer in connection with a specified asset or stock disposition, merger, or other similar transaction involving a change in employer of the employees of a trade or business (*i.e.*, a disposition within the meaning of §1.410(b)–2(f)), or in connection with any such disposition, merger, or other similar transaction.

(ii) A condition restricting the availability of the transfer to benefits of participants who have a change in employment status to an employment status with respect to which the participant is not entitled to additional allocations under the transferor plan.

(c) *Elective transfers of certain distributable benefits between qualified plans*—(1) *In general.* A transfer of a participant's benefits between qualified plans

that results in the elimination or reduction of section 411(d)(6) protected benefits does not violate section 411(d)(6) if—

(i) The transfer occurs at a time at which the participant's benefits are distributable (within the meaning of paragraph (c)(3) of this Q&A–3);

(ii) For a transfer that occurs on or after January 1, 2002, the transfer occurs at a time at which the participant is not eligible to receive an immediate distribution of the participant's entire nonforfeitable accrued benefit in a single-sum distribution that would consist entirely of an eligible rollover distribution within the meaning of section 401(a)(31)(C);

(iii) The voluntary election requirements of paragraph (b)(1)(i) of this Q&A–3 are met;

(iv) The participant is fully vested in the transferred benefit in the transferee plan;

(v) In the case of a transfer from a defined contribution plan to a defined benefit plan, the defined benefit plan provides a minimum benefit, for each participant whose benefits are transferred, equal to the benefit, expressed as an annuity payable at normal retirement age, that is derived solely on the basis of the amount transferred with respect to such participant; and

(vi) The amount of the benefit transferred, together with the amount of any contemporaneous section 401(a)(31) direct rollover to the transferee plan, equals the entire nonforfeitable accrued benefit under the transferor plan of the participant whose benefit is being transferred, calculated to be at least the greater of the single-sum distribution provided for under the plan for which the participant is eligible (if any) or the present value of the participant's accrued benefit payable at normal retirement age (calculated by using interest and mortality assumptions that satisfy the requirements of section 417(e) and subject to the limitations imposed by section 415).

(2) *Treatment of transfer*—(i) *In general.* A transfer of benefits pursuant to this paragraph (c) generally is treated as a distribution for purposes of section 401(a). For example, the transfer is subject to the cash-out rules of section 411(a)(7), the early termination requirements of section 411(d)(2), and the survivor annuity requirements of sections 401(a)(11) and 417. A transfer pursuant to the elective transfer rules of this paragraph (c) is not treated as a distribution for purposes of the minimum distribution requirements of section 401(a)(9).

(ii) *Status of elective transfer as optional form of benefit.* A right to a transfer of benefits from a plan pursuant to the elective transfer rules of this paragraph (c) is an optional form of benefit under section 411(d)(6), the availability of which is subject to the nondiscrimination requirements of section 401(a)(4) and §1.401(a)(4)–4.

(3) *Distributable benefits.* For purposes of paragraph (c)(1)(i) of this Q&A–3, a participant's benefits are distributable on a particular date if, on that date, the participant is eligible, under the terms of the plan from which the benefits are transferred, to receive an immediate distribution of these benefits (e.g., in the form of an immediately commencing annuity) from that plan under provisions of the plan not inconsistent with section 401(a).

(d) *Effective date.* This Q&A–3 is applicable for transfers made on or after September 6, 2000.

Q–4: May a plan provide that the employer may, through the exercise of discretion, deny a participant a section 411(d)(6) protected benefit for which the participant is otherwise eligible?

A–4: (a) *In general.* Except as provided in paragraph (d) of Q&A–2 of this section with respect to certain employee stock ownership plans, a plan that permits the employer, either directly or indirectly, through the exercise of discretion, to deny a participant a section 411(d)(6) protected benefit provided under the plan for which the participant is otherwise eligible (but for the employer's exercise of discretion) violates the requirements of section 411(d)(6). A plan provision that makes a section 411(d)(6) protected benefit available only to those employees as the employer may designate is within the scope of this prohibition. Thus, for example, a plan provision under which only employees who are designated by the employer are eligible to receive a subsidized early retirement benefit constitutes an impermissible provision

under section 411(d)(6). In addition, a pension plan that permits employer discretion to deny the availability of a section 411(d)(6) protected benefit violates the definitely determinable requirement of section 401(a), including section 401(a)(25). See §1.401–1(b)(1)(i). This is the result even if the plan specifically limits the employer's discretion to choosing among section 411(d)(6) protected benefits, including optional forms of benefit, that are actuarially equivalent. In addition, the provisions of sections 411(a)(11) and 417(e) that allow a plan to make involuntary distributions of certain amounts are not excepted from this limitation on employer discretion. Thus, for example, a plan may not permit employer discretion with respect to whether benefits will be distributed involuntarily in the event that the present value of the employee's benefit is not more than the cash-out limit in effect under §1.411(a)–11(c)(3)(ii) within the meaning of sections 411(a)(11) and 417(e). (An exception is provided for such provisions with respect to the nondiscrimination requirements of section 401(a)(4). See §1.401(a)(4)–4(b)(2)(ii)(C).)

(b) *Exception for administrative discretion.* A plan may permit limited discretion with respect to the ministerial or mechanical administration of the plan, including the application of objective plan criteria specifically set forth in the plan. Such plan provisions do not violate the requirements of section 411(d)(6) or the definitely determinable requirement of section 401(a), including section 401(a)(25). For example, these requirements are not violated by the following provisions that permit limited administrative discretion:

(1) Commencement of benefit payments as soon as administratively feasible after a stated date or event;

(2) Employer authority to determine whether objective criteria specified in the plan (e.g., objective criteria designed to identify those employees with a heavy and immediate financial need or objective criteria designed to determine whether an employee has a permanent and total disability) have been satisfied; and

(3) Employer authority to determine, pursuant to specific guidelines set forth in the plan, whether the participant or spouse is dead or cannot be located.

Q–5: When will the exercise of discretion by some person or persons, other than the employer, be treated as employer discretion?

A–5: For purposes of applying the rules of this section and §1.401(a)–4, the term ''employer'' includes plan administrator, fiduciary, trustee, actuary, independent third party, and other persons. Thus, if a plan permits any person, other than the participant (and other than the participant's spouse), the discretion to deny or limit the availability of a section 411(d)(6) protected benefit for which the employee is otherwise eligible under the plan (but for the exercise of such discretion), such plan violates the requirements of sections 401(a), including section 411(d)(6) and, where applicable, the definitely determinable requirement of section 401(a), including section 401(a)(25).

Q–6: May a plan condition the availability of a section 411(d)(6) protected benefit on the satisfaction of objective conditions that are specifically set forth in the plan?

A–6: (a) *Certain objective conditions permissible*—(1) *In general.* The availability of a section 411(d)(6) protected benefit may be limited to employees who satisfy certain objective conditions provided the conditions are ascertainable, clearly set forth in the plan and not subject to the employer's discretion except to the extent reasonably necessary to determine whether the objective conditions have been met. Also, the availability of the section 411(d)(6) protected benefit must meet the nondiscrimination requirements of section 401(a)(4). See §1.401(a)–4.

(2) *Examples of permissible conditions.* The following examples illustrate of permissible objective conditions: a plan may deny a single sum distribution form to employees for whom life insurance is not available at standard rates as defined under the terms of the plan at the time the single sum distribution would otherwise be payable; a plan may provide that a single sum distribution is available only if the employee is in extreme financial need as defined under the terms of the plan at the time

the single sum distribution would otherwise be payable; a plan my condition the availability of a single sum distribution on the execution of a covenant not to compete, provided that objective conditions with respect to the terms of such covenant and the employees and circumstances requiring execution of such covenant are set forth in the plan.

(b) *Conditions based on factors within employer's discretion generally impermissible.* A plan may not limit the availability of section 411(d)(6) protected benefits permitted under the plan on objective conditions that are within the employer's discretion. For example, the availability of section 411(d)(6) protected benefits in a plan may not be conditioned on a determination with respect to the level of the plan's funded status, because the amount of plan funding is within the employer's discretion. However, for example, although conditions based on the plan's funded status are impermissible, a plan may limit the availability of a section 411(d)(6) protected benefit (e.g., a single sum distribution) in an objective manner, such as the following:

(1) Single sum distributions of $25,000 and less are available without limit; and

(2) Single sum distributions in excess of $25,000 are available for a year only to the extent that the total amount of such single sum distributions for the year is not greater than $5,000,000; and

(3) An objective and nondiscriminatory method for determining which particular single sum distributions will not be available during a year in order for the $5,000,000 limit to be satisfied is set forth in the plan.

Q–7: May a plan be amended to add employer discretion or conditions restricting the availability of a section 411(d)(6) protected benefit?

A–7: No. The addition of employer discretion or objective conditions with respect to a section 411(d)(6) protected benefit that has already accrued violates section 411(d)(6). Also, the addition of conditions (whether or not objective) or any change to existing conditions with respect to section 411(d)(6) protected benefits that results in any further restriction violates section 411(d)(6). However, the addition of objective conditions to a section 411(d)(6) protected benefit may be made with respect to benefits accrued after the later of the adoption or effective date of the amendment. In addition, objective conditions may be imposed on section 411(d)(6) protected benefits accrued as of the date of an amendment where permitted under the transitional rules of §1.401(a)–4 Q&A–5 and Q&A–8 of this section. Finally, objective conditions may be imposed on section 411(d)(6) protected benefits to the extent permitted by the permissible benefit cutback provisions of Q&A–2 of this section.

Q–8: If a plan contains an impermissible employer discretion provision with respect to a section 411(d)(6) protected benefit, what acceptable alternative exist for amending the plan without violating the requirements of section 411(d)(6)?

A–8: (a) *In general.* The following rules apply for purposes of making necessary amendments to existing plans (as defined in Q&A–9 of this section) that contain discretion provisions with respect to the availability of section 411(d)(6) protected benefits that violate the requirements of section 401(a), including sections 401(a)(25) and 411(d)(6), and this section. These transitional rules are provided under the authority of section 411(d)(6) and section 7805(b).

(b) *Transitional alternatives.* If the availability of an optional forms of benefit, early or late retirement benefit, or retirement-type subsidy under an existing plan is conditioned on the exercise of employer discretion, the plan must be amended either to eliminate the optional form of benefit, early or late retirement benefit, or retirement-type subsidy to make such benefit available to all participants without limitation, or to apply objective and nondiscriminatory conditions to the availability of the optional form of benefit, early or later retirement benefit, or retirement-type subsidy. See paragraph (d) of this Q&A–8 for rules limiting the period during which section 411(d)(6) protected benefits may be eliminated or reduced under this paragraph.

(c) *Compliance and amendment date provisions*—(1) *Operational compliance requirement.* On or before the applicable

effective date for the plan (as determined under Q&A–9 of this section), the plan sponsor must select one of the alternatives permitted under paragraph (b) of the Q&A–8 with respect to each affected section 411(d)(6) protected benefit and the plan must be operated in accordance with this selection. This is an operational requirement and does not require a plan amendment prior to the period set forth in paragraph (c)(2) of this Q&A–8. There are no special reporting requirements under the Code or this section with respect to this selection.

(2) *Deferred amendment date.* If paragraph (c)(1) of this Q&A–8 is satisfied, a plan amendment conforming the plan to the particular alternative selected under paragraph (b) of this Q&A–8 must be adopted within the time period permitted for amending plans in order to meet the requirements of section 410(b) as amended by TRA '86. The plan amendment to conform the plan to these regulations may be made at an earlier date. Such conforming amendment must be consistent with the sponsor's selection as reflected by plan practice during the period from the effective date to the date the amendment is adopted. Thus, for example, if any existing calendar year noncollectively bargained defined benefit plan has a single sum distribution option that is subject to employer discretion as of August 1, 1986, and such employer makes one or more single sum distributions available on or after January 1, 1989 and before the effective date by which plan amendment is required pursuant to this section, then such employer may not adopt a plan amendment eliminating the single sum distribution, but rather must adopt an amendment eliminating the discretion provision. Any objective conditions that are adopted as part of such amendment must not be inconsistent with the plan practice for the applicable period prior to the amendment. A conforming amendment under this paragraph (c)(2) must be made with respect to each section 411(d)(6) protected benefit for which such amendment is required and must be retroactive to the applicable effective date.

(d) *Limitation on transitional alternatives.* The transitional alternatives permitting the elimination or reduction of section 411(d)(6) protected benefits are only permissible until the applicable effective date for the plan (see Q&A–9 of this section). After the applicable effective date, any amendment (other than one permitted under paragraph (c)(2) of this Q&A–8) that eliminates or reduces a section 411(d)(6) protected benefit or imposes new objective conditions on the availability of such benefit will fail to qualify for the exception to section 411(d)(6) provided in this Q&A–8. This is the case without regard to whether the section 411(d)(6) protected benefit is subject to employer discretion.

Q–9: What are the applicable effective date rules for purposes of this section?

A–9: (a) *General effective date.* Except as otherwise provided in this section, the provisions of this section are effective January 30, 1986.

(b) *New plans*—(1) *In general.* Unless otherwise provided in paragraph (b)(2) of this Q&A–9, plans that are either adopted or made effective on or after August 1, 1986, are ''new plans''. With respect to such new plans, this section is effective August 1, 1986. This effective date is applicable to such plans whether or not they are collectively bargained.

(2) *Exception with respect to certain new plans.* Plans that are new plans as defined in paragraph (b)(1) of this Q&A–9; under which the availability of a section 411(d)(6) protected benefit is subject to employer discretion; and that receive a favorable determination letter that covered such plan provisions with respect to an application submitted prior to July 11, 1988, will be treated as existing plans with respect to such section 411(d)(6) protected benefit for purposes of the transitional rules of this section. Thus, such plans are eligible for the compliance and amendment alternatives set forth in the transitional rule in Q&A–8 of this section.

(c) *Existing plans*—(1) *In general.* Plans, including plans that are adoptions of master or prototype plans, that are both adopted and in effect prior to August 1, 1986, are ''existing plans'' for purposes of this section. In addition, a plan that is established after July 31, 1986, but before January

1, 1989, as an initial adoption of a master or prototype plan for which a favorable opinion letter was issued by the Service after July 18, 1985 and before January 1, 1989, will be deemed to be an existing plan for purposes of this section. See sections 4.01 and 4.02 of Rev. Proc. 84–23, 1984–1 C.B. 457, 459, for the definitions of master prototype plans. However, if such plan ceases to be covered under an opinion letter of the type described above, as a result of amendment of the plan or adoption of a new plan, prior to the first day of the first plan year beginning on or after January 1, 1989, then the effective date for such plan will be determined as though the plan were a new plan initially adopted as of the date of such amendment or adoption of a new plan. Finally, new plans described in paragraph (b)(2) of this Q&A–9 are treated as existing plans with respect to certain section 411(d)(6) protected benefits. Subject to the limitations in paragraph (c) of this Q&A–9, the effective dates set forth in paragraphs (c)(2), (c)(3), and (c)(4) of this Q&A–9 apply to these existing plans for purposes of this section:

(2) *Existing noncollectively bargained plans*. With respect to existing plans other than collectively bargained plans this section is effective for the first day of the first plan year commencing on or after January 1, 1989.

(3) *Existing collectively bargained plans*. With respect to existing collectively bargained plans this section is effective for the later of the first day of the first plan year commencing on or after January 1, 1989, or the first day of the first plan year that the requirements of section 410(b) as amended by TRA '86 apply to such plan.

(4) *Existing master and prototype plans*. With respect to existing plans that are adoptions of master or prototype plans the effective date will be the first day of the first plan year commencing on or after January 1, 1989.

(d) *Delayed effective date not applicable to new alternatives or conditions*—(1) *In general*. The delayed effective dates in paragraphs (c)(2) and (c)(3) of this Q&A–9 for existing plans are only applicable with respect to a section 411(d)(6) protected benefit if both the section 411(d)(6) protected benefit and the condition providing employer discretion as to the availability of such benefit are both adopted and in effect prior to August 1, 1986. If the preceding sentence is not satisfied with respect to a particular section 411(d)(6) protected benefit, this section is effective with respect to such section 411(d)(6) protected benefit as if the plan were a new plan.

(2) *Addition of discretion on or after January 30, 1986*. The delayed effective dates in paragraphs (c)(2) and (c)(3) of this Q&A–9 are not available with respect to any section 411(d)(6) protected benefit if the section 411(d)(6) protected benefit was provided for in the plan prior to January 30, 1986, and the availability of such benefit was made subject to the exercise of employer discretion on or after January 30, 1986. If the conditions set forth in this paragraph are not satisfied with respect to a particular section 411(d)(6) protected benefit, this section is effective with respect to such section 411(d)(6) protected benefit as if the plan were a new plan. A limited exception is provided with respect to existing plans that provided a particular section 411(d)(6) protected benefit prior to January 30, 1986, and then amended the plan after January 30, 1986, and before August 1, 1986, to add a provision for employer discretion with respect to the availability of such benefit. Such plans are required to have been amended retroactively by December 31, 1987, to remove such provision for employer discretion, and, if the benefit made subject to such discretion was subsequently eliminated, the plan is required to have been further amended, by the same date, to retroactively reinstate the benefit.

(3) *Exception for certain amendments covered by a favorable determination letter*. If an amendment adding a section 411(d)(6) protected benefit subject to employer discretion was adopted or made effective after August 1, 1986, and the plan receives a favorable determination letter covering such provision with respect to an application for such letter made prior to July 11, 1988, then the effective date for purposes of amending such provision under the transitional rules is the applicable effective date determined under the rules with respect to existing plans.

(e) *Transitional rule effective date.* The transitional rule provided in Q&A–8 of this section is effective January 30, 1986.

Q–10: If a plan provides for an age 70½ distribution option that commences prior to retirement from employment with the employer maintaining the plan, to what extent may the plan be amended to eliminate this distribution option?

A–10: (a) *In general.* The right to commence benefit distributions in a particular form and at a particular time prior to retirement from employment with the employer maintaining the plan is a separate optional form of benefit within the meaning of section 411(d)(6)(B) and Q&A–1 of this section, even if the plan provision creating this right was included in the plan solely to comply with section 401(a)(9), as in effect for years before January 1, 1997. Therefore, except as otherwise provided in paragraph (b) of this Q&A–10 or any other Q&A in this section, a plan amendment violates section 411(d)(6) if it eliminates an age 70½ distribution option (within the meaning of paragraph (c) of this Q&A–10) to the extent that it applies to benefits accrued as of the later of the adoption date or effective date of the amendment.

(b) *Permitted elimination of age 70½ distribution option.* An amendment of a plan will not violate the requirements of section 411(d)(6) merely because the amendment eliminates an age 70½ distribution option to the extent that the option provides for distribution to an employee prior to retirement from employment with the employer maintaining the plan, provided that—

(1) The amendment eliminating this optional form of benefit applies only to benefits with respect to employees who attain age 70½ in or after a calendar year, specified in the amendment, that begins after the later of—

(i) December 31, 1998; or

(ii) The adoption date of the amendment;

(2) The plan does not, except to the extent required by section 401(a)(9), preclude an employee who retires after the calendar year in which the employee attains age 70½ from receiving benefits in any of the same optional forms of benefit (except for the difference in the timing of the commencement of payments) that would have been available had the employee retired in the calendar year in which the employee attained age 70½; and

(3) The amendment is adopted no later than—

(i) The last day of the remedial amendment period that applies to the plan for changes under the Small Business Job Protection Act of 1996 (110 Stat. 1755); or

(ii) Solely in the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before September 3, 1998, the last day of the twelfth month beginning after the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof on or after September 3, 1998), if later than the date described in paragraph (b)(3)(i) of this Q&A–10. For purposes of this paragraph (b)(3)(ii), the rules of §1.410(b)–10(a)(2) apply for purposes of determining whether a plan is maintained pursuant to one or more collective bargaining agreements, except that September 3, 1998 is substituted for March 1, 1986, as the date before which the collective bargaining agreements must be ratified.

(c) *Age 70½ distribution option.* For purposes of this Q&A–10, an age 70½ distribution option is an optional form of benefit under which benefits payable in a particular distribution form (including any modifications that may be elected after benefit commencement) commence at a time during the period that begins on or after January 1 of the calendar year in which an employee attains age 70½ and ends April 1 of the immediately following calendar year.

(d) *Examples.* The provisions of this Q&A–10 are illustrated by the following examples:

Example 1. Plan A, a defined benefit plan, provides each participant with a qualified joint and survivor annuity (QJSA) that is available at any time after the later of age 65 or retirement. However, in accordance with section 401(a)(9) as in effect prior to January 1, 1997, Plan A provides that if an employee does not retire by the end of the calendar year in which the employee attains age 70½, then the QJSA commences on the following

April 1. On October 1, 1998, Plan A is amended to provide that, for an employee who is not a 5-percent owner and who attains age 70½ after 1998, benefits may not commence before the employee retires but must commence no later than the April 1 following the later of the calendar year in which the employee retires or the calendar year in which the employee attains age 70½. This amendment satisfies this Q&A–10 and does not violate section 411(d)(6).

Example 2. Plan B, a money purchase pension plan, provides each participant with a choice of a QJSA or a single sum distribution commencing at any time after the later of age 65 or retirement. In addition, in accordance with section 401(a)(9) as in effect prior to January 1, 1997, Plan B provides that benefits will commence in the form of a QJSA on April 1 following the calendar year in which the employee attains age 70½, except that, with spousal consent, a participant may elect to receive annual installment payments equal to the minimum amount necessary to satisfy section 401(a)(9) (calculated in accordance with a method specified in the plan) until retirement, at which time a participant may choose between a QJSA and a single sum distribution (with spousal consent). On June 30, 1998, Plan B is amended to provide that, for an employee who is not a 5-percent owner and who attains age 70½ after 1998, benefits may not commence prior to retirement but benefits must commence no later than April 1 after the later of the calendar year in which the employee retires or the calendar year in which the employee attains age 70½. The amendment further provides that the option described above to receive annual installment payments prior to retirement will not be available under the plan to an employee who is not a 5-percent owner and who attains age 70½ after 1998. This amendment satisfies this Q&A–10 and does not violate section 411(d)(6).

Example 3. Plan C, a profit-sharing plan, contains two distribution provisions. Under the first provision, in any year after an employee attains age 59½, the employee may elect a distribution of any specified amount not exceeding the balance of the employee's account. In addition, the plan provides a section 401(a)(9) override provision under which, if, during any year following the year that the employee attains age 70½, the employee does not elect an amount at least equal to the minimum amount necessary to satisfy section 401(a)(9) (calculated in accordance with a method specified in the plan), Plan C will distribute the difference by December 31 of that year (or for the year the employee attains age 70½, by April 1 of the following year). On December 31, 1996, Plan C is amended to provide that, for an employee other than an employee who is a 5-percent owner in the year the employee attains age 70½, in applying the section 401(a)(9) override provision, the later of the year of retirement or year of attainment of age 70½, is substituted for the year of attainment of age 70½. After the amendment, Plan C still permits each employee to elect to receive the same amount as was available before the amendment. Because this amendment does not eliminate an optional form of benefit, the amendment does not violate section 411(d)(6). Accordingly, the amendment is not required to satisfy the conditions of paragraph (b) of this Q&A–10.

(e) *Effective date.* This Q&A–10 applies to amendments adopted and effective after June 5, 1998.

Q–11: To what extent may a plan amendment that is made pursuant to the Taxpayer Relief Act of 1997 (TRA '97) (Public Law 105–34, 111 Stat. 788), reduce or eliminate section 411(d)(6) protected benefits?

A–11: A plan amendment does not violate the requirements of section 411(d)(6) merely because the plan amendment reduces or eliminates section 411(d)(6) protected benefits as of the effective date of the plan amendment, provided that—

(a) The plan amendment is made pursuant to an amendment made by title XV, or subtitle H of title X, of TRA '97; and

(b) The plan amendment is adopted no later than the last day of any remedial amendment period that applies to the plan pursuant to §§ 1.401(b)–1 and 1.401(b)–1T for changes under TRA '97.

Q–12. Is there a transition period during which a plan is permitted to eliminate a right to in-service distributions in connection with an amendment to ensure that the plan's normal retirement age satisfies the requirements of § 1.401(a)–1(b)(2)?

A–12. (a) *In general.* A plan amendment that changes the normal retirement age under the plan to a later normal retirement age pursuant to § 1.401(a)–1(b)(2) does not violate section 411(d)(6) merely because it eliminates a right to an in-service distribution prior to the amended normal retirement age. However, this paragraph does not provide relief from any other applicable requirements; for example, this relief does not permit the amendment to violate section 411(a)(9) (requiring that the normal retirement benefit not be less than the greater of any early retirement benefit payable under the

plan or the benefit under the plan commencing at normal retirement age), section 411(a)(10) (if the amendment changes the plan's vesting rules), section 411(d)(6) (other than elimination of the right to an in-service distribution prior to the amended normal retirement age), or section 4980F (relating to an amendment that reduces the rate of future benefit accrual). This paragraph only applies to a plan amendment that is adopted after May 22, 2007 and on or before the last day of the applicable remedial amendment period under §1.401(b)–1 with respect to the requirements of §1.401(a)–1(b)(2) and (3).

(b) *Example*. The following example illustrates the application of this section:

(i) *Facts*. (A) Plan A is a defined benefit plan intended to be qualified under section 401(a). Plan A is maintained by a calendar year taxpayer and has a normal retirement age that is age 45. For employees who cease employment before normal retirement age with a vested benefit, Plan A permits benefits to commence at any date after the attainment of normal retirement age through attainment of age 70½ and provides for benefits to be actuarially increased to the extent they commence after normal retirement age. For employees who continue employment after attainment of normal retirement age, Plan A provides for benefits to continue to accrue and permits benefits to commence at any time, with an actuarial increase in benefits to apply to the extent benefits do not commence after normal retirement age. Age 45 is an age that is earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

(B) On February 18, 2008, Plan A is amended, effective May 22, 2007, to change its normal retirement age to the later of age 65 or the fifth anniversary of participation in the plan. The amendment provides full vesting for any participating employee who is employed on May 21, 2007, and who terminates employment on or after attaining age 45. The amendment provides employees who cease employment before the revised normal retirement age and who are entitled to a vested benefit with the right to be able to commence benefits at any date from age 45 to age 70½. The plan amendment also revises the plan's benefit accrual formula so that the benefit for prior service (payable commencing at the revised normal retirement age or any other age after age 45) is not less than would have applied under the plan's formula before the amendment (also payable commencing at the corresponding dates), based on the benefit accrued on May 21, 2007, and provides for service thereafter to have the same rate of future benefit accrual. Thus, for any participant employed on May 21, 2007, with respect to benefits accrued for service after May 21, 2007, the amount payable under the plan (as amended) at any benefit commencement date after age 45 is the same amount that would have been payable at that benefit commencement date under the plan prior to amendment. The plan amendment also eliminates the right to an in-service distribution between age 45 and the revised normal retirement age. Plan A has been operated since May 22, 2007, in conformity with the amendment adopted on February 18, 2008.

(ii) *Conclusion*. The plan amendment does not violate section 411(d)(6). Although the amendment eliminates the right to commence benefits in-service between age 45 and the revised normal retirement age, the amendment is made before the last day of the remedial amendment period applicable to the plan under §1.401(b)–1 with respect to the requirements of §1.401(a)–1(b)(2) and (3), and therefore the amendment is permitted under paragraph (a) of this A–12. Further, the amendment does not result in a reduction in any benefit for service after May 22, 2007.

Thus, the amendment does not result in a reduction in any benefit for future service, and advance notice of a significant reduction in the rate of future benefit accrual is not required under section 4980F.

[53 FR 26058, July 11, 1988]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting §1.411(d)–4, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at *www.fdsys.gov*.

§ 1.411(d)–5 Class year plans; plan years beginning after October 22, 1986.

(a) *Plan years beginning prior to 1989*. (1) The requirements of section 411(a)(2) shall be treated as satisfied in the case of a class-year plan if such plan provides that 100 percent of each employee's right to or derived from the contributions of the employer on the employee's behalf with respect to any plan year is nonforfeitable not later than when such participant was performing services for the employer as of the close of each of 5 plan years (whether or not consecutive) after the plan year for which the contributions were made.

(2) For purposes of paragraph (a)(1) of this section if—

(i) Any contributions are made on behalf of a participant with respect to any plan year, and

(ii) Before such participant meets the requirements of paragraph (a)(1) of this section, such participant was not performing services for the employer as of the close of each of any 5 consecutive plan years after such plan year, then the plan may provide that the participant forfeits any right to or derived from the contributions made with respect to such plan year.

(3) This paragraph (a) applies to contributions made for plan years beginning after October 22, 1986.

(b) *Plan years beginning after 1988.* (1) The special class year vesting rule in section 411(d)(4) was repealed by section 1113(b) of the Tax Reform Act of 1986 (1986 Act). The repeal is generally effective for plan years beginning after December 31, 1988. See section 1111(e) of the 1986 Act for a special effective date rule applicable to certain plans maintained pursuant to collective bargaining agreements.

(2)(i) This subparagraph (2) provides a special rule for class year plans that were in compliance with section 411(d)(4) immediately before the first plan year beginning after section 411(d)(4) is repealed. These plans are not required to retroactively compute years of service under the general section 411(a)(2) rules. Instead, a participant must receive a year of service for each such prior plan year if the employee was performing services on the last day of such year. Similarly, if the participant was not performing services on the last day of such years, the participant will be treated as if a one-year break-in-service occurred for such plan year. This subdivision (i) applies to plan years to which this section applies.

(ii) In the case of a plan year to which §1.411(d)–3 applied, a class year plan must compute years of service and breaks in service in a manner consistent with the rules in this paragraph (b)(2)(i), giving appropriate regard to the statutory changes made to section 411(d)(4).

[T.D. 8219, 53 FR 31854, Aug. 22, 1988; 53 FR 48534, Dec. 1, 1988]

§ 1.412(b)–2 Amortization of experience gains in connection with certain group deferred annuity contracts.

(a) *Experience gain treatment.* Dividends, rate credits, and credits for forfeitures arising in a plan described in paragraph (b) of this section are experience gains described in section 412(b)(3)(B)(ii) (relating to the amortization of experience gains).

(b) *Plan.* A plan is described in this paragraph (b) if—

(1) The plan is funded solely through a group deferred annuity contract,

(2) The annual single premium required under the contract for the purchase of the benefits accruing during the plan year is treated as the normal cost of the plan for that year, and

(3) The amount necessary to pay in equal annual installments, over the appropriate amortization period, an amount equal to the single premium necessary to provide all past service benefits not initially funded, together with interest thereon, is treated as the annual amortization amount determined under section 412(b)(2)(B) (i), (ii) or (iii).

(c) *Effective date.* This section applies for the first plan year to which section 412 applies that begins after May 22, 1981.

[T.D. 7764, 46 FR 6923, Jan. 22, 1981]

§ 1.412(b)–5 Election of the alternative amortization method of funding.

(a) *Alternative amortization method in general.* Section 1013(d) of the Employee Retirement Income Security Act of 1974 provides an alternative method which may be used by certain multiemployer plans (as defined in section 414(f)) which were in existence on January 1, 1974, for funding certain unfunded past service liability. The multiemployer plans which may elect to use this alternative method are those plans (1) under which, on January 1, 1974, contributions were based on a percentage of pay, (2) which use actuarial assumptions with respect to pay that are reasonably related to past and projected experience, and (3) which use rates of interest that are determined on the basis of reasonable acturial assumptions. The unfunded past service liability to which this method applies is that amount existing as of the date

12 months after the date on which section 412 first applies to the plan. The alternative method allows the plan to fund this liability over a period of 40 plan years by charging the funding standard account with an equal annual percentage of the aggregate pay of all participants in the plan instead of the level dollar charges required under section 412(b)(2)(B). Paragraphs (b), (c), (d) and (e) of this section contain procedural rules for electing this alternative method.

(b) *Election procedure*. To elect the alternative amortization method, a multiemployer plan must attach a statement to the annual report required under section 6058(a) for the plan year for which the election is made, stating that the alternative method for funding unfunded past service liability is being adopted. Advance approval from the Internal Revenue Service is not required. The alternative method must be adopted on or before the last day prescribed for filing the annual report corresponding to the last plan year beginning before January 1, 1982.

(c) *Charges to which the alternative amortization method is applicable*. Once elected, the alternative amortization method is applicable to the unfunded past service liability existing as of the date 12 months after the date on which section 412 first applies to the plan. This results in charges to the funding standard account which are in lieu of—

(1) Charges required under clause (i) of section 412(b)(2)(B), and

(2) Charges required under clause (iii) of section 412(b)(2)(B) if the plan amendments referred to in such clause result in a net increase in the unfunded past service liability existing as of the date 12 months after the date on which section 412 first applies to the plan. Such charges generally will arise only with respect to plan amendments adopted in the first plan year to which section 412 applies.

If the election is made on an annual report corresponding to a plan year after the first plan year to which section 412 applies, recomputation of the contributions due in the prior years (to which section 412 applied) will be necessary.

(d) *Limitation*. The sum of the charges described in this paragraph may not be less than the interest on the unfunded past service liabilities described in section 412(b)(2)(B) (i) and (iii), determined as of the date 12 months after the date on which section 412 first applies to the plan.

(e) *Reporting requirements*. Each annual report required by section 6058(a) and periodic report of the actuary required by section 6059 must include all additional information relevant to the use of the alternative amortization method as may be required by the applicable forms and the instructions for such forms.

[T.D. 7702, 45 FR 40113, June 13, 1980]

§ 1.412(c)(1)–1 Determinations to be made under funding method—terms defined.

(a) *Actuarial cost method and funding method*. Section 3 (31) of the Employee Retirement Income Security Act of 1974 (''ERISA'') provides certain acceptable (and unacceptable) actuarial cost methods which may (or may not) be used by employee plans. The term ''funding method'' when used in section 412 has the same meaning as the term ''actuarial cost method'' in section 3 (31) of ERISA. For shortfall method for certain collectively bargained plans, see § 1.412(c)(1)–2; for principles applicable to funding methods in general, see regulations under section 412(c)(3).

(b) *Computations included in funding method*. The funding method of a plan includes not only the overall funding method used by the plan but also each specific method of computation used in applying the overall method. However, the choice of which actuarial assumptions are appropriate to the overall method or to the specific method of computation is not a part of the funding method. For example, the decision to use or not to use a mortality factor in the funding method of a plan is not a part of such funding method. Similarly, the specific mortality rate determined to be applicable to a particular plan year is not part of the funding method. See section 412(c)(5) for the requirement of approval to change the funding method used by a plan.

[T.D. 7733, 45 FR 75202, Nov. 14, 1980]

§ 1.412(c)(1)–2 Shortfall method.

(a) *In general*—(1) *Shortfall method.* The shortfall method is a funding method that adapts a plan's underlying funding method for purposes of section 412. As such, the use of the shortfall method is subject to section 412(c)(3). A plan described in paragraph (a)(2) of this section may elect to determine the charges to the funding standard account required by section 412(b) under the shortfall method. These charges are computed on the basis of an estimated number of units of service or production (for which a certain amount per unit is to be charged). The difference between the net amount charged under this method and the net amount that otherwise would have been charged under section 412 for the same period is a shortfall loss (gain) and is to be amortized over certain subsequent plan years.

(2) *Eligibility for use of shortfall.* No plan may use the shortfall method unless—

(i) The plan is a collectively bargained plan described in section 413(a), and

(ii) Contributions to the plan are made at a rate specified under the terms of a legally binding agreement applicable to the plan.

For purposes of this section, a plan maintained by a labor organization which is exempt from tax under section 501(c)(5) is treated as a collectively bargained plan and the governing rules of the organization (such as its constitution, bylaws, or other document that can be altered only through action of a convention of the organization) are treated as a collectively bargained agreement.

(b) *Computation and effect of net shortfall charge*—(1) *In general.* The ''net shortfall charge'' to the funding standard account under the shortfall method is the product of (i) the estimated unit charge described in paragraph (c) of this section that applies for a particular plan year, multiplied by (ii) the actual number of base units (for example, units of service or production) which occurred during that plan year. When the shortfall method is used, the net shortfall charge is a substitute for the specific charges and credits to the funding standard account described in section 412 (b)(2) and (3)(B).

(2) *Example.* Paragraph (b)(1) of this section may be illustrated by the following example:

Example. A pension plan uses the calendar year as the plan year and the shortfall method. Its estimated unit charge applicable to 1980 is 80 cents per hour of covered employment. During 1980, there were 125,000 hours of covered employment. The net shortfall charge for the plan year is $100,000 (*i.e.*, 125,000 × $.80), regardless of the amount which would be charged and credited to the funding standard account under section 412 (b)(2) and (3)(B) had the shortfall method not applied. The funding standard account for 1980 will be separately credited for the amount considered contributed for the plan year under section 412 (b)(3)(A). The other items which may be credited, if applicable, are a waived funding deficiency and the alternative minimum funding standard credit adjustment under section 412(b)(3)(C) and (D) because these items are not credits under section 412(b)(3)(B).

(3) *Plans with more than one contract, contribution rate, employer, or benefit level*—(i) *General rule.* A single plan with more than one contract, contribution rate, employer, or benefit level may compute a separate net shortfall charge for each contract, contribution rate, each employer, or each benefit level. The sum of these charges is the plan's total net shortfall charge. under § 1.412(c)(1)–1(b), the use of separate computations would be a specific method of computation used in applying the overall funding method. See also paragraph (f)(5) of this section.

(ii) *Single valuation.* Only one actuarial valuation shall be made for the single plan on each actuarial valuation date.

(iii) *Reasonableness test.* The specific method of computation of the net shortfall charge must be reasonable, determined in the light of the facts and circumstances.

(c) *Estimated unit charge.* The estimated unit charge is the annual computation charge described in paragraph (d) of this section divided by the estimated base units of service or production described in paragraph (e) of this section.

(d) *Annual computation charge.* The annual computation charge for a plan year is the sum of the following amounts:

(1) The net charges and credits which, but for using the shortfall method, would be made under section 412 (b)(2) and (b)(3)(B).

(2) The amount described in paragraph (g)(3) of this section, if applicable, for amortization of shortfall gain or loss.

(e) *Estimated base units*—(1) *In general.* The estimated base units are the expected units of service or production for a plan year (hours, days, tons, dollars of compensation, etc.), determined as of the base unit estimation date for that plan year under paragraph (f) of this section. This estimate must be based on the past experience of the plan and the reasonable expectations of the plan for the plan year. The specific type of unit used must be described in the statement of funding method for the plan year. (See paragraph (i)(3) of this section for reporting requirements.)

(2) *Reasonable expectations.* The reasonableness of expectations used under paragraph (e)(1) of this section is determined under the facts and circumstances of the plan for each plan year as of the relevant base unit estimation date. Expectations will be considered unreasonable if, for example, they do not reflect a consistent and substantial decline or growth in actual base units that has occurred over the course of recent years and that is likely to continue beyond the base unit estimation date. This determination of reasonableness is independent of determinations made under section 412(c)(3) of the reasonableness of actuarial assumptions.

(f) *Base unit estimation date*—(1) *In general.* The base unit estimation date for the current plan year is determined under this paragraph (f). This date shall be an actuarial valuation date no earlier than the last actuarial valuation date occurring at least one year before the earliest date any current collectively bargained agreement in existence during the plan year came into effect.

(2) *Four-month rule.* For purposes of this paragraph (f), a current collectively bargained agreement is one in effect during at least four months of the current plan year.

(3) *Effective date of agreement.* For purposes of this paragraph (f), a collectively bargained agreement shall be deemed to have come into effect on the effective date of the agreement containing the currently effective provision for contributions to the plan or the benefits provided under the plan.

(4) *Long-term contract rule.* The effective date of a collectively bargained agreement shall be deemed not to occur prior to the first day of the third plan year preceding the current year.

(5) *Special rule for plans computing separate net shortfall charge.* A plan that computes a separate net shortfall charge for each contract, contribution rate, employer, or benefit level under paragraph (b)(3) of this section shall determine the base unit estimation date for each separate charge without regard to any collectively bargained agreement that does not relate to that contract, contribution rate, employer, or benefit level. If a collective bargaining agreement requiring contributions by a certain employer, or prescribing a certain benefit level, is in effect on December 31, 1980, the preceding sentence shall not apply to the computation of a separate net shortfall charge for that employer or benefit level until the earlier of—

(i) The first plan year beginning after the date on which expires the collective bargaining agreement requiring contributions by that employer (or the last collective bargaining agreement relating to that benefit level), or

(ii) The first plan year beginning after December 31, 1983.

(6) *Example.* The rules contained in paragraph (f) of this section are illustrated by the following table. In the table, ''V'' signifies actuarial valuation date (January 1 in each case shown); ''B'' signifies beginning of a contract; and ''E'' signifies end of a contract. The table shows the resulting earliest base unit estimation date with respect to the following assumed items:

COMPUTATION OF EARLIEST BASE UNIT ESTIMATION DATE

Example	Plan year (calendar year basis)											
	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Plan A	V			V			V			V		
Contract 1	.....	.....	E/B	.....	.....	E/B	.....	E/B	.....	.....	.....	E/B
Base unit estimation date [1]				1973	1973	1973	1976	1976	1979	1979	1979	1979
Plan B	V			V			V			V		
Contract 2	[2]	[2]	[2]	B*	.....	E/B	.....	.....	.....	E/B*		
Contract 3	E/B	.....	.....	E/B	.....	.....	E/B	.....	.....	E/B		
Base unit estimation date [1]	.....	.....	.....	1973	1973	1973	1976	1976	1976	1976	1979	1979
Plan C	V	V	V	V	V	V	V	V	V	V	V	V
Contract 4	.....	.....	E/B	.....	.....	E/B*	.....	.....	.....	E/B*		
Contract 5	.....	.....	E/B	.....	.....	E/B*	.....	.....	.....	.....	E/B*	
Base unit estimation date [1]				1974	1974	1977	1977	1977	1977	1978	1979	1981

[1] The base unit estimation date may be on or any time after the actuarial valuation date in the year indicated on this line.
[2] No contract.
* Denotes that a prior contract ends and a new contract begins prior to the fifth month of a plan year.

(g) *Amortization of shortfall gain or loss*—(1) *Definition*. The shortfall gain for a plan is the excess for the plan year of—

(i) The net shortfall charge computed under paragraph (b) of this section over

(ii) The annual computation charge described in paragraph (d) of this section.

The shortfall loss for a plan is the excess for the plan year of the annual computation charge over the net shortfall charge.

(2) *Shortfall amortization period*—(i) *First year*. The plan year in which the amortization of a shortfall gain or loss must begin is the earlier of two years: the fifth plan year following the plan year in which the shortfall gain or loss arose, or the first plan year beginning after the latest scheduled expiration date of a collectively bargained agreement in effect with respect to the plan during the plan year in which the shortfall gain or loss arose. For purposes of this subparagraph, a contract expiring on the last day of a plan year shall be deemed to be renewed on such last day for the same period of years as the contract that succeeds the expiring contract.

(ii) *Last year*. The plan year in which the amortization of a shortfall gain or loss must end is the 15th plan year following the plan year in which the shortfall gain or loss arose. For a multiemployer plan described in section 414(f), the amortization must end with the 20th plan year instead of the 15th.

(3) *Annual amortization amount*. The shortfall gain or loss must be amortized in equal annual installments. The total amount to be amortized must be adjusted for interest at the rate used for determining the plan's normal cost.

(4) *Shortfall gain or loss under spread gain type of funding method*—(i) *In general*. A spread gain type of funding method spreads experience gains and losses over future periods as part of a plan's normal cost. (Examples of spread gain types of funding methods are the aggregate cost method, the frozen initial liability method, and the attained age normal method.) However, a shortfall gain or loss is not an experience gain or loss. Therefore, a plan using a spread gain type of funding method together with the shortfall method must amortize shortfall gains and losses and otherwise meet the requirements of paragraph (g) of this section.

(ii) *Asset adjustment for aggregate method*. A plan using the shortfall method with the aggregate cost method of funding must adjust its plan assets for a shortfall gain or loss in calculating normal cost. The unamortized portion of any shortfall gain is subtracted from plan assets. The unamortized portion of any shortfall loss is added to plan assets.

(5) *Reconciliation of shortfall gain or loss with funding standard account*. At the beginning of each year, the actual unfunded liability under the method used by the plan must equal the outstanding balance of all amortization bases, including bases for shortfall

gains and losses, less the credit balance under the funding standard account at the end of the prior year.

(6) *Example*. This paragraph is illustrated by the following examples:

Example 1. A multiemployer plan described in section 414 (f) is maintained with the calendar year as the plan year and uses the shortfall method. The plan uses the frozen initial liability funding method. A five percent interest assumption is used by the plan, with payments computed as of the first day of each plan year for all items. The expiration dates of contracts in effect during plan years 1976, 1977, and 1978 are such that the amortization of gains or losses for each year must begin in the fifth following plan year. The assumed plan costs and estimated base units for selected years, and the computations under this section which follow from such assumptions are shown in the following table. In the table, ''*'' denotes an assumed item. The remaining figures have been calculated on the basis of these assumptions.

(A) COMPUTATION OF NET SHORTFALL CHARGE AND SHORTFALL GAIN OR LOSS

Plan year	1976	1977	1978
1. Normal cost*	$100,000	$100,000	$100,000
2. Amortization of unfunded liability*	50,000	50,000	50,000
3. Total annual computation charges	$150,000	$150,000	$150,000
4. Estimated base units*	100,000	100,000	100,000
5. Estimated unit charge (line 3 ÷ line 4)	$1.50	$1.50	$1.50
6. Actual units during year*	80,000	90,000	110,000
7. Net shortfall charge for year (line 5 × line 6)	120,000	135,000	165,000
8. Shortfall (gain) or loss (line 3 − line 7)	30,000	15,000	($15,000)

(B) ANNUAL AMORTIZATION AMOUNT

9. Year of shortfall gain or loss	1976	1977	1978
10. First year of amortization	1981	1982	1983
11. Last year of amortization	1996	1997	1998
12. (Gain) or loss adjusted for interest to year amortization begins (1–1–76 to 1–1–81, etc.)	$38,288	$19,144	($19,144)
13. Annual amortization (16 years)	$3,364	$1,682	($1,682)

(C) COMPUTATION OF NET SHORTFALL CHARGES FOR SELECTED YEARS (INCLUDING SHORTFALL AMORTIZATION)

Plan year	1981	1982	1983
14. Normal cost*	$120,000	$125,000	$130,000
15. Amortization of unfunded liability*	50,000	50,000	50,000
16. Shortfall amortization (see line 13) from:			
1976	3,364	3,364	3,364
1977	.....	1,682	1,682
1978	.....	.....	(1,682)
17. Total annual computation charges	173,364	180,046	183,364
18. Estimated base units*	110,000	110,000	110,000
19. Estimated unit charge (line 17 ÷ line 18)	1.576	1.637	1.667
20. Actual units during year*	105,000	110,000	105,000
21. Net shortfall charge for year (line 19 × line 20)	165,480	180,070	175,035
22. Shortfall (gain) loss (line 17 − line 21)	7,884	(24)	8,329

The amounts in line 22 will be amortized beginning 1986, 1987, and 1988, respectively. The $24 gain in 1982 results from rounding the estimated unit charge.

Example 2. Assume the facts in Example 1. Also assume that the plan uses the frozen initial liability funding method, that the unfunded liability as of January 1, 1976 (corresponding to a 40-year charge of $50,000 due at the beginning of the year) is $900,850, and that actual contributions at the rate of $1.75 per unit are paid at mid-year in 1976.

(A) COMPUTATION OF THE UNFUNDED LIABILITY AS OF DECEMBER 31, 1976

1. Unfunded liability as of 1/1/76	$900,850
2. Normal cost (that used in the calculation of the total annual computation charges)	100,000
3. Interest at 5% due on items 1 and 2	50,043
4. Contribution with interest: $1.75 × 80,000 × 1.025 (actual contribution rate times acutal base units times interest adjustment from mid-year)	143,500
5. Unfunded liability as of 12/31/76: item 1 + item 2 + item 3 − item 4	907,393

(B) COMPUTATION OF THE OUTSTANDING BALANCE OF THE BASES AS OF DECEMBER 31, 1976

1. Original base: ($900,850 − $50,000) × 1.05	$893,393
2. Shortfall loss $30,000 × 1.05	31,500
3. Total	924,893

(C) COMPUTATION OF THE CREDIT BALANCE AS OF DECEMBER 31, 1976

1. Net shortfall charge (§ 1.412 (c) (1)–2 (b)) adjusted for interest: $120,000 × 1.05	$126,000
2. Actual contributions with interest	143,500
3. Credit balance as of 12/31/76: item 2 – item 1	17,500

(D) RECONCILIATION OF COMPUTATIONS

As of January 1, 1977, the unfunded liability ($907,393) equals the outstanding balance of the bases minus the credit balance ($924,893 – $17,500 = $907,393).

(h) *Amortization of experience gain or loss*—(1) *General rule*. In the case of a plan using an immediate gain type of funding method, an experience gain or loss shall be amortized pursuant to section 412 (b)(2)(B)(iv) or (b)(3)(B)(ii). (Examples of the immediate gain type of funding method are the unit credit method, the entry age normal cost method, and the individual level premium cost method.) For purposes of this section, a shortfall gain or loss is not an experience gain or loss. The amount of the experience gain or loss must be adjusted for interest at the rate used for determining the plan's normal cost.

(2) *Experience amortization period under shortfall method*—(i) *First year*. The plan year in which the amortization of an experience gain or loss must begin in the case of a plan using the shortfall method is the earlier of two years: the fifth plan year following the plan year in which the experience gain or loss arose, or the first plan year beginning after the last scheduled expiration date of a contract in effect during the plan year in which the experience gain or loss arose. For purposes of this subparagraph a contract expiring on the last day of the plan year shall be deemed to be renewed on such last day for the same period of years as the contract that succeeds the expiring contract.

(ii) *Last year*. The plan year in which the amortization of an experience gain or loss must end in the case of a plan using the shortfall method is the 15th plan year following the plan year in which the experience gain or loss arose. For a multi-employer plan described in section 414 (f), the amortization must end with the 20th plan year instead of the 15th.

(3) *Use of annual computation charge in determining experience gain or loss*. In the case of a plan using an immediate gain type of funding method, an experience gain or loss is the difference between the expected unfunded liability and the actual unfunded liability under the plan. The expected unfunded liability as of the end of a plan year equals the actual unfunded liability as of the beginning of the year plus normal cost, minus contributions, all adjusted for interest. If the plan adopts the shortfall method, the expected unfunded liability is computed by using the normal cost applicable for the plan year in determining the annual computation charge under paragraph (d) of this section. The same normal cost is used in computing the unfunded liability under the frozen initial liability funding method.

(4) *Example*. This paragraph is illustrated by the following example:

Example. Assume the facts in Example 2 from paragraph (g) (6) of this section, except that the entry age normal funding method is used. Also assume that as of December 31, 1976, the actual unfunded liability is $900,000.

(A) COMPUTATION OF EXPECTED UNFUNDED LIABILITY

1. Actual unfunded liability as of 1–1–76	$900,850
2. Normal cost portion of annual computation charge as of 1–1–76	100,000
3. Interest at 5% due on items 1 and 2	50,043
4. Contribution received with interest: $1.75 × 80,000 × 1.025 (actual contribution rate times actual base units times interest adjustment at mid-year)	143,500
5. Expected unfunded liability as of 12–31–76 (item 1 + item 2 + item 3 – item 4)	907,393

(B) COMPUTATION OF GAIN OR LOSS

1. Expected unfunded liability as of 12–31–76	$907,393
2. Actual unfunded liability as of 12–31–76	900,000
3. Gain (or loss) (item 1 – item 2)	7,393

(i) *Election procedure*—(1) *In general*. To elect the shortfall method, a collectively bargained plan must attach a statement to the annual report required under section 6058 (a) for the first plan year to which it is applied. The statement shall state that the shortfall method is adopted, beginning with the plan year covered by such report. Advance approval from the Internal Revenue Service is not required if the shortfall method is first adopted on or before the later of—

(i) The first plan year to which section 412 applies or

(ii) The last plan year commencing before December 31, 1981.

However, approval must be received pursuant to section 412(c)(5) prior to the adoption of the shortfall method at a later time, or the discontinuance of such method, once adopted.

(2) *Use of specific computation method.* A specific method of computation under the shortfall method is described in paragraph (b)(3) of this section, regarding the treatment of more than one contract, employer, or benefit level under the plan. This specific method may be adopted with respect to any plan year to which the shortfall method applies. Approval from the Commissioner must be received under section 412(c)(5) prior to the adoption of this specific computation method for a plan year subsequent to the first plan year to which the shortfall method applies, or prior to the discontinuance of a specific computation method, once adopted.

(3) *Reporting requirements.* Each annual report required by section 6058(a) and periodic report of the actuary required by section 6059 must include all additional information relevant to the use of the shortfall method as may be required by the applicable forms and the instructions for such forms.

(j) *Transitional rule.* In lieu of paragraphs (g)(2) and (h)(2) of this section relating to the amortization period for shortfall and experience gains and losses, for gains and losses arising in plan years beginning before January 1, 1981, a plan may rely on the prior published position of the Internal Revenue Service with respect to the amortization period for shortfall and experience gains and losses.

(k) *Supersession.* This section and § 1.412 (c) (1)–1 supersede §§ 11.412 (c) (1)–1 and (c) (1)–2 of the Temporary Income Tax Regulations Under the Employee Retirement Income Security Act of 1974.

(Secs. 412, 7805, Internal Revenue Code of 1954 (88 Stat. 914 and 68A Stat. 917; (26 U.S.C. 412 and 7805)), and sec. 3 (31) of the Employee Retirement Income Security Act of 1974 (88 Stat. 837; (29 U.S.C. 1002)))

[T.D. 7733, 45 FR 75202, Nov. 14, 1980]

§ 1.412(c)(1)–3 Applying the minimum funding requirements to restored plans.

(a) *In general*—(1) *Restoration method.* The restoration method is a funding method that adapts the underlying funding method of section 412 in the case of certain plans that are or have been terminated and are later restored by the Pension Benefit Guaranty Corporation (PBGC). The normal operation of the funding standard account, and all other provisions of section 412 and the regulations thereunder, are unchanged except as provided in this § 1.412(c)(1)–3. Under the restoration method, the PBGC shall determine a restoration payment schedule, extending over no more than 30 years, that replaces all charges and credits to the funding standard account attributable to pre-restoration amortization bases. The restoration payment schedule is determined on the basis of an actuarial valuation of the accrued liability of the plan on the initial post-restoration valuation date less the actuarial value of the plan assets on that date. The initial post-restoration valuation date is the date of the valuation that falls in the first plan year beginning on or after the date of the restoration order.

(2) *Applicability of restoration method.* A plan must use the restoration method if, and only if—

(i) The plan is being or has been terminated pursuant to section 4041(c) or section 4042 of the Employee Retirement Income Security Act of 1974 (ERISA); and

(ii) The plan has been restored by the PBGC pursuant to its authority under section 4047 of ERISA.

(b) *Computation and effect of the initial restoration amortization base*—(1) *In general.* The initial restoration amortization base is determined under the underlying funding method used by the plan. When the plan uses a spread gain funding method that does not maintain an unfunded liability, the plan must change either to an immediate gain method that directly calculates an accrued liability or to a spread gain method that maintains an unfunded liability. A plan may adopt any cost method that satisfies this requirement and that is acceptable under section 412

and the regulations thereunder, provided that the plan administrator follows the procedures established by the Commissioner for changes in funding methods. The initial restoration amortization base is determined using the valuation for the plan year in which the initial post-restoration valuation date falls. The initial restoration amortization base equals the accrued liability with respect to plan benefit liabilities returned by the PBGC less the value of the plan assets returned by the PBGC. The initial restoration amortization base replaces all prior amortization bases including those under section 412(b)(2) (B), (C), and (D) and under section 412(b)(3)(B). Any base resulting from a change in funding method, including a change required under this paragraph, is treated as a prior amortization base within the meaning of this paragraph (b). Any accumulated funding deficiency or credit balance in the funding standard account is set equal to zero when the initial restoration amortization base is established.

(2) *Example*. The following example illustrates the provisions of this paragraph (b):

Example. A pension plan uses the calendar year as its plan year, makes its annual periodic valuation as of January 1, and uses the unit credit actuarial cost method for funding purposes. The plan is in the process of being terminated. By order of the PBGC the plan is restored as of July 1, 1991. The initial post-restoration valuation date is January 1, 1992, and a restoration payment schedule order is issued on October 31, 1992. If, as of January 1, 1992, the accrued liability of the plan is $1,000,000 and the value of the plan assets is $200,000, the initial restoration amortization base is $800,000.

(c) *Establishment of a restoration payment schedule*—(1) *Certification requirement*. When the PBGC establishes a restoration payment schedule, the Executive Director of the PBGC must certify to the PBGC's Board of Directors, and to the Internal Revenue Service, that the PBGC has reviewed the funding of the plan, the financial condition of the plan sponsor and its controlled group members, the payments required under the restoration payment schedule (taking into account the availability of deferrals authorized under paragraph (c)(4) of this section), and any other factor that the PBGC deems relevant, and, based on that review, determines that it is in the best interests of participants and beneficiaries of the plan and the pension insurance program that the restored plan not be reterminated.

(2) *Requirements for restoration payment schedule*—(i) *Amortization of base over period of no more than 30 years*. The restoration payment schedule must be prescribed in an order requiring the employer to make stated contributions to the plan sufficient to amortize the initial restoration amortization base over a period extending not more than 30 years after the initial post-restoration valuation date (the restoration payment period). Payments included in the restoration payment schedule order are charged to the funding standard account of the plan at the end of each plan year in accordance with paragraph (d) of this section. The restoration payment schedule must provide for total charges that are sufficient to amortize the entire amount of the initial restoration amortization base by the end of the restoration payment period. The scheduled charges need not be in level amounts, but the present value of the prescribed charges on the initial post-restoration valuation date, computed with interest at the valuation rate, must equal the initial restoration amortization base.

(ii) *Minimum annual charge*. The restoration payment schedule must prescribe annual charges that are sufficient to prevent the outstanding balance of the initial restoration amortization base from exceeding whichever of the following amounts is applicable—

(A) During the first 10 plan years on the restoration payment schedule, the amount of the initial restoration amortization base on the date the base was established; or

(B) During plan years 11 through 20 on the restoration payment schedule, the maximum permitted outstanding balance of the initial restoration amortization base at the end of the tenth plan year, as calculated under paragraph (c)(2)(iii) of this section; or

(C) During plan years 21 through the end of the restoration payment schedule, the maximum permitted outstanding balance of the initial restoration amortization base at the end of the twentieth plan year, as calculated under paragraph (c)(2)(iii) of this section.

(iii) *Interim amortization requirements.* The restoration payment schedule must provide for sufficient periodic charges so that the outstanding balance of the initial restoration amortization base at the end of the tenth plan year and at the end of the twentieth plan year of the restoration payment period will not be larger than the outstanding balance that would have remained at the end of the tenth plan year and at the end of the twentieth plan year, respectively, if the initial restoration amortization base had been amortized in level annual amounts over the restoration payment period at the valuation rate.

(3) *Amendments to the restoration payment schedule.* The order establishing the restoration payment schedule may be amended by the PBGC from time to time with respect to any remaining payments, provided that no amendment may extend the restoration payment period beyond 30 years from the initial post-restoration valuation date, and provided further that the restoration payment schedule, as amended, satisfies the requirements of paragraph (c)(2) of this section.

(4) *Deferral of minimum scheduled annual payment amounts*—(i) *Authority to grant deferral.* Not later than 2½ months following the end of the plan year, the PBGC may grant a deferral of the charges required in the restoration payment schedule for that plan year if the requirements in paragraph (c)(4)(ii) of this section are satisfied. The PBGC may require the plan sponsor and its controlled group members to provide security to the plan as a condition to granting a deferral.

(ii) *Determination of business hardship.* Before granting a deferral under this paragraph (c)(4), the PBGC must make a determination that the granting of the deferral is in the best interests of plan participants and the plan termination insurance system, and that the plan sponsor and its controlled group members are unable to make the scheduled restoration payments without experiencing temporary substantial business hardship. In making these determinations, the factors the PBGC shall consider, include, but are not limited to, the following—

(A) Whether the plan sponsor and its controlled group members are operating at an economic loss;

(B) Whether there is substantial unemployment or underemployment in the trades or businesses of the plan sponsor and its controlled group members;

(C) Whether the sales and profits of the industry or industries are depressed or declining; and

(D) Whether it is reasonable to expect that the plan termination insurance system will suffer a greater loss if the plan is terminated than if it is continued as a restored plan.

(iii) *Amount of deferral.* The amount of the deferral for any particular plan year may not exceed the lesser of the amount that would have been required to be contributed under the restoration payment schedule for that year or interest at the valuation rate on the outstanding balance of the initial restoration amortization base for that year. An amortization payment for a deferral granted for a prior plan year may not be deferred. No deferral may extend the overall restoration payment period beyond 30 years.

(iv) *Modification of payment schedule.* The restoration payment schedule must be adjusted to reflect any deferral granted for a plan year in the manner prescribed in this paragraph (c). The charge otherwise specified in the schedule is reduced by the amount of any deferral. The charges under the restoration payment schedule for the subsequent plan years are increased by the amounts in paragraph (c)(4)(v) of this section.

(v) *Amortization of deferred amount.* The amount of any deferral granted by the PBGC for any plan year must be amortized in level amounts over five years or such shorter period as may be prescribed by the PBGC, at the valuation rate, beginning with the plan year following the year of the deferral.

(vi) *Number of deferrals permitted.* The PBGC may not grant more than five

deferrals of the minimum scheduled payments as required by this section during the restoration payment period and no more than three of these deferrals may be granted during the first ten years of that period.

(vii) *Deferrals override minimum annual charges and interim amortization requirements.* In determining the minimum annual charge under paragraph (c)(2)(ii) of this section and in applying the interim amortization requirements of paragraph (c)(2)(iii) of this section, the unamortized balances of any deferrals granted by the PBGC under this paragraph shall be added to the outstanding balance of the initial restoration amortization base otherwise allowable.

(d) *Charging the scheduled restoration payments to the funding standard account.* In addition to any other charges and credits prescribed in the normal operation of the funding standard account under section 412, the amount of each payment specified in the restoration payment schedule shall be charged against the funding standard account of the plan for the plan year to which that payment is attributed in the restoration payment schedule. To the extent that the restoration payment schedule provides for payments before the end of the plan year, the annual charge to the funding standard account attributable to the restoration payment schedule is equal to the sum of the periodic payments for the plan year accumulated with interest at the valuation rate to the last day of the plan year.

(e) *Changes in actuarial assumptions or methods.* The plan administrator must notify the PBGC of any changes in the actuarial assumptions or methods used by the plan. Upon notification of any such change, the PBGC may make any changes to the restoration payment schedule that it deems appropriate.

(f) *Change to restoration method.* A plan that has been restored must use the restoration method until the initial restoration amortization base has been fully amortized. The use of this method does not require prior approval from the Commissioner. A plan using the restoration method must compute the charges to the funding standard account to amortize the initial restoration amortization base in accordance with the order of the PBGC and in accordance with this section.

(g) *Deficit reduction contribution*—(1) *Calculation of deficit reduction contribution.* For any plan using the restoration method, the deficit reduction contribution under section 412(l)(2) is equal to the sum of—

(i) The unfunded section 412(l) restoration liability amount; plus

(ii) The unfunded new liability amount.

(2) *Unfunded section 412(l) restoration liability amount.* The unfunded section 412(l) restoration liability amount is the amount necessary to amortize fully the unfunded section 412(l) restoration liability in installments, as prescribed by the PBGC, over not more than 30 years. The annual amount need not be level, but at all times the present value of the future amortization charges prescribed under the restoration payment schedule, at the current liability interest rate, must equal the outstanding balance of the unfunded section 412(l) restoration liability and the schedule must provide that at the end of no more than 30 years the entire amount of the unfunded section 412(l) restoration liability base will have been fully amortized. The schedule prescribed for amortization of the unfunded section 412(l) restoration liability must comply with the requirements imposed in paragraph (c) of this section on the restoration payment schedule, except as provided in paragraph (g)(7) of this section and except that the maximum permitted outstanding balance of the unfunded section 412(l) restoration liability at the end of the tenth plan year must not be greater than the outstanding balance of the section 412(l) restoration liability that would have remained at the end of the tenth plan year if the unfunded section 412(l) restoration liability had been amortized in level amounts over the restoration payment period at the actual current liability interest rate for each year, increased by the current liability interest rate differential as defined under paragraph (g)(7) of this section. The unfunded section 412(l) restoration liability amount for the tenth plan year otherwise prescribed under the restoration payment schedule is increased by any

outstanding current liability interest rate differential. By issuing an appropriate order, the PBGC may permit the outstanding current liability interest rate differential to be amortized over the tenth through the fourteenth plan years. If the PBGC permits the amortization of the outstanding current liability interest rate differential, then the unfunded section 412(l) restoration liability amount for each year to which an amortization payment is attributed under the order shall be increased by such payment. The outstanding balance otherwise required by paragraph (g)(2) of this section is increased by the outstanding balance, if any, of the base resulting from the amortization of the current liability interest rate differential. The PBGC may amend the amortization schedule for the unfunded section 412(l) restoration liability subject to the limits on amendments to the amortization schedule prescribed for the initial restoration amortization base.

(3) *Establishment of unfunded section 412(l) restoration liability*. In the plan year in which the initial post-restoration valuation date falls, the unfunded section 412(l) restoration liability is equal to the unfunded current liability of the plan.

(4) *Unfunded new liability amount*. In the case of a plan using the restoration method, the unfunded new liability amount is the applicable percentage, as defined in section 412(l)(4)(C), of the unfunded new liability determined under paragraph (g)(5) of this section.

(5) *Unfunded new liability*. The unfunded new liability of a plan using the restoration method is the excess, if any, of the unfunded current liability of the plan, within the meaning of section 412(l)(8)(A) for the plan year (determined without taking into account any unpredictable contingent event benefits, even if the event has occurred) over the outstanding balance of the unfunded section 412(l) restoration liability determined under paragraph (g)(3) of this section.

(6) *Offset of amortization charges*. The amounts charged to the funding standard account pursuant to the restoration payment schedule in order to amortize the initial restoration base, as described in paragraph (d) of this section, must be offset against the deficit reduction contribution in paragraph (g)(1) of this section along with any other applicable amounts provided in section 412(l)(1)(A)(ii).

(7) *Interest rate differential*. During the first 10 plan years after the initial post-restoration valuation date, the restoration payment schedule must prescribe an unfunded section 412(l) restoration liability amount for each plan year that is sufficient to prevent the outstanding balance of the unfunded section 412(l) restoration liability from exceeding the initial amount of the unfunded section 412(l) restoration liability increased by the current liability interest rate differential. The current liability interest rate differential at any point during the first ten years of the restoration payment period is the excess, if any, of the outstanding balance of the unfunded section 412(l) restoration liability determined using the actual current liability interest rate for each year, taking into account the charges described in paragraph (d) of this section, over the outstanding balance of the unfunded section 412(l) restoration liability determined using the lowest, for each year, of the initial current liability interest rate, the current liability interest rate for the computation year, and the valuation interest rate, taking into account the charges described in paragraph (d) of this section.

(h) *Election of the alternative minimum funding standard*. A plan using the restoration method may not elect the alternative minimum funding standard under section 412(g).

(i) *Funding review by the PBGC*. The PBGC must review the funding of any plan using the restoration method at least once in each plan year. As a result of a funding review, the PBGC may amend the restoration payment schedule as provided in paragraph (c)(3) of this section. As part of the funding review, the Executive Director of the PBGC must certify to the PBGC's Board of Directors, and to the Internal Revenue Service, that the PBGC has reviewed the funding of the plan, the financial condition of the plan sponsor and its controlled group members, the

payments required under the restoration payment schedule (taking into account the availability of deferrals authorized under paragraph (c)(4) of this section), and any other factor that the PBGC deems relevant, and, based on that review, determines that it is in the best interests of participants and beneficiaries of the plan and the pension insurance program that the restored plan not be reterminated.

[T.D. 8494, 58 FR 54491, Oct. 22, 1993]

§ 1.412(c)(1)–3T Applying the minimum funding requirements to restored plans (temporary).

(a) *In general*—(1) *Restoration method.* The restoration method is a funding method that adapts the underlying funding method of section 412 in the case of certain plans that are or have been terminated and are later restored by the Pension Benefit Guaranty Corporation. The normal operation of the funding standard account, and all other provisions of section 412 and the regulations thereunder, are unchanged except as provided in this § 1.412(c)(1)–3T. Under the restoration method, the Pension Benefit Guaranty Corporation shall determine a restoration payment schedule, extending over no more than 30 years, that replaces all charges and credits to the funding standard account attributable to pre-restoration amortization bases. The restoration payment schedule is determined on the basis of an actuarial valuation of the accrued liability of the plan on the initial post-restoration valuation date less the actuarial value of the plan assets on that date. The initial post-restoration valuation date is the date of the first valuation that falls in the first plan year beginning on or after the later of October 23, 1990, or the date of the restoration order.

(2) *Applicability of restoration method.* A plan must use the restoration method if, and only if:

(i) The plan is being or has been terminated pursuant to section 4041(c) or section 4042 of the Employee Retirement Income Security Act of 1974 (ERISA), and

(ii) The plan has been restored by the Pension Benefit Guaranty Corporation pursuant to its authority under section 4047 of ERISA.

(b) *Computation and effect of the initial restoration amortization base*—(1) *In general.* The initial restoration amortization base is determined under the underlying funding method used by the plan. When the plan uses a spread gain funding method that does not maintain an unfunded liability, the plan must change either to an immediate gain method that directly calculates an accrued liability or to a spread gain method that maintains an unfunded liability. A plan may adopt any cost method that satisfies this requirement and that is acceptable under section 412 and the regulations thereunder, provided that the plan follows the procedures established by the Commissioner for changes in funding methods. The initial restoration amortization base is determined using the valuation for the plan year in which the initial post-restoration valuation date falls. The initial restoration amortization base equals the accrued liability with respect to plan benefit liabilities returned by the Pension Benefit Guaranty Corporation less the value of the plan assets returned by the Pension Benefit Guaranty Corporation. The initial restoration amortization base replaces all prior amortization bases including those under subparagraphs (B), (C), and (D) of section 412(b)(2) and under subparagraph (B) of section 412(b)(3). Any base resulting from a change in funding method is treated as a prior amortization base within the meaning of this paragraph (b). Any accumulated funding deficiency or credit balance in the funding standard account is set equal to zero when the initial restoration amortization base is established.

(2) *Example.* A pension plan uses the calendar year as its plan year, makes its annual periodic valuation as of January 1, and uses the unit credit actuarial cost method for funding purposes. The plan is in the process of being terminated. By order of the Pension Benefit Guaranty Corporation the plan is restored as of July 1, 1991, and a restoration payment schedule order issued on October 31, 1992. The initial post-restoration valuation date is January l, 1993. If, as of that date, the accrued liability of the plan is $1,000,000 and the value of the plan assets is $200,000, the

initial restoration amortization base is $800,000.

(c) *Establishment of a restoration payment schedule*—(1) *Certification requirement.* When the PBGC establishes a restoration payment schedule, the Executive Director of the PBGC must certify to the Corporation's Board of Directors, and to the Internal Revenue Service, that the Corporation has reviewed the funding of the plan, the financial condition of the plan sponsor and its controlled group members, the payments required under the restoration payment schedule (taking into account the availability of deferrals authorized under paragraph (c)(4) of this section), and any other factor that the Corporation deems relevant, and, based on that review, determines that it is in the best interests of participants and beneficiaries of the plan and the pension insurance program that the restored plan not be reterminated.

(2) *Requirements for restoration payment schedule*—(i) *Amortization of base over period of no more than 30 years.* The restoration payment schedule must be prescribed in an order requiring the employer to make stated contributions to the plan sufficient to amortize the initial restoration amortization base over a period extending not more than 30 years after the initial post-restoration valuation date (the restoration payment period). The restoration payment schedule must be sufficient to amortize the entire amount of the initial restoration amortization base by the end of the restoration payment period. The scheduled charges need not be in level amounts, but the present value of the prescribed charges on the initial post-restoration valuation date, computed with interest at the valuation rate, must equal the initial restoration amortization base.

(ii) *Minimum annual charge.* The restoration payment schedule must require annual charges that are sufficient to prevent the outstanding balance of the initial restoration amortization base from exceeding whichever of the following amounts is applicable:

(A) During the first 10 plan years on the restoration payment schedule, the amount of the initial restoration amortization base on the date the base was established, or

(B) During plan years 11 through 20 on the restoration payment schedule, the maximum permitted outstanding balance of the initial restoration amortization base at the end of the tenth plan year, as calculated under paragraph (c)(2)(iii) below, or

(C) During plan years 21 through the end of the restoration payment schedule, the maximum permitted outstanding balance of the initial restoration amortization base at the end of the twentieth plan year, as calculated under paragraph (c)(2)(iii) below.

(iii) *Interim amortization requirements.* The restoration payment schedule must provide for sufficient periodic charges so that the outstanding balance of the initial restoration amortization base at the end of the tenth plan year and at the end of the twentieth plan year of the restoration payment period will not be larger than the outstanding balance that would have remained at the end of the tenth plan year and at the end of the twentieth plan year, respectively, if the initial restoration amortization base had been amortized in level amounts over the restoration payment period at the valuation rate.

(3) *Amendments to the restoration payment schedule.* The order establishing the restoration payment schedule may be amended by the Pension Benefit Guaranty Corporation from time to time with respect to any remaining payments, provided that no amendment may extend the restoration payment period beyond 30 years from the initial post-restoration valuation date, and provided further that the restoration payment schedule, as amended, satisfies the requirements of paragraph (c)(2) of this section.

(4) *Deferral of minimum scheduled annual payment amounts*—(i) *Authority to grant deferral.* Not later than 2½ months following the end of the plan year, the Pension Benefit Guaranty Corporation may grant a deferral of the charges required in the restoration payment schedule for that plan year if the requirements in paragraph (c)(4)(ii) of this section are satisfied. The Pension Benefit Guaranty Corporation may require the plan sponsor and its controlled group members to provide

security to the plan as a condition to granting a deferral.

(ii) *Determination of business hardship.* Before granting a deferral under this paragraph (c)(4), the Pension Benefit Guaranty Corporation must make a determination that the granting of the deferral is in the best interests of plan participants and the plan termination insurance system, and that the plan sponsor and its controlled group members are unable to make the scheduled restoration payments without experiencing temporary substantial business hardship. In making these determinations, the factors the Pension Benefit Guaranty Corporation shall consider, include, but are not limited to, the following:

(A) Whether the plan sponsor and its controlled group members are operating at an economic loss,

(B) Whether there is substantial unemployment or underemployment in the trades or businesses of the plan sponsor and its controlled group members,

(C) Whether the sales and profits of the industry or industries are depressed or declining, and

(D) Whether it is reasonable to expect that the plan termination insurance system will suffer a greater loss if the plan is terminated than if it is continued as a restored plan.

(iii) *Amount of deferral.* The amount of the deferral for any particular plan year may not exceed the lesser of the amount that would have been required to be contributed under the restoration payment schedule for that year or interest on the outstanding balance of the initial restoration amortization base for that year. An amortization payment for a deferral granted for a prior plan year may not be deferred. No deferral may extend the overall restoration payment period beyond 30 years.

(iv) *Modification of payment schedule.* The restoration payment schedule must be adjusted to reflect any deferral granted for a plan year in the manner prescribed in this paragraph (c). The charge otherwise specified in the schedule is reduced by the amount of any deferral. The charges under the restoration payment schedule for the subsequent plan years are increased by the amounts in paragraph (c)(4)(v) of this section.

(v) *Amortization of deferred amount.* The amount of any deferral granted by the Pension Benefit Guaranty Corporation for any plan year must be amortized in level amounts over five years or such shorter period as may be prescribed by the Pension Benefit Guaranty Corporation, at the valuation rate, beginning with the plan year following the year of the deferral.

(vi) *Number of deferrals permitted.* The Pension Benefit Guaranty Corporation may not grant more than five deferrals of the minimum scheduled payments as required by this section during the restoration payment period and no more than three of these deferrals may be granted during the first ten years of that period.

(d) *Charging the scheduled restoration charges to the funding standard account.* In addition to any other charges and credits prescribed in the normal operation of the funding standard account under section 412, the amount of each charge specified in the restoration payment schedule shall be charged against the funding standard account of the plan for the plan year to which that payment is attributed in the restoration payment schedule.

(e) *Changes in actuarial assumptions.* If changes in actuarial assumptions increase or decrease the charges that would be required to amortize the outstanding balance of the initial restoration amortization base over the remaining years of the restoration payment schedule, the plan must notify the Pension Benefit Guaranty Corporation of the changes so that it may make appropriate changes to the restoration payment schedule.

(f) *Change to restoration method.* A plan that has been restored must use the restoration method until the initial restoration amortization base has been fully amortized. The use of this method does not require prior approval from the Commissioner. A plan using the restoration method must compute the charges and credits to the initial restoration amortization base in accordance with the order of the Pension Benefit Guaranty Corporation and in accordance with this section.

(g) *Deficit reduction contribution*—(1) *Calculation of deficit reduction contribution*. For any plan using the restoration method, the deficit reduction contribution under section 412(l)(2) is equal to the sum of—

(i) The unfunded section 412(l) restoration liability amount, plus

(ii) The unfunded new liability amount.

(2) *Unfunded section 412(l) restoration liability amount*. The unfunded section 412(l) restoration liability amount is the amount necessary to amortize fully the unfunded section 412(l) restoration liability in installments, as prescribed by the Pension Benefit Guaranty Corporation, over not more than 30 years. The annual amount need not be level, but at all times the present value of the future amortization charges under the restoration payment schedule, at the current liability interest rate, must equal the outstanding balance of the unfunded section 412(l) restoration liability and the schedule must provide that at the end of no more than 30 years the entire amount of the unfunded section 412(l) restoration liability base will have been fully amortized. The schedule prescribed for amortization of the unfunded section 412(l) restoration liability must comply with the requirements imposed in paragraph (c) of this section on the restoration payment schedule, except as provided in paragraph (g)(7) of this section and except that the maximum permitted outstanding balance of the unfunded section 412(l) restoration liability at the end of the tenth plan year must not be greater than the outstanding balance of the section 412(l) restoration liability that would have remained at the end of the tenth plan year if the unfunded section 412(l) restoration liability had been amortized in level amounts over the restoration payment period at the current liability interest rate, increased by the current liability interest rate differential as defined under paragraph (g)(7) of this section. The Pension Benefit Guaranty Corporation may amend the amortization schedule for the unfunded section 412(l) restoration liability subject to the limits on amendments to the amortization schedule prescribed for the initial restoration amortization base.

(3) *Establishment of unfunded section 412(l) restoration liability*. In the plan year in which the initial post-restoration valuation date falls, the unfunded section 412(l) restoration liability is equal to the unfunded current liability of the plan.

(4) *Unfunded new liability amount*. In the case of a plan using the restoration method, the unfunded new liability amount is the applicable percentage, as defined in section 412(l)(4)(C), of the unfunded new liability determined under paragraph (g)(5) of this section.

(5) *Unfunded new liability*. The unfunded new liability of a plan using the restoration method is the unfunded current liability of the plan for the plan year less the outstanding balance of the unfunded section 412(l) restoration liability determined under paragraph (g)(3) of this section and less any unpredictable contingent event benefit liabilities (without regard to whether or not the event has occurred).

(6) *Offset of amortization charges*. The charges specified in the restoration payment schedule to amortize the initial restoration amortization base, must be offset against the deficit reduction contribution in paragraph (g)(1) of this section along with any other applicable amounts provided in section 412 (l)(1)(A)(ii).

(7) *Interest rate differential*. During the first 10 plan years after the initial post-restoration valuation date, the unfunded section 412(l) restoration liability amount for the plan as determined for purposes of this section must be sufficient to prevent the outstanding balance of the unfunded section 412(l) restoration liability from exceeding the initial amount of the unfunded section 412(l) restoration liability increased by the current liability interest rate differential. The current liability interest rate differential at any point during the first ten years of the restoration payment period is the excess if any of the accumulated interest on the unfunded section 412(l) restoration liability computed at the current liability interest rate over the accumulated interest on the unfunded section 412(l) restoration liability computed at the least of the valuation rate, the current liability interest rate and current liability interest rate for

the plan year in which the initial post restoration valuation date falls. The current liability interest rate differential is charged to the funding standard account at the end of the tenth plan year, but the Pension Benefit Guaranty Corporation may, as part of the restoration payment schedule order, or a modification to that order, direct that the charging of this amount must be spread over not more than 5 years, beginning with the eleventh plan year.

(h) *Election of the alternative minimum funding standard.* A plan using the restoration method may not elect the alternative minimum funding standard under section 412(g).

(i) *Funding review by the Pension Benefit Guaranty Corporation.* The Pension Benefit Guaranty Corporation must review the funding of any plan using the restoration method at least once in each plan year. As a result of a funding review, the Pension Benefit Guaranty Corporation may amend the restoration payment schedule as provided in paragraph (c)(3) of this section. As part of the funding review, the Executive Director of the PBGC must certify to the Corporation's Board of Directors, and to the Internal Revenue Service, that the Corporation has reviewed the funding of the plan, the financial condition of the plan sponsor and its controlled group members, the payments required under the restoration payment schedule (taking into account the availability of deferrals authorized under paragraph (c)(4) of this section), and any other factor that the Corporation deems relevant, and, based on that review, determines that it is in the best interests of participants and beneficiaries of the plan and the pension insurance program that the restored plan not be reterminated.

[T.D. 8317, 55 FR 42707, Oct. 23, 1990; 56 FR 19038, Apr. 25, 1991]

§ 1.412(c)(2)–1 Valuation of plan assets; reasonable actuarial valuation methods.

(a) *Introduction*—(1) *In general.* This section prescribes rules for valuing plan assets under an actuarial valuation method which satisfies the requirements of section 412(c)(2)(A). An actuarial valuation method is a funding method within the meaning of section 412(c)(3) and the regulations thereunder. Therefore, certain changes affecting the actuarial valuation method are identified in this section as changes in a plan's funding method.

(2) *Exception for certain bonds, etc.* The rules of this section do not apply to bonds or other evidences of indebtedness for which the election described in section 412(c)(2)(B) has been made, nor are such assets counted in applying paragraphs (b) or (c) of this section. Also, an election under section 412(c)(2)(B) is not a change in funding method within the meaning of section 412(c)(5).

(3) *Money purchase pension plan.* A money purchase pension plan must value assets for the purpose of satisfying the requirements of section 412(c)(2)(A) solely on the basis of their fair market value (under paragraph (c) of this section).

(4) *Defined benefit plans.* (i) To satisfy the requirements of section 412(c)(2)(A), an actuarial method valuing assets of a defined benefit plan must meet the requirements of paragraph (b) of this section.

(ii) In general, the purpose of paragraph (b) of this section is to permit use of reasonble actuarial valuation methods designed to mitigate short-run changes in the fair market value of plan assets. The funding of plan benefits and the charges and credits to the funding standard account required by section 412 are generally based upon the assumption that the defined benefit plan will be continued by the employer. Thus, short-run changes in the value of plan assets presumably will offset one another in the long term. Accordingly, in the determination of the amount required to be contributed under section 412 it is generally not necessary to recognize fully each change in fair market value of the assets in the period in which it occurs.

(iii) The asset valuation rules contained in paragraph (b) produce a ''smoothing'' effect. Thus, investment performance, including appreciation or depreciation in the market value of the assets occurring in each plan year, may be recognized gradually over several plan years. This ''smoothing'' is in addition to the ''smoothing'' effect which results, for example, from amortizing

experience losses and gains over 15 or 20 years under section 412(b)(2 (B)(iv) and (3)(B)(ii).

(b) *Asset valuation method requirements*—(1) *Consistent basis.* (i) The actuarial asset valuation method must be applied on a consistent basis. Any change in meeting the requirements of this paragraph (b) is a change in funding method subject to section 412(c)(5).

(ii) A method may satisfy the consistency requirement even though computations are based only on the period elapsed since the adoption of the method or on asset values occurring during that period.

(2) *Statement of plan's method.* The method of determining the actuarial value (but not fair market value) of the assets must be specified in the plan's actuarial report (required under section 6059). The method must be described in sufficient detail so that another actuary employing the method described would arrive at a reasonably similar result. Whether a deviation from the stated actuarial valuation method is a change in funding method is to be determined in accordance with section 412(c)(5) and the regulations thereunder. A deviation to include a type of asset not previously held by the plan would not be a change in funding method.

(3) *Consistent valuation dates.* The same day or days (such as the first or the last day of a plan year) must be used for all purposes to value the plan's assets for each plan year, or portion of plan year, for which a valuation is made. For purposes of this section, each such day is a valuation date. A change in the day or days used is a change in funding method.

(4) *Reflect fair market value.* The valuation method must take into account fair market value by making use of the—

(i) Fair market value (determined under paragraph (c) of this section), or

(ii) Average value (determined under paragraph (b)(7) of this section) of the plan's assets as of the applicable asset valuation date. This is done either directly in the computation of their actuarial value or indirectly in the computation of upper or lower limits placed on that value.

(5) *Results above and below fair market or average value.* A method will not satisfy the requirements of this paragraph (b) if it is designed to produce a result which will be consistently above or below the values described in paragraph (b)(4) (i) and (ii). However, a method designed to produce a result which consistently falls between fair market value and average value will satisfy this requirement. See Example 5 in paragraph (b)(9) of this section for an illustration of a method described in the preceding sentence.

(6) *Corridor limits.* (i) Regardless of how the method reflects fair market value under paragraph (b)(4), the method must result in an actuarial value of the plan's assets which is not less than a minimum amount and not more than a maximum amount. The minimum amount is the lesser of 80 percent of the current fair market value of plan assets as of the applicable asset valuation date or 85 percent of the average value (as described in subparagraph (7)) of plan assets as of that date. The maximum amount is the greater of 120 percent of the current fair market value of plan assets as of the applicable asset valuation date or 115 percent of the average value of plan assets as of that date.

(ii) Under a plan's method, a preliminary computation of the expected actuarial value may fall outside the prescribed corridor. A method meets the requirements of paragraph (b)(6)(i) of this section is such a case only by adjusting the expected actuarial value to the nearest corridor limit applicable under the method. A plan may use an actuarial valuation method with a narrower corridor than the general corridor required under paragraph (b)(6)(i). The adjustment to the nearest corridor limit of such a method for purposes of this subdivision (ii) would be determined by the narrower corridor stated in the description of the plan's method.

(7) *Average value.* the average value of plan assets is computed by—

(i) Determining the fair market value of plan assets at least annually,

(ii) Adding the current fair market value of the assets (as of the applicable valuation date) and their adjusted values (as described in paragraph (b)(8) of this section) for a stated period not to

exceed the five most recent plan years (including the current year), and

(iii) Dividing this sum by the number of values (including the current fair market value) considered in computing the sum described in subdivision (ii).

(8) *Adjusted value.* (i) the adjusted value of plan assets for a prior valuation date is their fair market value on that date with certain positive and negative adjustments. These adjustments reflect changes that occur between the prior asset valuation date and the current valuation date. However, no adjustment is made for increases or decreases in the total value of plan assets that result from the purchase, sale, or exchange of plan assets or from the receipt of payment on a debt obligation held by the plan.

(ii) In determining the adjusted value of plan assets for a prior valuation date, there is added to the fair market value of the plan assets of that date the sum of all additions to the plan assets since that date, excluding appreciation in the fair market value of the assets. The additions would include, for example, any contribution to the plan; any interest or dividend paid to the plan; and any asset not taken into account in a prior valuation of assets, but taken into account for the current year, in computing the fair market value of plan assets under paragraph (c) of this section.

(iii) In determining the adjusted value of plan assets for a prior valuation date, there is subtracted from the fair market value of the plan assets on that date the sum of all reductions in plan assets since that date, excluding depreciation in the fair market value of the assets. The reductions would include, for example, any benefit paid from plan assets; any expense paid from plan assets; and any asset taken into account in a prior valuation of assets but not taken into account for the current year, in computing the fair market value of plan assets under paragraph (c) of this section.

(9) *Examples.* This paragraph (b) may be illustrated by the following examples. In each example, assume that the pension plan uses a consistent actuarial method of valuing its assets within the meaning of paragraph (b)(1), (2), and (3) of this section.

Example 1. Plan A considers the value of its assets to be initial cost, increased by an assumed rate of growth of X percent annually. Under the circumstances, the X-percent factor used by the plan is a reasonable assumption. Thus, this method is not designed to produce results consistently above or below fair market value as prohibited by paragraph (b)(5) of this section. Also, the method requires that the actuarial value be adjusted as required to fall within the corridor under paragraph (b) (6) and (7) of this section. Therefore, the method reflects fair market value as required by paragraph (b)(4) of this section.

Example 2. Plan B computes the actuarial value of its assets as follows: It determines the fair market value of the plan assets. Then the fair market value is adjusted to the extent necessary to make the actuarial value fall within a ''5 percent'' corridor. This corridor is plus or minus 5 percent of the following amount: the fair market value of the assets at the beginning of the valuation period plus an assumed annual growth of 4 percent with adjustments for contributions and benefit payments during the period. This method reflects fair market value in a manner prescribed by paragraph (b)(4) of this section. If the 4 percent factor used by the plan is a reasonable assumption, this method is not designed to produce results consistently above or below fair market value, and thus it satisfies paragraph (b)(5). However, this method is unacceptable because in some instances it may result in an actuarial value outside the corridor described in paragraph (b)(6) of this section. This method would be permitted if a second corridor were imposed which would adjust the value of the total plan assets to the corridor limits as required by paragraph (b)(6).

Example 3. Plan C values its assets by multiplying their fair market value by an index number. The use of the index results in the hypothetical average value that plan assets present on the valuation date would have had if they had been held during the current and four preceding years, and had appreciated or depreciated at the actual yield rates including appreciation and depreciation experienced by the plan during that period. However, the method requires an adjustment to the extent necessary to bring the resulting actuarial value of the assets inside the corridor described in the statement of the plan's actuarial valuation method. In this case, the stated corridor is 90 to 110 percent of fair market value, a corridor narrower than that described in paragraph (b)(7) of this section. This method is permitted.

Example 4. Plan D values its assets by multiplying their fair market value by 95 percent. Although the method reflects fair market value and the results of this method will always be within the required corridor, it is

not acceptable because it will consistently result in a value less than fair market value.

Example 5. Plan E values its assets by using a five-year average method with appropriate adjustments for the period. Under the particular method used by Plan E, assets are not valued below 80 percent of fair market value or above 100 percent of fair market value. If the average produces a value that exceeds 100 percent of fair market value, the excess between 100 and 120 percent is recorded in a ''value reserve account.'' In years after one in which the average exceeds 100 percent of fair market value, amounts are subtracted from this account and added, to the extent necessary, to raise the value produced by the average for that year to 100 percent of fair market value. This method is permitted because it reflects fair market value under paragraph (b)(4) of this section by appropriately computing an average value, it satisfies paragraph (b)(5) by producing a result that falls consistently between fair market value and average value, and it properly reflects the corridor described in paragraph (b)(7).

Example 6. All assets of Plan F are invested in a trust fund and the plan year is the calendar year. The actuarial value is determined by averaging fair market value over 4 years. An actuarial valuation is performed as of December 31, 1988.

(i) The average value as of December 31, 1988, is computed as follows:

	1986	1986	1987	1987	1988	1988
Fair market value: Jan. 1	.....	$150,000	.....	$196,500	.....	$238,000
Contributions	$65,000	.....	$62,000	.....	$66,000	
Benefit payments	(22,000)	.....	(24,000)	.....	(25,000)	
Expenses	(6,500)	.....	(7,000)	.....	(7,500)	
Interest and dividends	8,000	44,500	7,500	38,500	7,000	240,500
Net realized gains (losses)	.....	(2,000)	.....	6,000	.....	(8,000)
Balancing item [1]	.....	4,000	.....	(3,000)	.....	(42,000)
Fair market value: Dec. 31	.....	196,500	.....	238,000	.....	228,000

[1] This equals the increase (decrease) in unrealized appreciation.

Adjusted values	1985	1986	1987	1988
Fair market value: Dec. 31	$150,000	$196,500	$238,000	$228,000
Net adjustments:				
1988	40,500	40,500	40,500	
1987	38,500	38,500		
1986	44,500			
Total	273,500	275,500	278,500	228,000

Average value: 1988 = $273,500 + $275,500 + $278,500 + $228,000 ÷ 4 = $263,875

(ii) Plan F properly determines an average value under paragraph (b)(7) of this section for use as an actuarial value. Therefore, the valuation method meets the requirements of this section.

Example 7. Plan G computes the actuarial value of the plan assets as follows: The current fair market value of the plan assets is averaged with the most recent prior adjusted actuarial value. This average value is adjusted up or down toward the current fair market value by 20 percent of the difference between it and the current fair market value of the assets. This value is further adjusted to the extent necessary to fall within the corridor described in the statement of the plan's actuarial valuation method. The lower end of the corridor is the lesser of 80 percent of the fair market value of the plan assets or 85 percent of the average value of the plan assets. The higher end of the corridor is the greater of 120 percent of the fair market value of plan assets or 115 percent of the average value of plan assets. Average value for purposes of the corridor is determined under paragraph (b)(7) of this section. Assuming the numerical data of Example 6, the application of the corridor is as follows. The actuarial asset value as of December 31, 1988, must not be less than $182,400 (80 percent of current fair market value, $228,000) nor greater than $303,456 (115 percent of average value, 263,875). This method is permitted because it reflects fair market value in a manner permitted by paragraph (b)(4) of this section, it produces an actuarial value which is neither consistently above nor consistently below fair market or average value to satisfy paragraph (b)(5), and it is appropriately limited by the corridor described in paragraph (b)(6).

(c) *Fair market value of assets*—(1) *General rules.* Except as otherwise provided in this paragraph (c), the fair market value of a plan's assets for purposes of this section is the price at which the property would change hands between

a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

(d) *Methods for taking into account the fair market value of certain agreements.* [Reserved]

(e) *Effective date and transition rules*—(1) *Effective date.* This section applies to plan years to which section 412, or section 302 of the Employee Retirement Income Security Act of 1974, applies.

(2) *Special rule for certain plan years.* For plan years beginning prior to November 12, 1980, the amounts required to be determined under section 412 may be computed on the basis of any reasonable actuarial method of asset valuation which takes into account the fair market value of the plan's assets, even if the method does not meet all of the requirements of paragraphs (a) through (c) of this section.

(3) *Plan years beginning on or after November 12, 1980.* Paragraphs (a) through (c) of this section apply beginning with the first valuation of plan assets made for a plan year to which section 412 applies that begins on or after November 12, 1980. The statement of the plan's actuarial asset valuation method required by paragraph (b)(2) of this section must be included with the plan's actuarial report for that year, in addition to any subsequent reports.

(4) *Effect of change of asset valuation method.* A plan which is required to change its asset valuation method to comply with paragraphs (a) through (c) of this section must make the change no later than the time when the plan is first required to comply with this section under paragraph (e)(3). A method of adjustment must be used to take account of any difference in the actuarial value of the plan's assets based on the old and new valuation methods. The plan may use either—

(i) A method of adjustment described in paragraph (e)(5) or (e)(6) of this section without prior approval by the Commissioner, or

(ii) Any other method of adjustment if the Commissioner gives prior approval under section 412(c)(5).

(5) *Retroactive recomputation method.* (i) Under this method of adjustment, the plan recomputes the balance of the funding standard account as of the beginning of the first plan year for which it uses its new asset valuation method to comply with paragraphs (a) through (c) of this section. This new balance is recomputed by retroactively applying the plan's new method as of the first day of the first plan year to which section 412 applies.

(ii) Beginning with the first plan year for which it uses its new method, the plan computes the normal cost and amortization charges and credits to the funding standard account based on the retroactive application of its new method as of the first day of the first plan year to which section 412 applies.

(iii) If the recomputed aggregate charges exceed the recomputed aggregate credits to the funding standard account as of the end of the first plan year for which the plan uses its new method, an additional contribution to the plan may be necessary to avoid an accumulated funding deficiency in that year. The use of the retroactive recomputation method may also result in an accumulated funding deficiency for years prior to that first year. In such cases, the rules of section 412(c)(10), relating to the time when certain contributions are deemed to have been made, apply.

(6) *Prospective gain or loss adjustment method.* (i) Under this method of adjustment the plan values its assets under its new method no later than the valuation date for the first plan year beginning after [the publication date of this section]

(ii) Regardless of the type of funding method used by a plan, the difference in the value of the assets under the old and the new asset valuation methods may be treated as arising from an experience loss or gain; or alternatively it may be treated as arising from a change in actuarial assumptions.

(iii) The treatment of this difference as an experience gain or loss or as a change in actuarial assumptions must be consistent with the treatment of such gains, losses, or changes under the funding method used by the plan. Thus, if a plan uses a spread gain type funding method other than the aggregate cost method, the difference in the value of assets under the old and the new asset valuation methods may be either amortized or spread over future

periods as a part of normal cost. Examples of this type of funding method are the frozen initial liability cost method and the attained age normal cost method. With an aggregate method, the difference in the value of assets under the old and the new asset valuation methods must be spread over future periods as a part of normal cost.

(Secs. 412(c)(2) and 7805 of the Internal Revenue Code of 1954 (88 Stat. 916 and 68A Stat. 917; 26 U.S.C. 412(c)(2) and 7805))

[T.D. 7734, 45 FR 74718, Nov. 12, 1980]

§ 1.412(c)(3)–1 Reasonable funding methods.

(a) *Introduction*—(1) *In general*. This section prescribes rules for determining whether or not, in the case of an ongoing plan, a funding method is reasonable for purposes of section 412(c)(3). A method is unreasonable only if it is found to be inconsistent with a rule prescribed in this section. The term ''reasonable funding method'' under this section has the same meaning as the term ''acceptable actuarial cost method'' under section 3(31) of the Employee Retirement Income Security Act of 1974 (ERISA).

(2) *Computations included in method*. See § 1.412(c)(1)–1(b) for a discussion of matters that are, and are not, included in the funding method of a plan.

(3) *Plans using shortfall*. The shortfall method is a method of determining charges to the funding standard account by adapting the underlying funding method of certain collectively bargained plans in the manner described in § 1.412(c)(1)–2. As such, the shortfall method is a funding method. The underlying method of a plan that uses the shortfall method must be a reasonable funding method under this section. The rules contained in this section, relating to cost under a reasonable funding method, apply in the shortfall method to the annual computation charge under § 1.412(c)(1)–2(d).

(4) *Scope of funding method*. Except for the shortfall method, a reasonable funding method is applied to the computation of—

(i) The normal cost of a plan for a plan year; and, if applicable,

(ii) The bases established under section 412(b)(2)(B), (C), and (D), and (3)(B) (''amortizable bases'').

(b) *General rules for reasonable funding methods*—(1) *Basic funding formula*. At any time, except as provided by the Commissioner, the present value of future benefits under a reasonable funding method must equal the sum of the following amounts:

(i) The present value of normal costs (taking into account future mandatory employee contributions, within the meaning of section 411(c)(2)(C), in the case of a contributory plan) over the future working lifetime of participants;

(ii) The sum of the unamortized portions of amortizable bases, if any, treating credit bases under section 412(b)(3)(B) as negative numbers; and

(iii) The plan assets, decreased by a credit balance (and increased by a debit balance) in the funding standard account under section 412(b).

(2) *Normal cost*. Normal cost under a reasonable funding method must be expressed as—

(i) A level dollar amount, or a level percentage of pay, that is computed from year to year on either an individual basis or an aggregate basis; or

(ii) An amount equal to the present value of benefits accruing under the method for a particular plan year.

(3) *Application to shortfall*. Paragraph (b)(2) will not fail to be satisfied merely because an amount described in (i) or (ii) is expressed as permitted under the shortfall method.

(c) *Additional requirements*—(1) *Inclusion of all liabilities*. Under a reasonable funding method, all liabilities of the plan for benefits, whether vested or not, must be taken into account.

(2) *Production of experience gains and losses*. If each actuarial assumption is exactly realized under a reasonable funding method, no experience gains or losses are produced.

(3) *Plan population*—(i) *In general*. Under a reasonable funding method, the plan population must include three classes of individuals: participants currently employed in the service of the employer; former participants who either terminated service with the employer, or retired, under the plan; and all other individuals currently entitled to benefits under the plan. See § 1.412(c)(3)–1(d)(2) for rules concerning anticipated future participants.

(ii) *Limited exclusion for certain recent participants.* Under a reasonable funding method, certain individuals may be excluded from the first class of individuals described in paragraph (c)(3)(i) of this section unless otherwise provided by the Commissioner. The excludable individuals are participants who would be excluded from participation by the minimum age or service requirement of section 410 but who, under the terms of the plan, participate immediately upon entering the service of the employer.

(iii) *Special exclusion for ''rule of parity'' cases.* Under a reasonable funding method, certain individuals may be excluded from the second class of individuals described in paragraph (c)(3)(i) of this section. The excludable individuals are those former participants who have terminated service with the employer without vested benefits and whose service might be taken into account in future years because the ''rule of parity'' of section 411(a)(6)(D) does not permit that service to be disregarded. However if the plan's experience as to separated employees' returning to service has been such that the exclusion described in this subparagraph would be unreasonable, the exclusion would no longer apply.

(4) *Use of salary scale*—(i) *General acceptability.* The use of a salary scale assumption is not inappropriate merely because of the funding method with which it is used. Therefore, in determining whether actuarial assumptions are reasonable, a salary scale will not be considered to be prohibited merely because a particular funding method is being used.

(ii) *Projection to appropriate salary.* Under a reasonable funding method, salary scales reflected in projected benefits must be the expected salary on which benefits would be based under the plan at the age when the receipt of benefits is expected to begin.

(5) *Treatment of allocable items.* Under a reasonable funding method that allocates assets to individual participants to determine costs, the allocation of assets among participants must be reasonable. An initial allocation of assets among participants will be considered reasonable only if it is in proportion to related liabilities. However, the Commissioner may determine, based on the facts and circumstances, that it is unreasonable to continue to allocate assets on this basis beyond the initial year. Under a reasonable funding method that allocates liabilities among different elements of past and future service, the allocation of liabilities must be reasonable.

(d) *Prohibited considerations under a reasonable funding method*—(1) *Anticipated benefit changes*—(i) *In general.* Except as otherwise provided by the Commissioner, a reasonable funding method does not anticipate changes in plan benefits that become effective, whether or not retroactively, in a future plan year or that become effective after the first day of, but during, a current plan year.

(ii) *Exception for collectively bargained plans.* A collectively bargained plan described in section 413(a) may on a consistent basis anticipate benefit increases scheduled to take effect during the term of the collective-bargaining agreement applicable to the plan. A plan's treatment of benefit increases scheduled in a collective bargaining agreement is part of its funding method. Accordingly, a change in a plan's treatment of such benefit increases (for example, ignoring anticipated increases after taking them into account) is a change of funding method.

(2) *Anticipated future participants.* A reasonable funding method must not anticipate the affiliation with the plan of future participants not employed in the service of the employer on the plan valuation date. However, a reasonable funding method may anticipate the affiliation with the plan of current employees who have not satisfied the participation requirements of the plan.

(e) *Special rules for certain funding methods*—(1) *Applicability of special rules.* Paragraph (e) of this section applies to a funding method that determines normal cost under paragraph (b)(2)(ii) of this section.

(2) *Use of salary scale.* For rules relating to use of a salary scale assumption, see paragraph (c)(4) of this section.

(3) *Allocation of liabilities.* In determining a plan's normal cost and accrued liability for a particular plan year, the projected benefits of the plan must be allocated between past years and future years. Except in the case of

a career average pay plan, this allocation must be in proportion to the applicable rates of benefit accrual under the plan. Thus, the allocation to past years is effected by multiplying the projected benefit by a fraction. The numerator of the fraction is the participant's credited years of service. The denominator is the participant's total credited years of service at the anticipated benefit commencement date. Adjustments are made to account for changes in the rate of benefit accrual. An allocation based on compensation is not permitted. In the case of a career average pay plan, an allocation between past and future service benefits must be reasonable.

(f) *Treatment of ancillary benefit costs*—(1) *General rule*. Under a reasonable funding method, except as otherwise provided by this paragraph (f), ancillary benefit costs must be computed by using the same method used to compute retirement benefit costs under a plan.

(2) *Ancillary benefit defined*. For purposes of this paragraph an ancillary benefit is a benefit that is paid as a result of a specified event which—

(i) Occurs not later than a participant's separation from service, and

(ii) Was detrimental to the participant's health.

Thus, for example, benefits payable if a participant dies or becomes disabled prior to separation from service are ancillary benefits because the events giving rise to the benefits are detrimental to the participant's health. However, an early retirement benefit, a social security supplement (as defined in §1.411(a)–7(c)(4)(ii)), and the vesting of plan benefits (even if more rapid than is required by section 411) are not ancillary benefits because those benefits do not result from an event which is detrimental to the participant's health.

(3) *Exception for certain insurance contracts*. Under a reasonable funding method, regardless of the method used to compute retirement benefit costs, the cost of an ancillary benefit may equal the premium paid for that benefit under an insurance contract if—

(i) The ancillary benefit is provided under the contract, and

(ii) The benefit is guaranteed under the contract.

(4) *Exception for 1-year term funding and other approved methods*. [Reserved]

(5) *Section 401(h) benefits*. Section 412 does not apply to benefits that are described in section 401(h) and for which a separate account is maintained.

(g) *Examples*. The principles of this section are illustrated by the following examples:

Example 1. Assume that a plan, using funding method A, is in its first year. No contributions have been made to the plan, other than a nominal contribution to establish a corpus for the plan's trust. There is no past service liability, and the normal cost is a constant percentage of an annually determined amount. The constant percentage is 99 percent, and the annually determined amount is the excess of the present value of future benefits over plan assets. The present value of future benefits is $10,000. Under paragraph (b)(1) of this section, the present value of future benefits must equal the present value of future normal costs plus plan assets. (No amortizable bases exist, nor are there credit or debit balances.) Under method A, the present value of future normal costs would equal the sum of a series of annually decreasing amounts. Because of the constant percentage factor, the present value of future normal costs over the years can never equal $10,000, the present value of future benefits. In effect, then, assets under method A can never equal the present value of future benefits if all assumptions are exactly realized. Therefore, method A is not a reasonable funding method.

Example 2. Assume that a plan, using funding method B, determines normal cost by computing the present value of benefits expected to be accrued under the plan by the end of 10 years after the valuation date and adding to this the present value of benefits expected to be paid within these 10 years. Plan assets are subtracted from the sum of the two present value amounts. The difference then is divided by the present value of salaries projected over the 10 years. Under paragraph (c)(1) of this section, all liabilities of a plan must be taken into account. Because method B takes into account only benefits paid or accrued by the end of 10 years, it is not a reasonable funding method.

Example 3. Assume that a plan, using funding method C, determines normal cost as a constant percentage of compensation. (This percentage is determined as follows: The excess of projected benefits over accrued benefits is computed. Then the present value of this excess is divided by the present value of future salaries.) However, the accrued liability is computed each year as the present value of accrued benefits. (This computation

does not reflect normal cost as a constant percentage of compensation. Thus, normal cost under the plan does not link accrued liabilities under the plan for consecutive years as would be the case, for example, under a unit credit cost method.) In determining gains and losses, method C compares the actual unfunded liability (the accrued liability less assets) with the expected unfunded liability (the sum of the actual unfunded liability in the previous year and the normal cost for the previous year less the contribution made for the previous year, all adjusted for interest). Under paragraph (c)(2) of this section, if actuarial assumptions are exactly realized, experience gains and losses must not be produced. Under method C, the use of a constant percentage in computing normal cost (and the expected unfunded liability) coupled with the manner of computing the accrued liability (and the actual unfunded liability) generally produces gains in the earlier years and losses in the later years if each actuarial assumption is exactly realized. Therefore, method C is not a reasonable funding method.

Example 4. Assume that a plan, using funding method D, bases benefits on final average pay. Under method D, the past service liability on any date equals the present value of the accrued benefit on that date based on compensation as of that date. The normal cost for any year equals the present value of a certain amount. That amount is the excess of the projected accrued benefit as of the end of the year over the actual accrued benefit at the beginning of the year. Accrued benefits, projected as of the end of a year, reflect a 1-year salary projection. Under paragraph (c)(4) of this section, salary scales reflected in projected benefits must project salaries to the salary on which benefits would be based under the plan at the age when the receipt of benefits under the plan is expected to begin. Because the plan is not a career average pay plan and compensation is projected only 1 year, method D is not a reasonable funding method. (Under paragraph (c)(4) of this section, the use of a salary scale assumption could be required with a unit credit method if, without the use of a salary scale, assumptions in the aggregate are unreasonable.)

Example 5. Assume that a plan, using method E, a unit credit funding method, calculates a participant's accrued benefit according to the following formula: 2 percent of final salary for the first 10 years of service and 1 percent of final salary for the years of service in excess of 10. Under the plan, no employee may be credited with more than 25 years of service. The actuarial assumptions for the valuation include a salary scale of 5 percent per year. For a participant at age 40 with 15 years of service, a current salary of $20,000 and a normal retirement age of 65, the accrued liability for the retirement benefit is the present value of an annuity of $16,932 per year, commencing at age 65. The $16,932 is calculated as follows:

$$\$20{,}000 \times 3.3864 \times 35\% \times \frac{(10 \times 2) + (5 \times 1)}{(10 \times 2) - (15 \times 1) + (15 \times 0)}$$

(3.3864 is 1.05 raised to the 25th power; the 25th power reflects the difference between normal retirement age and attained age (65–40).)

Salary under this method is projected to the age when the receipt of benefits is expected to begin. Therefore, method E meets the requirement of paragraph (c)(4) of this section. Also, the allocation of benefits under method E between past and future years of service meets the requirements of paragraph (e)(3) of this section.

Example 6. Assume that a plan that has two participants and that previously used the unit credit cost method wishes to change the funding method at the beginning of the plan year to funding method F, a modification of the aggregate cost method. The modification involves determining normal cost for each of the two participants under the plan. Therefore, it requires an allocation of assets to each participant for valuation purposes. The actuary proposes to allocate the assets on hand at the beginning of the plan year of the change in funding method in proportion to the accrued liabilities calculated under the unit credit cost method. The relevant results of the calculations are shown below:

	Employees		Totals
	M	N	
Accrued Liabilities (unit credit method):			
Dollar amount	15,670	906	16,576
Per cent of total	94.53	5.47	100.00
Assets:			
Dollar amount	7,835	453	8,288
per cent of total	94.53	5.47	100.00

The proposed allocation in proportion to the accrued liabilities under the unit credit cost method satisfies the requirements of paragraph (c)(5) of this section at the beginning of the first plan year for which the new method is used.

Example 7. The facts are the same as in Example 6. However, the actuary proposes to

allocate all the assets to employee M, the older employee. Method F, under these facts, is not an acceptable funding method because the allocation is not in proportion to related liabilities as required under paragraph (c)(5) of this section.

[T.D. 7746, 45 FR 86430, Dec. 31, 1980]

§ 1.412(c)(3)–2 Effective dates and transitional rules relating to reasonable funding methods.

(a) *Introduction*. This section prescribes effective dates for rules relating to reasonable funding methods, under section 412(c)(3) and § 1.412(c)(3)–1. Also, this section sets forth rules concerning adjustments to a plan's funding standard account that are necessitated by a change in funding method, and a provision setting forth procedural requirements for use of an optional phase-in of required changes.

(b) *Effective date*—(1) *General rule*. Except as otherwise provided by subparagraph (2) of this paragraph, § 1.412(c)(3)–1 applies to any valuation of a plan's liabilities (within the meaning of section 412(c)(9)) as of a date after April 30, 1981.

(2) *Exception*. If a collective bargaining agreement which determines contributions to a plan is in effect on April 30, 1981, then § 1.412(c)(3)–1 applies to any valuation of that plan's liabilities as of a date after the earlier of the date on which the last such collective bargaining agreement expires or April 30, 1984.

(3) *Transitional rule*. The reasonableness of a funding method used in making a valuation of a plan's liability as of a date before the effective date determined under subparagraph (1) or (2) of this paragraph is determined on the basis of such published guidance as was available on the date as of which the valuation was made.

(c) *Change of funding method without approval*—(1) *In general*. A plan that is required to change its funding method to comply with § 1.412(c)(3)–1 is not required to submit the change of funding method for approval as otherwise required by section 412(c)(5). However, this change must be described on Form 5500, Schedule B for the plan year with respect to which the change is first effective.

(2) *Amortization base*. An amortization base must be established in the plan year of the change in method equal to the change in the unfunded liability due to the change (where both unfunded liabilities are based on the same actuarial assumptions). Such a base must be amortized over 30 years in determining the charges or credits to the funding standard account, unless the Commissioner upon application permits amortization over a shorter period.

(d) *Phase-in of additional funding required by new method*—(1) *In general*. A plan that is required to change its funding method to comply with § 1.412(c)(3)–1 may elect to charge and credit the funding standard account as provided in this paragraph. An election under this paragraph shall be irrevocable.

(2) *Credit in year of change*. In the plan year of the change in method the funding standard account may be credited with an amount not in excess of 0.8 multiplied by the excess (if any) of—

(i) The normal cost under the new method plus the amortization charge (or minus the amortization credit) computed as described in § 1.412(c)(3)–2(c)(2), over

(ii) The normal cost under the prior method, for the plan year of the change in method.

(3) *Credits in the next three years*. In the three years following the year of the change the funding standard account may be credited with an amount not in excess of 0.6, 0.4, and 0.2 respectively in the first, second, and third years, multiplied by either of the following amounts, computed as of the last day of the year of credit—

(i) The excess described in § 1.412(c)(3)–2(d)(2) multiplied by a fraction (not greater than 1), the numerator of which is the number of participants in the year of the credit and the denominator of which is the number of participants in the year of the change, or, at the option of the plan,

(ii) The excess (if any) in the year of credit of—

(A) The net charge to the funding standard account based on the new method, over

(B) The net charge to the funding standing account based on the prior method.

(4) *Computational rules.* For purposes of the calculation described in §1.412(c)(3)–2(d)(3)(ii), the net charge is the excess of charges under section 412(b)(2) (A) and (B) over the credits under section 412(b)(3)(B) (including the charge or credit described in §1.412(c)(3)–2(c)) which would be required using the actuarial assumptions and plan benefit structure in effect on the last day of the plan year of change.

(5) *Fifteen-year amortization of credits.* The funding standard account shall be charged with 15-year amortization of each credit described in §1.412(c)(3)–2(d) (2) and (3) beginning in the year following each such credit.

(6) *Manner of election.* An election under this paragraph shall be made by the claiming of the credits described in §1.412(c)(3)–2(d) (2) and (3) on Schedule B to Form 5500 and by filing such other information as may be required by the Commissioner.

(e) *Effect on shortfall method.* The charges and credits described in this section apply in the shortfall method to the annual computation charge described in §1.412(c)(1)–2(d). The amounts described in §1.412(c)(3)–2(d) shall be determined before the application of the shortfall method.

(Sec. 3(31) of the Employee Retirement Income Security Act of 1974 (88 Stat. 837; 29 U.S.C. 1002) and sec. 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805))

[T.D. 7746, 45 FR 86432, Dec. 31, 1980]

§1.412(i)–1 Certain insurance contract plans.

(a) *In general.* Under section 412(h)(2) of the Internal Revenue Code of 1954, as added by section 1013(a) of the Employee Retirement Income Security Act of 1974 (88 Stat. 914) (hereinafter referred to as ''the Act''), an insurance contract plan described in section 412(i) for a plan year is not subject to the minimum funding requirements of section 412 for that plan year. Consequently, if an individual or group insurance contract plan satisfies all of the requirements of paragraph (b)(2) or (c)(2) of this section, whichever are applicable, for the plan year, the plan is not subject to the requirements of section 412 for that plan year. The effective date for section 412 of the Code is determined under section 1017 of the Act. In general, in the case of a plan which was not in existence on January 1, 1974, this section applies for plan years beginning after September 2, 1974, and in the case of a plan in existence on January 1, 1974, to plan years beginning after December 31, 1975.

(b) *Individual insurance contract plans.* (1) An individual insurance contract plan is described in section 412(i) during a plan year if the plan satisfies the requirements of paragraph (b)(2) of this section for the plan year.

(2) The requirements of this paragraph are:

(i) The plan must be funded exclusively by the purchase from an insurance company or companies (licensed under the law of a State or the District of Columbia to do business with the plan) of individual annuity or individual insurance contracts, or a combination thereof. The purchase may be made either directly by the employer or through the use of a custodial account or trust. A plan shall not be considered to be funded otherwise than exclusively by the purchase of individual annuity or individual insurance contracts merely because the employer makes a payment necessary to comply with the provisions of section 411(c)(2) (relating to accrued benefit from employee contributions).

(ii) The individual annuity or individual insurance contracts issued under the plan must provide for level annual, or more frequent, premium payments to be paid under the plan for the period commencing with the date each individual participating in the plan became a participant and ending not later than the normal retirement age for that individual or, if earlier, the date the individual ceases his participation in the plan. Premium payments may be considered to be level even though items such as experience gains and dividends are applied against premiums. In the case of an increase in benefits, the contracts must provide for level annual payments with respect to such increase to be paid for the period commencing at the time the increase becomes effective. If payment commences on the first payment date under the contract occurring after the

date an individual becomes a participant or after the effective date of an increase in benefits, the requirements of this subdivision will be satisfied even though payment does not commence on the date on which the individual's participation commenced or on the effective date of the benefit increase, whichever is applicable. If an individual accrues benefits after his normal retirement age, the requirements of this subdivision are satisfied if payment is made at the time such benefits accrue. If the provisions required by this subdivision are set forth in a separate agreement with the issuer of the individual contracts, they need not be included in the individual contracts.

(iii) The benefits provided by the plan for each individual participant must be equal to the benefits provided under his individual contracts at his normal retirement age under the plan provisions.

(iv) The benefits provided by the plan for each individual participant must be guaranteed by the life insurance company, described in paragraph (b)(2)(i) of this section, issuing the individual contracts to the extent premiums have been paid.

(v) Except as provided in the following sentence, all premiums payable for the plan year, and for all prior plan years, under the insurance or annuity contracts must have been paid before lapse. If the lapse has occurred during the plan year, the requirements of this subdivision will be considered to have been met if reinstatement of the insurance policy, under which the individual insurance contracts are issued, occurs during the year of the lapse and before distribution is made or benefits commence to any participant whose benefits are reduced because of the lapse.

(vi) No rights under the individual contracts may have been subject to a security interest at any time during the plan year. This subdivision shall not apply to contracts which have been distributed to participants if the security interest is created after the date of distribution.

(vii) No policy loans, including loans to individual participants, on any of the individual contracts may be outstanding at any time during the plan year. This subdivision shall not apply to contracts which have been distributed to participants if the loan is made after the date of distribution. An application of funds by the issuer to pay premiums due under the contracts shall be deemed not to be a policy loan if the amount of the funds so applied, and interest thereon, is repaid during the plan year in which the funds are applied and before distribution is made or benefits commence to any participant whose benefits are reduced because of such application.

(c) *Group insurance contract plans.* (1) A group insurance contract plan is described in section 412(i) during a plan year if the plan satisfies the requirements of subparagraph (2) for the plan year.

(2) The requirements of this subparagraph are:

(i) The plan must be funded exclusively by the purchase from an insurance company or companies, described in paragraph (b)(2)(i) of this section, of group annuity or group insurance contracts, or a combination thereof. The purchase may be made either directly by the employer or through the use of a custodial account or trust. A plan shall not be considered to be funded otherwise than exclusively by the purchase of group annuity or group insurance contracts merely because the employer makes a payment necessary to comply with the provisions of section 411 (c)(2) (relating to accrued benefit derived from employee contributions).

(ii) In the case of a plan funded by a group insurance contract or a group annuity contract the requirements of paragraph (b)(2)(ii) of this section must be satisfied by the group contract issued under the plan. Thus, for example, each individual participant's benefits under the group contract must be provided for by level annual, or more frequent, payments equivalent to the payments required to satisfy such paragraph. The requirements of this subdivision will not be satisfied if benefits for any individual are not provided for by level payments made on his behalf under the group contract.

(iii) The group annuity or group insurance contract must satisfy the requirements of clauses (iii), (iv), (v), (vi), and (vii) of paragraph (b)(2). Thus,

for example, each participant's benefits provided by the plan must be equal to his benefits provided under the group contract at his normal retirement age.

(iv)(A) If the plan is funded by a group annuity contract, the value of the benefits guaranteed by the insurance company issuing the contract under the plan with respect to each participant under the contract must not be less than the value of such benefits which the cash surrender value would provide for that participant under any individual annuity contract plan satisfying the requirements of paragraph (b) and approved for sale in the State where the principal office of the plan is located.

(B) If the plan is funded by a group insurance contract, the value of the benefits guaranteed by the insurance company issuing the contract under the plan with respect to each participate under the contract must not be less than the value of such benefits which the cash surrender value would provide for that participant under any individual insurance contract plan satisfying the requirements of paragraph (b) and approved for sale in the State where the principal office of the plan is located.

(v) Under the group annuity or group insurance contract, premiums or other consideration received by the insurance company (and, if a custodial account or trust is used, the custodian or trustee thereof) must be allocated to purchase individual benefits for participants under the plan. A plan which maintains unallocated funds in an auxiliary trust fund or which provides that an insurance company will maintain unallocated funds in a separate account, such as a group deposit administration contract, does not satisfy the requirements of this subdivision.

(d) *Combination of plans.* A plan which is funded by a combination of individual contracts and a group contract shall be treated as a plan described in section 412 (i) for the plan year if the combination, in the aggregate, satisfies the requirements of this section for the plan year.

[T.D. 7746, 45 FR 47676, July 16, 1980; 45 FR 50563, July 30, 1980]

§ 1.412(l)(7)–1 Mortality tables used to determine current liability.

(a) *In general.* The mortality tables set forth in paragraph (d) of this section are to be used in determining current liability under section 412(l)(7) for participants and beneficiaries (other than disabled participants) for plan years beginning in 2007. For plan years beginning on or after January 1, 2008, the mortality tables described in section 430(h)(3)(A) are to be used in determining current liability under section 412(l)(7) for participants and beneficiaries (other than disabled participants).

(b) *Separate tables for annuitants and nonannuitants.* The separate tables for annuitants and nonannuitants are used unless the plan applies the optional combined table pursuant to paragraph (c) of this section. If these separate tables are used, the nonannuitant mortality table is applied to determine the probability of survival for a nonannuitant for the period before the nonannuitant is projected to commence receiving benefits. The annuitant mortality table is applied to determine the present value of benefits for each annuitant, and for each nonannuitant for the period after which the nonannuitant is projected to commence receiving benefits. For purposes of this section, an annuitant means a plan participant who has commenced receiving benefits and a nonannuitant means a plan participant who has not yet commenced receiving benefits (e.g., an active employee or a terminated vested participant). Thus, for example, with respect to a 45-year-old active participant who is projected to commence receiving an annuity at age 55, current liability would be determined using the nonannuitant mortality table for the period before the participant attains age 55 (i.e., so that the probability of an active male participant living from age 45 to the age of 55 for the table that applies in plan years beginning in 2007 is 98.59%) and the annuitant mortality table for the period ages 55 and above. Similarly, if a 45-year-old terminated vested participant is projected to commence an annuity at age 65, current liability would be determined using the nonannuitant mortality table for the period before the participant attains

age 65 and the annuitant mortality table for ages 65 and above. For purposes of this section, a participant whose benefit has partially commenced is treated as an annuitant with respect to the portion of the benefit which has commenced and a nonannuitant with respect to the balance of the benefit.

(c) *Optional combined tables.* As an alternative to the separate tables specified for annuitants and nonannuitants as described in paragraph (b) of this section, the optional combined table, which applies the same mortality rates to both annuitants and nonannuitants, can be used.

(d) *Mortality tables for 2007.* As set forth in paragraph (a) of this section, the following tables are to be used for determining current liability for plan years beginning during 2007 in accordance with the rules of this section.

Age	Male			Female		
	Nonannuitant table	Annuitant table	Optional combined table	Nonannuitant table	Annuitant table	Optional combined table
1	0.000408	0.000408	0.000408	0.000366	0.000366	0.000366
2	0.000276	0.000276	0.000276	0.000239	0.000239	0.000239
3	0.000229	0.000229	0.000229	0.000178	0.000178	0.000178
4	0.000178	0.000178	0.000178	0.000133	0.000133	0.000133
5	0.000163	0.000163	0.000163	0.000121	0.000121	0.000121
6	0.000156	0.000156	0.000156	0.000113	0.000113	0.000113
7	0.000150	0.000150	0.000150	0.000106	0.000106	0.000106
8	0.000138	0.000138	0.000138	0.000094	0.000094	0.000094
9	0.000134	0.000134	0.000134	0.000090	0.000090	0.000090
10	0.000136	0.000136	0.000136	0.000090	0.000090	0.000090
11	0.000140	0.000140	0.000140	0.000092	0.000092	0.000092
12	0.000146	0.000146	0.000146	0.000095	0.000095	0.000095
13	0.000154	0.000154	0.000154	0.000099	0.000099	0.000099
14	0.000167	0.000167	0.000167	0.000109	0.000109	0.000109
15	0.000176	0.000176	0.000176	0.000119	0.000119	0.000119
16	0.000186	0.000186	0.000186	0.000127	0.000127	0.000127
17	0.000197	0.000197	0.000197	0.000135	0.000135	0.000135
18	0.000207	0.000207	0.000207	0.000138	0.000138	0.000138
19	0.000217	0.000217	0.000217	0.000136	0.000136	0.000136
20	0.000226	0.000226	0.000226	0.000134	0.000134	0.000134
21	0.000239	0.000239	0.000239	0.000132	0.000132	0.000132
22	0.000251	0.000251	0.000251	0.000133	0.000133	0.000133
23	0.000267	0.000267	0.000267	0.000138	0.000138	0.000138
24	0.000282	0.000282	0.000282	0.000144	0.000144	0.000144
25	0.000301	0.000301	0.000301	0.000152	0.000152	0.000152
26	0.000331	0.000331	0.000331	0.000164	0.000164	0.000164
27	0.000342	0.000342	0.000342	0.000171	0.000171	0.000171
28	0.000352	0.000352	0.000352	0.000180	0.000180	0.000180
29	0.000369	0.000369	0.000369	0.000190	0.000190	0.000190
30	0.000398	0.000398	0.000398	0.000212	0.000212	0.000212
31	0.000447	0.000447	0.000447	0.000257	0.000257	0.000257
32	0.000503	0.000503	0.000503	0.000293	0.000293	0.000293
33	0.000565	0.000565	0.000565	0.000323	0.000323	0.000323
34	0.000629	0.000629	0.000629	0.000349	0.000349	0.000349
35	0.000692	0.000692	0.000692	0.000372	0.000372	0.000372
36	0.000753	0.000753	0.000753	0.000394	0.000394	0.000394
37	0.000810	0.000810	0.000810	0.000415	0.000415	0.000415
38	0.000844	0.000844	0.000844	0.000439	0.000439	0.000439
39	0.000875	0.000875	0.000875	0.000465	0.000465	0.000465
40	0.000904	0.000904	0.000904	0.000506	0.000506	0.000506
41	0.000936	0.000963	0.000936	0.000555	0.000555	0.000555
42	0.000974	0.001081	0.000975	0.000611	0.000611	0.000611
43	0.001018	0.001258	0.001021	0.000672	0.000672	0.000672
44	0.001071	0.001493	0.001079	0.000738	0.000738	0.000738
45	0.001131	0.001788	0.001146	0.000788	0.000791	0.000788
46	0.001185	0.002142	0.001211	0.000839	0.000896	0.000840
47	0.001244	0.002554	0.001286	0.000889	0.001054	0.000893
48	0.001304	0.003026	0.001366	0.000962	0.001265	0.000972
49	0.001368	0.003557	0.001457	0.001039	0.001528	0.001059
50	0.001434	0.004146	0.001557	0.001149	0.001844	0.001184
51	0.001500	0.004226	0.001636	0.001272	0.001962	0.001312
52	0.001570	0.004254	0.001754	0.001442	0.002173	0.001496
53	0.001681	0.004312	0.001932	0.001637	0.002445	0.001714
54	0.001803	0.004369	0.002134	0.001861	0.002771	0.001969
55	0.001986	0.004514	0.002508	0.002117	0.003155	0.002314
56	0.002217	0.004749	0.003020	0.002414	0.003608	0.002755
57	0.002488	0.005069	0.003464	0.002696	0.004088	0.003170

Age	Male			Female		
	Nonannuitant table	Annuitant table	Optional combined table	Nonannuitant table	Annuitant table	Optional combined table
58	0.002803	0.005501	0.003990	0.002947	0.004588	0.003583
59	0.003095	0.005972	0.004529	0.003223	0.005156	0.004066
60	0.003421	0.006539	0.005177	0.003521	0.005780	0.004640
61	0.003860	0.007284	0.006030	0.003838	0.006450	0.005354
62	0.004244	0.008024	0.006929	0.004170	0.007168	0.006148
63	0.004746	0.008989	0.008099	0.004513	0.007932	0.007084
64	0.005154	0.009947	0.009159	0.004862	0.008758	0.007996
65	0.005553	0.011015	0.010377	0.005213	0.009662	0.009018
66	0.006073	0.012379	0.011951	0.005559	0.010640	0.010192
67	0.006447	0.013705	0.013349	0.005896	0.011690	0.011323
68	0.006650	0.014940	0.014641	0.006220	0.012838	0.012522
69	0.006974	0.016504	0.016231	0.006528	0.014126	0.013843
70	0.007115	0.017971	0.017689	0.006818	0.015607	0.015309
71	0.008002	0.019884	0.019606	0.007450	0.017078	0.016784
72	0.009777	0.022078	0.021822	0.008714	0.018995	0.018716
73	0.012439	0.024592	0.024371	0.010610	0.020819	0.020577
74	0.015988	0.027435	0.027256	0.013139	0.023074	0.022872
75	0.020425	0.031057	0.030919	0.016299	0.025117	0.024967
76	0.025749	0.034615	0.034523	0.020092	0.027673	0.027570
77	0.031961	0.039054	0.038999	0.024516	0.030911	0.030846
78	0.039059	0.044018	0.043992	0.029573	0.034074	0.034043
79	0.047046	0.049617	0.049610	0.035261	0.037618	0.037610
80	0.055919	0.055919	0.055919	0.041582	0.041582	0.041582
81	0.063476	0.063476	0.063476	0.046024	0.046024	0.046024
82	0.071926	0.071926	0.071926	0.051021	0.051021	0.051021
83	0.080176	0.080176	0.080176	0.056651	0.056651	0.056651
84	0.090433	0.090433	0.090433	0.063006	0.063006	0.063006
85	0.100383	0.100383	0.100383	0.071188	0.071188	0.071188
86	0.111295	0.111295	0.111295	0.080522	0.080522	0.080522
87	0.125051	0.125051	0.125051	0.091080	0.091080	0.091080
88	0.140385	0.140385	0.140385	0.101448	0.101448	0.101448
89	0.155142	0.155142	0.155142	0.114246	0.114246	0.114246
90	0.173400	0.173400	0.173400	0.126258	0.126258	0.126258
91	0.188868	0.188868	0.188868	0.138648	0.138648	0.138648
92	0.207683	0.207683	0.207683	0.151126	0.151126	0.151126
93	0.224037	0.224037	0.224037	0.165722	0.165722	0.165722
94	0.240367	0.240367	0.240367	0.177747	0.177747	0.177747
95	0.260098	0.260098	0.260098	0.189133	0.189133	0.189133
96	0.276058	0.276058	0.276058	0.199703	0.199703	0.199703
97	0.291564	0.291564	0.291564	0.212246	0.212246	0.212246
98	0.310910	0.310910	0.310910	0.220832	0.220832	0.220832
99	0.325614	0.325614	0.325614	0.228169	0.228169	0.228169
100	0.339763	0.339763	0.339763	0.234164	0.234164	0.234164
101	0.358628	0.358628	0.358628	0.244834	0.244834	0.244834
102	0.371685	0.371685	0.371685	0.254498	0.254498	0.254498
103	0.383040	0.383040	0.383040	0.266044	0.266044	0.266044
104	0.392003	0.392003	0.392003	0.279055	0.279055	0.279055
105	0.397886	0.397886	0.397886	0.293116	0.293116	0.293116
106	0.400000	0.400000	0.400000	0.307811	0.307811	0.307811
107	0.400000	0.400000	0.400000	0.322725	0.322725	0.322725
108	0.400000	0.400000	0.400000	0.337441	0.337441	0.337441
109	0.400000	0.400000	0.400000	0.351544	0.351544	0.351544
110	0.400000	0.400000	0.400000	0.364617	0.364617	0.364617
111	0.400000	0.400000	0.400000	0.376246	0.376246	0.376246
112	0.400000	0.400000	0.400000	0.386015	0.386015	0.386015
113	0.400000	0.400000	0.400000	0.393507	0.393507	0.393507
114	0.400000	0.400000	0.400000	0.398308	0.398308	0.398308
115	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
116	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
117	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
118	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
119	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
120	1.000000	1.000000	1.000000	1.000000	1.000000	1.000000

(e) *Effective date.* This section applies for plan years beginning on or after January 1, 2007.

[T.D. 9310, 72 FR 4958, Feb. 2, 2007]

§ 1.413–1 Special rules for collectively bargained plans.

(a) *Application of section 413(b) to certain collectively bargained plans*—(1) *In general.* Section 413(b) sets forth special rules applicable to certain pension, profit-sharing, and stock bonus plans (and each trust which is a part of such a plan), hereinafter referred to as ''section 413(b) plans'', described in paragraph (a)(2) of this section. Notwithstanding any other provision of the Code, a section 413(b) plan is subject to the special rules of section 413(b) (1) through (8) and paragraphs (b) through (i) of this section.

(2) *Requirements.* Section 413(b) applies to a plan (and each trust which is a part of such plan) if the plan is a single plan which is maintained pursuant to one or more agreements which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers. A plan which provides benefits for employees of more than one employer is considered a single plan subject to the requirements of section 413(b) and this section if the plan is considered a single plan for purposes of applying section 414(l) (see § 1.414(l)–1(b)(1)). For purposes of determining whether one or more plans (or agreements) are a single plan, under sections 413(a) and 414(l), it is irrelevant that there are in form two or more separate plans (or agreements). For example, a single plan will be considered to exist where agreements are entered into separately by a national labor organization (or one or more local units of such organization), on one hand, and individual employers, on the other hand, if the plan is considered a single plan for purposes of applying section 414(*l*).

(3) *Additional rules and effective dates.* (i) If a plan is a section 413(b) plan at a relevant time, the rules of section 413(b) and this section apply, and the rules of section 413(c) and § 1.413–2 do not apply to the plan.

(ii) The qualification of a section 413(b) plan, at any relevant time, under section 401(a), 403(a), or 405(a), as modified by sections 413(b) and this section, is determined with respect to all employers maintaining the plan. Consequently, the failure by one employer maintaining the plan (or by the plan itself) to satisfy an applicable qualification requirement will result in the disqualification of the plan for all employers maintaining the plan.

(iii) Except as otherwise provided, section 413 (a) and (b) and this section apply to a plan for plan years beginning after December 31, 1953.

(b) *Participation.* Section 410 and the regulations thereunder shall be applied as if all employees of each of the employers who are parties to the collective-bargaining agreement and all such employees who are subject to the same benefit computation formula under the plan were employed by a single employer.

(c) *Discrimination, etc.*—(1) *General rule.* Section 401(a)(4) (relating to prohibited discrimination) and section 411(d)(3) (relating to vesting required on termination, partial termination, or discontinuance of contributions) shall be applied as if all the participants in the plan, who are subject to the same benefit computation formula and who are employed by employers who are parties to the collective bargaining agreement, are employed by a single employer.

(2) *Application of discrimination rules.* Under section 401(a)(4) and the regulations thereunder a plan is not qualified unless the contributions or benefits provided under the plan do not discriminate in favor of officers, shareholders or highly compensated employees (hereinafter referred to collectively as ''the prohibited group''). The presence or absence of such discrimination under a plan to which this section applies at any time shall not be determined on an employer-by-employer basis, but rather by testing separately each group of employees who are subject to the same benefit computation formula to determine if there is discrimination within such group. Consequently, discrimination in contributions or benefits among two or more different groups or among employees in different groups covered by the plan may be present without causing the plan to be disqualified. However, the

presence of prohibited discrimination within one such group will result in the disqualification of the plan for all groups. Section 401(a)(4) and the regulations thereunder provide rules relating to the determination of which employees are members of the prohibited group and to the determination of discrimination in contributions or benefits which are applicable to a plan to which this section applies. The determination of whether or not an individual employee is a highly compensated employee shall be based on the relationship of the compensation of the employee to the compensation of all the other employees of all employers who are maintaining the plan and have employees covered under the same benefit computation formula, whether or not such other employees are covered by the plan or are covered under the same benefit computation formula, rather than to the compensation of all the other employees of the employer of such individual employee.

(3) *Application of termination, etc. rules.* Section 411(d)(3) and the regulations thereunder (relating to vesting required in the case of a termination, partial termination, or complete discontinuance of contributions) apply to a plan subject to the provisions of this section. The requirements of section 411(d)(3) shall be applied as if all participants in the plan who are subject to the same benefit computation formula and who are employed by employers who are parties to the collective bargaining agreement are employed by a single employer. The determination of whether or not there is a termination, partial termination, or complete discontinuance of contributions shall be made separately for each such group of participants who are treated as employed by a single employer. Consequently, if there are two or more groups of participants, a termination, partial termination, or complete discontinuance can take place under a plan with respect to one group of participants but not with respect to another such group of participants or for the entire plan. See §1.411(d)–2 for rules prescribed under section 411(d)(3).

(4) *Effective dates and transitional rules.* (i) Section 413(b)(2) and this paragraph apply to a plan for plan years beginning after December 31, 1953.

(ii) In applying the rules of this paragraph to a plan for plan years to which section 411 does not apply, section 401(a)(7) (as in effect on September 1, 1974) shall be substituted for section 411(d)(3). See §1.401–6 for rules prescribed under section 401(a)(7) as in effect on September 1, 1974. See §1.411(a)–2 for the effective dates of section 411.

(5) *Examples.* The provisions of this paragraph are illustrated by the following examples:

Example 1. Plan A is a defined benefit plan subject to the provisions of this section and covers two groups of participants, local unions 1 and 2. Each local union has negotiated its own bargaining agreement with employers X, Y, and Z to provide its own benefit computation formula. The following table indicates the composition of the plan A participants:

	Employer X	Employer Y	Employer Z	Total
Local union 1	20	10	70	100
Local union 2	30	70	100	200

Under the rules of subparagraph (2) of this paragraph, the determination of whether contributions or benefits provided under the plan discriminate in favor of the prohibited group is made by applying the rules of section 401(a)(4) separately to participants who are members of local union 1 and local union 2. Thus, plan A will satisfy the qualification requirements of section 401(a)(4) if, within local union 1 and local union 2, respectively, plan benefits do not discriminate in favor of participants who are prohibited group employees within local union 1 and local union 2. Under the rules of subparagraph (2) of this paragraph, the determination under section 401(a)(4) of whether or not any individual employee, included within the 300 participants in plan A, is a highly compensated employee is based on the relationship of the compensation of such individual employee to the compensation of all the employees of Employers X, Y, and Z, whether or not such employees are participants in plan A. Thus, if there are 20 participants who are prohibited group employees within the 100 participants of local union 1, discrimination is determined by comparing the benefits of the 20 prohibited group participants to the benefits of the other 80 participants within local union 1. The same comparison would have to be made for the local union 2 participants between the prohibited group participants and the other participants in local union 2. Discrimination in benefits, if any, between the participants in local union 1 and local union 2,

or among the employees of X, Y, or Z, would not affect the qualification of plan A under section 401(a)(4).

Example 2. Assume the same facts as in example (1). Employer X withdraws from the plan. Under subparagraph (3) of this paragraph, whether or not as a result of the withdrawal there is a partial termination under section 411(d)(3) is to be determined by applying the requirements of such section separately to the local union 1 and local union 2 participants. See §1.411(d)–2 for the requirements relating to partial terminations. The application of such requirements raises the following possibilities with respect to the plan: (1) A partial termination as to local union 1, (2) a partial termination as to local union 2, (3) a partial termination as to both local unions 1 and 2, or (4) no partial termination for either local union.

Example 3. Assume the same facts as in example (1). Plan A is amended to cease future benefit accruals under the plan for local union 1 participants. Under subparagraph (3) of the paragraph, whether or not as a result of the cessation there is a partial termination under section 411(d)(3) is to be determined by applying the requirements of such section separately to the local union 1 and local union 2 participants.

Example 4. Plan A is a defined benefit plan that provides for two normal retirement benefits, X and 2X. A participant receives benefit X if the collective bargaining agreement covering his employment provides for a contribution rate, M. If such agreement provides for a contribution rate of N, the participant receives benefit 2X. Benefit X and benefit 2X constitute separate benefit computation formulas.

Example 5. Plan B is a defined benefit plan that provides for a normal retirement benefit, X. Benefit X is provided for all plan participants even though there are two collective bargaining agreements providing for different contribution rates, M and N. Plan B has a single benefit computation formula, even though there are two contribution rates.

(d) *Exclusive benefit.* Under section 401(a), a plan is not qualified unless the plan is for the exclusive benefit of the employees (and their beneficiaries) of the employer establishing and maintaining the plan. Other qualification requirements under section 401(a) require the application of the exclusive benefit rule (for example, section 401(a)(2), which precludes diversion of plan assets). For purposes of applying the requirements of section 401(a) in determining whether a plan subject to this section is, with respect to each employer establishing and maintaining the plan, for the exclusive benefit of its employees (and their beneficiaries), all of the employees participating in the plan shall be treated as employees of each such employer. Thus, for example, contributions by employer A to a plan subject to this section could be allocated to employees of other employers maintaining the plan without violating the requirements of section 401(a)(2), because all the employees participating in the plan are deemed to be employees of A.

(e) *Vesting.* Section 411 (other than section 411(d)(3) relating to termination or partial termination; discontinuance of contributions) and the regulations thereunder shall be applied as if all employers who have been parties to the collective-bargaining agreement constituted a single employer. The application of any rules with respect to breaks in service under section 411 shall be made under regulations prescribed by the Secretary of Labor. Thus, for example, all the hours which an employee worked for each employer in a collectively-bargained plan would be aggregated in computing the employee's hours of service under the plan. See also 29 CFR Part 2530 (Department of Labor regulations relating to minimum standards for employee pension benefit plans.)

(f)–(h) [Reserved]

(i) *Employees of labor unions*—(1) *General rule.* For purposes of section 413(b) and this section, employees of employee representatives shall be treated as employees of an employer establishing and maintaining a plan to which section 413(b) and this section apply if, with respect to the employees of such representatives, the plan satisfies the nondiscrimination requirements of section 401(a)(4) (determined without regard to section 413(b)(2)) and the minimum participation and coverage requirements of section 410 (determined without regard to section 413(b)(1)). For purposes of the preceding sentence, the plan and any affiliated employee health or welfare plan shall be deemed to be an employee representative. If employees of employee representatives, the plan, or an affiliated employee health or welfare plan are covered by the plan and are not treated as employees of an employer

establishing and maintaining the plan under the provisions of this paragraph, the plan fails to satisfy the qualification requirements of section 401(a). In addition, in order for such a plan to be qualified, the plan must satisfy the requirements of section 413(b) (1) and (2), relating to participation and discrimination, respectively; see paragraphs (b) and (c) of this section. For purposes of this paragraph, an affiliated health or welfare plan is a health or welfare plan that is maintained under the same collective bargaining agreement or agreements, and that covers the same membership.

(2) *Effective dates and transitional rules*. (i) Section 413(b)(8) and this paragraph apply to a plan for plan years beginning after December 31, 1953.

(ii) In applying the rules of this paragraph to a plan for plan years to which section 410 does not apply, section 401(a)(3) (as in effect on September 1, 1974) shall be substituted for section 410. See §1.401–3 for rules prescribed under section 401(a)(3) as in effect on September 1, 1974. See §1.410(a)–2 for the effective dates of section 410.

(3) *Examples*. The provisions of this paragraph are illustrated by the following examples:

Example 1. Plan A is a defined benefit plan, maintained pursuant to a collective bargaining agreement between employers, X, Y, and Z and labor union, L, which covers members of L employed by X, Y, and Z. In 1978, plan A is amended to cover, under the same benefit formula, all five employees of L who have satisfied the minimum age and service requirements of the plans (age 25 and 1 year of service). Assume that plan A is subject to section 413(b) and satisfies the requirements of section 413(b) (1) and (2). Assume further that with respect to employees of L, plan A (i) satisfies the nondiscrimination requirements of section 401(a)(4), (ii) meets the minimum participation requirements of section 410(a), and (iii) meets the minimum coverage requirements of section 410(b)(1)(A). Under the rules of subparagraph (1) of this paragraph, because such requirements are all satisfied, the employees of L are treated as employees of an employer establishing and maintaining plan A.

Example 2. Assume the same facts as example (1), except that plan A is amended to cover only one of the five employees of L, none of whom is covered by any other plan. Assume further that, under plan A, L does not satisfy the minimum percentage coverage requirement of section 410(b)(1)(A) with respect to employees of L. Assume further that the compensation of the one L employee who is covered by the plan is such that he is highly compensated relative to the four employees of L not covered by the plan. Consequently, L does not satisfy the minimum coverage requirements of section 410(b)(1)(B), with respect to employees of L. Under the rules of subparagraph (1) of this paragraph, the employees of L cannot be treated as employees of an employer establishing and maintaining the A plan because such coverage requirements are not satisfied by L. Consequently, the A plan fails to satisfy the qualification requirements of section 401(a).

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42340, Aug. 23, 1977, as amended by 42 FR 47198, Sept. 20, 1977; T.D. 7654, 44 FR 65063, Nov. 9, 1979]

§1.413–2 Special rules for plans maintained by more than one employer.

(a) *Application of section 413(c)*—(1) *In general*. Section 413(c) describes certain plans (and each trust which is a part of any such plan) hereinafter referred to as ''section 413(c) plans.'' A plan (and each trust which is a part of such plan) is deemed to be a section 413(c) plan if it is described in subparagraph (2) of this paragraph. Notwithstanding any other provision of the code (not specifically in conflict with the special rules hereinafter mentioned), a section 413(c) plan is subject to the special rules of section 413(c) (1) through (6) and paragraphs (b) through (g) of this section.

(2) *Section 413(c) plan*. A plan (and each trust which is a part of such plan) is a section 413(c) plan if—

(i) The plan is a single plan, within the meaning of section 413(a) and §1.413–1(a)(2), and

(ii) The plan is maintained by more than one employer.

For purposes of subdivision (ii) of this subparagraph, the number of employers maintaining the plan is determined by treating any employers described in section 414(b) (relating to a controlled group of corporations) or any employers described in section 414(c) (relating to trades or businesses under common control), whichever is applicable, as if such employers are a single employer. See §1.411(a)–5(b)(3) for rules relating to the time when an employer maintains a plan. A master or prototype plan is not a section 413(c) plan unless

such a plan is described in this subparagraph. Similarly, the mere fact that a plan, or plans, utilizes a common trust fund or otherwise pools plan assets for investment purposes does not, by itself, result in a particular plan being treated as a section 413(c) plan.

(3) *Additional rules.* (i) If a plan is a collectively bargained plan described in § 1.413–1(a), the rules of section 413(c) and this section do not apply, and the rules of section 413(b) and § 1.413–1 do apply to the plan.

(ii) The special rules of section 413(b)(1) and § 1.413–1(b) relating to the application of section 410, other than the rules of section 410(a), do not apply to a section 413(c) plan. Thus, for example, the minimum coverage requirements of section 410(b) are generally applied to a section 413(c) plan on an employer-by-employer basis, taking into account the generally applicable rules such as section 401(a)(5) and section 414 (b) and (c).

(iii) The special rules of section 413(b)(2) and § 1.413–1(c) (relating to (A) section 401(a)(4) and prohibited discrimination, and (B) 411(d)(3) and vesting required on termination, partial termination, or discontinuance of contributions) do not apply to a section 413(c) plan. Thus, for example, the determination of whether or not there is a termination, within the meaning of section 411(d)(3), of a section 413(c) plan is made solely by reference to the rules of sections 411(d)(3) and 413(c)(3).

(iv) The qualification of a section 413(c) plan, at any relevant time, under section 401(a), 403(a) or 405(a), as modified by section 413(c) and this section, is determined with respect to all employers maintaining the section 413(c) plan. Consequently, the failure by one employer maintaining the plan (or by the plan itself) to satisfy an applicable qualification requirement will result in the disqualification of the section 413(c) plan for all employers maintaining the plan.

(4) *Effective dates.* Except as otherwise provided, section 413(c) and this section apply to a plan for plan years beginning after December 31, 1953.

(b) *Participation.* Section 410(a) and the regulations thereunder shall be applied as if all employees of each of the employers who maintain the plan were employed by a single employer.

(c) *Exclusive benefit.* In the case of a plan subject to this section, the exclusive benefit requirements of section 401(a) shall be applied to the plan in the same manner as under section 413(b)(3) and § 1.413–1(d).

(d) *Vesting.* Section 411 and the regulations thereunder shall be applied as if all employers who maintain the plan constituted a single employer. The application of any rules with respect to breaks in service under section 411 shall be made under regulations prescribed by the Secretary of Labor. Thus, for example, all the hours which an employee worked for each employer maintaining the plan would be aggregated in computing the employee's hours of service under the plan. See also 29 CFR Part 2530 (Department of Labor regulations relating to minimum standards for employee pension benefit plans).

(Sec. 411 (88 Stat. 901; 26 U.S.C. 411))

[T.D. 7501, 42 FR 42340, Aug. 23, 1977, as amended by 42 FR 47198, Sept. 20, 1977; T.D. 7654, 44 FR 65065, Nov. 9, 1979]

§ 1.414(b)–1 Controlled group of corporations.

(a) *Defintion of controlled group of corporations.* For purposes of this section, the term ''controlled group of corporations'' has the same meaning as is assigned to the term in section 1563(a) and the regulations thereunder, except that (1) the term ''controlled group of corporations'' shall not include an ''insurance group'' described in section 1563(a)(4), and (2) section 1563(e)(3)(C) (relating to stock owned by certain employees' trusts) shall not apply. For purposes of this section, the term ''members of a controlled group'' means two or more corporations connected through stock ownership described in section 1563(a) (1), (2), or (3), whether or not such corporations are ''component members of a controlled group'' within the meaning of section 1563(b). Two or more corporations are members of a controlled group at any time such corporations meet the requirements of section 1563(a) (as modified by this paragraph). For purposes of this section, if a corporation is a member of more than one controlled group

of corporations, such corporation shall be treated as a member of each controlled group.

(b) *Single plan adopted by two or more members.* If two or more members of a controlled group of corporations adopt a single plan for a plan year, then the minimum funding standard provided in section 412, the tax imposed by section 4971, and the applicable limitations provided by section 404(a) shall be determined as if such members were a single employer. In such a case, the amount of such items and the allocable portion attributable to each member shall be determined in the manner provided in regulations under sections 412, 4971, and 404(a).

(c) *Cross reference.* For rules relating to the application of sections 401, 408(k), 410, 411, 415, and 416 with respect to two or more trades or businesses which are under common control, see section 414(c) and the regulations thereunder.

[T.D. 8179, 53 FR 6605, Mar. 2, 1988]

§ 1.414(c)–1 Commonly controlled trades or businesses.

For purposes of applying the provisions of sections 401 (relating to qualified pension, profit-sharing, and stock bonus plans), 408(k) (relating to simplified employee pensions), 410 (relating to minimum participation standards), 411 (relating to minimum vesting standards), 415 (relating to limitations on benefits and contributions under qualified plans), and 416 (relating to top-heavy plans), all employees of two or more trades or businesses under common control within the meaning of § 1.414(c)–2 for any period shall be treated as employed by a single employer. See sections 401, 408(k), 410, 411, 415, and 416 and the regulations thereunder for rules relating to employees of trades or businesses which are under common control. See § 1.414(c)–5 for effective date.

[T.D. 8179, 53 FR 6606, Mar. 2, 1988]

§ 1.414(c)–2 Two or more trades or businesses under common control.

(a) *In general.* For purposes of this section, the term ''two or more trades or businesses under common control'' means any group of trades or businesses which is either a ''parent-subsidiary group of trades or businesses under common control'' as defined in paragraph (b) of this section, a ''brother-sister group of trades or businesses under common control'' as defined in paragraph (c) of this section, or a ''combined group of trades or businesses under common control'' as defined in paragraph (d) of this section. For purposes of this section and §§ 1.414(c)–3 and 1.414(c)–4, the term ''organization'' means a sole proprietorship, a partnership (as defined in section 7701(a)(2)), a trust, an estate, or a corporation.

(b) *Parent-subsidiary group of trades or businesses under common control*—(1) *In general.* The term ''parent-subsidiary group of trades or businesses under common control'' means one or more chains of organizations conducting trades or businesses connected through ownership of a controlling interest with a common parent organization if—

(i) A controlling interest in each of the organizations, except the common parent organization, is owned (directly and with the application of § 1.414(c)–4(b)(1), relating to options) by one or more of the other organizations; and

(ii) The common parent organization owns (directly and with the application of § 1.414(c)–4(b)(1), relating to options) a controlling interest in at least one of the other organizations, excluding, in computing such controlling interest, any direct ownership interest by such other organizations.

(2) *Controlling interest defined*—(i) *Controlling interest.* For purposes of paragraphs (b) and (c) of this section, the phrase ''controlling interest'' means:

(A) In the case of an organization which is a corporation, ownership of stock possessing at least 80 percent of total combined voting power of all classes of stock entitled to vote of such corporation or at least 80 percent of the total value of shares of all classes of stock of such corporation;

(B) In the case of an organization which is a trust or estate, ownership of an actuarial interest of at least 80 percent of such trust or estate;

(C) In the case of an organization which is a partnership, ownership of at

least 80 percent of the profits interest or capital interest of such partnership; and

(D) In the case of an organization which is a sole proprietorship, ownership of such sole proprietorship.

(ii) *Actuarial interest.* For purposes of this section, the actuarial interest of each beneficiary of trust or estate shall be determined by assuming the maximum exercise of discretion by the fiduciary in favor of such beneficiary. The factors and methods prescribed in § 20.2031–7 or, for certain prior periods, § 20.2031–7A (Estate Tax Regulations) for use in ascertaining the value of an interest in property for estate tax purposes shall be used for purposes of this subdivision in determining a beneficiary's actuarial interest.

(c) *Brother-sister group of trades or businesses under common control*—(1) *In general.* The term ''brother-sister group of trades or businesses under common control'' means two or more organizations conducting trades or businesses if (i) the same five or fewer persons who are individuals, estates, or trusts own (directly and with the application of § 1.414(c)–4) a controlling interest in each organization, and (ii) taking into account the ownership of each such person only to the extent such ownership is identical with respect to each such organization, such persons are in effective control of each organization. The five or fewer persons whose ownership is considered for purposes of the controlling interest requirement for each organization must be the same persons whose ownership is considered for purposes of the effective control requirement.

(2) *Effective control defined.* For purposes of this paragraph, persons are in ''effective control'' of an organization if—

(i) In the case of an organization which is a corporation, such persons own stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of such corporation;

(ii) In the case of an organization which is a trust or estate, such persons own an aggregate actuarial interest of more than 50 percent of such trust or estate;

(iii) In the case of an organization which is a partnership, such persons own an aggregate of more than 50 percent of the profits interest or capital interest of such partnership; and

(iv) In the case of an organization which is a sole proprietorship, one of such persons owns such sole proprietorship.

(d) *Combined group of trades or businesses under common control.* The term ''combined group of trades or businesses under common control'' means any group of three or more organizations, if (1) each such organization is a member of either a parent-subsidiary group of trades or businesses under common control or a brother-sister group of trades or businesses under common control, and (2) at least one such organization is the common parent organization of a parent-subsidiary group of trades or businesses under common control and is also a member of a brother-sister group of trades or businesses under common control.

(e) *Examples.* The definitions of parent-subsidiary group of trades or businesses under common control, brother-sister group of trades or businesses under common control, and combined group of trades or businesses under common control may be illustrated by the following examples.

Example 1. (a) The ABC partnership owns stock possessing 80 percent of the total combined voting power of all classes of stock entitled to voting of S corporation. ABC partnership is the common parent of a parent-subsidiary group of trades or businesses under common control consisting of the ABC partnership and S Corporation.

(b) Assume the same facts as in (a) and assume further that S owns 80 percent of the profits interest in the DEF Partnership. The ABC Partnership is the common parent of a parent-subsidiary group of trades or businesses under common control consisting of the ABC Partnership, S Corporation, and the DEF Partnership. The result would be the same if the ABC Partnership, rather than S, owned 80 percent of the profits interest in the DEF Partnership.

Example 2. L Corporation owns 80 percent of the only class of stock of T Corporation, and T, in turn, owns 40 percent of the capital interest in the GHI Partnership. L also owns 80 percent of the only class of stock of N Corporation and N, in turn, owns 40 percent of the capital interest in the GHI Partnership.

L is the common parent of a parent-subsidiary group of trades or businesses under common control consisting of L Corporation, T Corporation, N Corporation, and the GHI Partnership.

Example 3. ABC Partnership owns 75 percent of the only class of stock of X and Y Corporations; X owns all the remaining stock of Y, and Y owns all the remaining stock of X. Since interorganization ownership is excluded (that is, treated as not outstanding) for purposes of determining whether ABC owns a controlling interest of at least one of the other organizations, ABC is treated as the owner of stock possessing 100 percent of the voting power and value of all classes of stock of X and of Y for purposes of paragraph (b)(1)(ii) of this section. Therefore, ABC is the common parent of a parent-subsidiary group of trades or businesses under common control consisting of the ABC Partnership, X Corporation, and Y Corporation.

Example 4. Unrelated individuals A, B, C, D, E, and F own an interest in sole proprietorship A, a capital interest in the GHI Partnership, and stock of corporations M, W, X, Y, and Z (each of which has only one class of stock outstanding) in the following proportions:

ORGANIZATIONS

Individuals	A	GHI	M	W	X	Y	Z
A	100%	50%	100%	60%	40%	20%	60%
B	—	40%	—	15%	40%	50%	30%
C	—	—	—	—	10%	10%	10%
D	—	—	—	25%	—	20%	—
E	—	10%	—	—	10%	—	—
	100%	100%	100%	100%	100%	100%	100%

Under these facts the following four brother-sister groups of trades or businesses under common control exist: GHI, X and Z; X, Y and Z; W and Y; A and M. In the case of GHI, X, and Z, for example, A and B together have effective control of each organization because their combined identical ownership of GHI, X and Z is greater than 50%. (A's identical ownership of GHI, X and Z is 40% because A owns at least a 40% interest in each organization. B's identical ownership of GHI, X and Z is 30% because B owns at least a 30% interest in each organization.) A and B (the persons whose ownership is considered for purposes of the effective control requirement) together own a controlling interest in each organization because they own at least 80% of the capital interest of partnership GHI and at least 80% of the total combined voting power of corporations X and Z. Therefore, GHI, X and Z comprise a brother-sister group of trades or businesses under common control. Y is not a member of this group because neither the effective control requirement nor the 80% controlling interest requirement are met. (The effective control requirement is not met because A's and B's combined identical ownership in GHI, X, Y and Z (20% for A and 30% for B) does not exceed 50%. The 80% controlling interest test is not met because A and B together only own 70% of the total combined voting power of the stock of Y.) A and M are not members of this group because B owns no interest in either organization and A's ownership of GHI, X and Z, considered alone, is less than 80%.

Example 5. The outstanding stock of corporations U and V, which have only one class of stock outstanding, is owned by the following unrelated individuals:

CORPORATIONS

Individuals	U	V
	(percent)	(percent)
A	12	12
B	12	12
C	12	12
D	12	12
E	13	13
F	13	13
G	13	13
H	13	13
	100	100

Any group of five of the shareholders will own more than 50 percent of the stock in each corporation, in identical holdings. However, U and V are not members of a brother-sister group of trades or businesses under common control because at least 80 percent of the stock of each corporation is not owned by the same five or fewer persons.

Example 6. A, an individual, owns a controlling interest in ABC Partnership and DEF Partnership. ABC, in turn, owns a controlling interest in X Corporation. Since ABC, DEF, and X are each members of either a parent-subsidiary group or a brother-sister group of trades or businesses under common control, and ABC is the common parent of a parent-subsidiary group of trades or businesses under common control consisting of

ABC and X, and also a member of a brother-sister group of trades or businesses under common control consisting of ABC and DEF, ABC Partnership, DEF Partnership, and X Corporation are members of the same combined group of trades or businesses under common control.

[T.D. 8179, 53 FR 6606, Mar. 2, 1988, as amended by T.D. 8540, 59 FR 30102, June 10, 1994]

§ 1.414(c)–3 Exclusion of certain interests or stock in determining control.

(a) *In general.* For purposes of § 1.414(c)–2 (b)(2)(i) and (c)(2), the term ''interest'' and the term ''stock'' do not include an interest which is treated as not outstanding under paragraph (b) of this section in the case of a parent-subsidiary group of trades or businesses under common control or under paragraph (c) of this section in the case of a brother-sister group of trades or businesses under common control. In addition, the term ''stock'' does not include treasury stock or nonvoting stock which is limited and preferred as to dividends. For definitions of certain terms used in this section, see paragraph (d) of this section.

(b) *Parent-subsidiary group of trades or businesses under common control*—(1) *In general.* If an organization (hereinafter in this section referred to as ''parent organization'') owns (within the meaning of paragraph (b)(2) of this section)—

(i) In the case of a corporation, 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of such corporation.

(ii) In the case of a trust or an estate, an actuarial interest (within the meaning of § 1.414(c)–2(b)(2)(ii)) of 50 percent or more of such trust or estate, and

(iii) In the case of a partnership, 50 percent or more of the profits or capital interest of such partnership, then for purposes of determining whether the parent organization or such other organization (hereinafter in this section referred to as ''subsidiary organization'') is a member of a parent-subsidiary group of trades or businesses under common control, an interest in such subsidiary organization excluded under paragraph (b) (3), (4), (5), or (6) of this section shall be treated as not outstanding.

(2) *Ownership.* For purposes of paragraph (b)(1) of this section, a parent organization shall be considered to own an interest in or stock of another organization which it owns directly or indirectly with the application of § 1.414(c)–4(b)(1) and—

(i) In the case of a parent organization which is a partnership, a trust, or an estate, with the application of paragraphs (b) (2), (3), and (4) of § 1.414(c)–4, and

(ii) In the case of a parent organization which is a corporation, with the application of § 1.414(c)–4(b)(4).

(3) *Plan of deferred compensation.* An interest which is an interest in or stock of the subsidiary organization held by a trust which is part of a plan of deferred compensation (within the meaning of section 406(a)(3) and the regulations thereunder) for the benefit of the employees of the parent organization or the subsidiary organization shall be excluded.

(4) *Principal owners, officers, etc.* An interest which is an interest in or stock of the subsidiary organization owned (directly and with the application of § 1.414(c)–4) by an individual who is a principal owner, officer, partner, or fiduciary of the parent organization shall be excluded.

(5) *Employees.* An interest which is an interest in or stock of the subsidiary organization owned (directly and with the application of § 1.414(c)–4) by an employee of the subsidiary organization shall be excluded if such interest or such stock is subject to conditions which substantially restrict or limit the employee's right (or if the employee constructively owns such interest or such stock, the direct or record owner's right) to dispose of such interest or such stock and which run in favor of the parent or subsidiary organization.

(6) *Controlled exempt organization.* An interest which is an interest in or stock of the subsidiary organization shall be excluded if owned (directly and with the application of § 1.414(c)–4) by an organization (other than the parent organization):

(i) To which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies, and

(ii) Which is controlled directly or indirectly (within the meaning of paragraph (d)(7) of this section) by the parent organization or subsidiary organization, by an individual, estate, or trust that is a principal owner of the parent organization, by an officer, partner, or fiduciary of the parent organization, or by any combination thereof.

(c) *Brother-sister group of trades or businesses under common control*—(1) *In general*. If five or fewer persons (hereinafter in this section referred to as ''common owners'') who are individuals, estates, or trusts own (directly and with the application of §1.414(c)–4)—

(i) In the case of a corporation, 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock or such corporation,

(ii) In the case of a trust or an estate, an actuarial interest (within the meaning of §1.414(c)–2(b)(2)(ii)) of 50 percent or more of such trust or estate, and

(iii) In the case of a partnership, 50 percent or more of the profits or capital interest of such partnership, then for purposes of determining whether such organization is a member of a brother-sister group of trades or businesses under common control, an interest in such organization excluded under paragraph (c) (2), (3), or (4) of this section shall be treated as not outstanding.

(2) *Exempt employees' trust*. An interest which is an interest in or stock of such organization held by an employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be excluded if such trust is for the benefit of the employees of such organization.

(3) *Employees*. An interest which is an interest in or stock of such organization owned (directly and with the application of §1.414(c)–4) by an employee of such organization shall be excluded if such interest or stock is subject to conditions which run in favor of a common owner of such organization or in favor of such organization and which substantially restrict or limit the employee's right (or if the employee constructively owns such interest or stock, the direct or record owner's right) to dispose of such interest or stock.

(4) *Controlled exempt organization*. An interest which is an interest in or stock of such organization shall be excluded if owned (directly and with the application of §1.414(c)–4) by an organization:

(i) To which section 501(c)(3) (relating to certain educational and charitable organizations which are exempt from tax) applies, and

(ii) Which is controlled directly or indirectly (within the meaning of paragraph (d)(7) of this section) by such organization, by an individual, estate, or trust that is a principal owner of such organization, by an officer, partner, or fiduciary of such organization, or by any combination thereof.

(d) *Definitions*—(1) *Employee*. For purposes of this section, the term ''employee'' has the same meaning such term is given in section 3306(i) of the Code (relating to definitions for purposes of the Federal Unemployment Tax Act).

(2) *Principal owner*. For purposes of this section, the term ''principal owner'' means a person who owns (directly and with the application of §1.414(c)–4)—

(i) In the case of a corporation, 5 percent or more of the total combined voting power of all classes of stock entitled to vote in such corporation or 5 percent of more of the total value of shares of all classes of stock of such corporation;

(ii) In the case of a trust or estate, an actuarial interest of 5 percent or more of such trust or estate; or

(iii) In the case of a partnership, 5 percent or more of the profits or capital interest of such partnership.

(3) *Officer*. For purposes of this section, the term ''officer'' includes the president, vice-presidents, general manager, treasurer, secretary, and comptroller of a corporation, and any other person who performs duties corresponding to those normally performed by persons occupying such positions.

(4) *Partner*. For purposes of this section, the term ''partner'' means any person defined in section 7701(a)(2) (relating to definitions of partner).

(5) *Fiduciary*. For purposes of this section and § 1.414(c)–4, the term ''fiduciary'' has the same meaning as such term is given in section 7701(a)(6) and the regulations thereunder.

(6) *Substantial conditions*. (i) *In general*. For purposes of this section, an interest in or stock of an organization is subject to conditions which substantially restrict or limit the right to dispose of such interest or stock and which run in favor of another person if the condition extends directly or indirectly to such person preferential rights with respect to the acquisition of the direct owner's (or the record owner's) interest or stock. For a condition to be in favor of another person it is not necessary that such person be extended a discriminatory concession with respect to price. A right of first refusal with respect to an interest or stock in favor of another person is a condition which substantially restricts or limits the direct or record owner's right of disposition which runs in favor of such person. Further, any legally enforceable condition which prohibits the direct or record owner from disposing of his or her interest or stock without the consent of another person will be considered to be a substantial limitation running in favor of such person.

(ii) *Special rule*. For purposes of paragraph (c)(3) of this section only, if a condition which restricts or limits an employee's right (or direct or record owner's right) to dispose of his or her interest or stock also applies to the interest or stock in such organization held by a common owner pursuant to a bonafide reciprocal purchase arrangement, such condition shall not be treated as a substantial limitation or restriction. An example of a reciprocal purchase arrangement is an agreement whereby a common owner and the employee are given a right of first refusal with respect to stock of the employer corporation owned by the other party. If, however, the agreement also provides that the common owner has the right to purchase the stock of the employer corporation owned by the employee in the event the corporation should discharge the employee for reasonable cause, the purchase arrangement would not be reciprocal within the meaning of this subdivision.

(7) *Control*. For purposes of paragraphs (b)(6) and (c)(4) of this section, the term ''control'' means control in fact. The determination of whether there exists control in fact will depend upon all of the facts and circumstances of each case, without regard to whether such control is legally enforceable and irrespective of the method by which such control is exercised or exercisable.

(e) *Examples*. The provisions of this section may be illustrated by the following examples:

Example 1. ABC Partnership owns 70 percent of the capital interest and of the profits interest in the DEF Partnership. The remaining capital interest and profits interest in DEF is owned as follows: 4 percent by A (a general partner in ABC), and 26 percent by D (a limited partner in ABC). ABC satisfies the 50-percent capital interest or profits interest ownership requirement of paragraph (b)(1)(iii) of this section with respect to DEF. Since A and D are partners of ABC, under paragraph (b)(4) of this section the capital and profits interests in DEF owned by A and D are treated as not outstanding for purposes of determining whether ABC and DEF are members of a parent-subsidiary group of trades or businesses under common control under § 1.414 (c)–2(b). Thus, ABC is considered to own 100 percent (70 ÷ 70) of the capital interest and profits interest in DEF. Accordingly, ABC and DEF are members of a parent-subsidiary group of trades or businesses under common control.

Example 2. Assume the same facts as in example (1) and assume further that A owns 15 shares of the 100 shares of the only class of stock of S Corporation and DEF Partner-ship owns 75 shares of such stock. ABC satisfies the 50 percent stock requirement of paragraph (b)(1)(i) of this section with respect to S since ABC is considered as owning 52.5 percent (70 percent × 75 percent) of the S stock with the application of § 1.414 (c)–4(b)(2). Since A is a partner of ABC, the S stock owned by A is treated as not outstanding for purposes of determining whether S is a member of a parent-subsidiary group of trades or businesses under common control. Thus, DEF Partnership is considered to own stock possessing 88.2 percent (75 ÷ 85) of the voting power and value of the S stock. Accordingly, ABC Partnership, DEF Partnership, and S Corporation are members of a parent-subsidiary group of trades or businesses under common control.

Example 3. ABC Partnership owns 60 percent of the only class of stock of Corporation Y. D, the president of Y, owns the remaining 40 percent of the stock of Y. D has agreed that if she offers her stock in Y for sale she

will first offer the stock to ABC at a price equal to the fair market value of the stock on the first date the stock is offered for sale. Since D is an employee of Y within the meaning of section 3306(i) of the Code and her stock in Y is subject to a condition which substantially restricts or limits her right to dispose of such stock and runs in favor of ABC Partnership, under paragraph (b)(5) of this section such stock is treated as not outstanding for purposes of determining whether ABC and Y are members of a parent-subsidiary group of trades or businesses under common control. Thus, ABC Partnership is considered to own stock possessing 100 percent of the voting power and value of the stock of Y. Accordingly, ABC Partnership and Y Corporation are members of a parent-subsidiary group of trades or businesses under common control. The result would be the same if D's husband, instead of D, owned directly the 40 percent stock interest in Y and such stock was subject to a right of first refusal running in favor of ABC Partnership.

(f) *Exception*—(1) *In general*. If an interest in an organization (including stock of a corporation) is owned by a person directly or with the application of the rules of paragraph (b) of § 1.414 (c)–4 and such ownership results in the membership of that organization in a group of two or more trades or businesses under common control for any period, then the interest will not be treated as an excluded interest under paragraph (b) or (c) of this section if the result of applying such provisions is that the organization is not a member of a group of two or more trades or businesses under common control for the period.

(2) *Example*. The provisions of this paragraph may be illustrated by the following example:

Example. Corporation P owns directly 50 of the 100 shares of the only class of stock of corporation S. A, an officer of P, owns directly 30 shares of S stock which P has an option to acquire. If, under paragraph (b)(4) of this section, the 30 shares owned directly by A are treated as not outstanding, P would be treated as owning stock possessing only 71 percent (50/70) of the total voting power and value of S stock, and S should not be a member of a parent-subsidiary group of trades or businesses under common control. However, because the 30 shares owned by A that P has an option to purchase are considered as owned by P under paragraph (b)(2) of this section, and that ownership plus P's direct ownership of 50 shares result in S's membership in a parent-subsidiary group of trades or businesses under common control for 1985, the provisions of this paragraph apply. Therefore, A's stock is not treated as an excluded interest and S is a member of a parent-subsidiary group consisting of P and S.

[T.D. 8179, 53 FR 6607, Mar. 2, 1988; 53 FR 8302, Mar. 14, 1988]

§ 1.414(c)–4 Rules for determining ownership.

(a) *In general*. In determining the ownership of an interest in an organization for purposes of § 1.414(c)–2 and § 1.414(c)–3, the constructive ownership rules of paragraph (b) of this section shall apply, subject to the operating rules contained in paragraph (c). For purposes of this section the term ''interest'' means: in the case of a corporation, stock; in the case of a trust or estate, an actuarial interest; in the case of a partnership, an interest in the profits or capital; and in the case of a sole proprietorship, the proprietorship.

(b) *Constructive ownership*—(1) *Options*. If a person has an option to acquire any outstanding interest in an organization, such interest shall be considered as owned by such person. For this purpose, an option to acquire an option, and each one of a series of such options shall be considered as an option to acquire such interest.

(2) *Attribution from partnerships*—(i) *General*. An interest owned, directly or indirectly, by or for a partnership shall be considered as owned by any partner having an interest of 5 percent or more in either the profits or capital of the partnership in proportion to such partner's interest in the profits or capital, whichever such proportion is greater.

(ii) *Example*. The provisions of paragraph (b)(2)(i) of this section may be illustrated by the following example:

Example. A, B, and C, unrelated individuals, are partners in the ABC Partnership. The partners' interest in the capital and profits of ABC are as follows:

(IN PERCENT)

Partner	Capital	Profits
A	36	25
B	60	71
C	4	4

The ABC Partnership owns the entire outstanding stock (100 shares) of X Corporation. Under paragraph (b)(2)(i) of this section, A is considered to own the stock of X owned by

the partnership in proportion to his interest in capital (36 percent) or profits (25 percent), whichever such proportion is greater. Therefore, A is considered to own 36 shares of X stock. Since B has a greater interest in the profits of the partnership than in the capital, B is considered to own X stock in proportion to his interest in such profits. Therefore, B is considered to own 71 shares of X stock. Since C does not have an interest of 5 percent or more in either the capital or profits of ABC, he is not considered to own any shares of X stock.

(3) *Attribution from estates and trusts*—(i) *In general.* An interest in an organization (hereinafter called an ''organization interest'') owned, directly or indirectly, by or for an estate or trust shall be considered as owned by any beneficiary of such estate or trust who has an actuarial interest of 5 percent or more in such organization interest, to the extent of such actuarial interest. For purposes of this subparagraph, the actuarial interest of each beneficiary shall be determined by assuming the maximum exercise of discretion by the fiduciary in favor of such beneficiary and the maximum use of the organization interest to satisfy the beneficiary's rights. A beneficiary of an estate or trust who cannot under any circumstances receive any part of an organization interest held by the estate or trust, including the proceeds from the disposition thereof, or the income therefrom, does not have an actuarial interest in such organization interest. Thus, where stock owned by a decedent's estate has been specifically bequeathed to certain beneficiaries and the remainder of the estate has been specifically bequeathed to other beneficiaries, the stock is attributable only to the beneficiaries to whom it is specifically bequeathed. Similarly a remainderman of a trust who cannot under any circumstances receive any interest in the stock of a corporation which is a part of the corpus of the trust (including any accumulated income therefrom or the proceeds from a disposition thereof) does not have an actuarial interest in such stock. However, an income beneficiary of a trust does have an actuarial interest in stock if he has any right to the income from such stock even though under the terms of the trust instrument such stock can never be distributed to him. The factors and methods prescribed in § 20.2031–7 or, for certain prior periods, § 20.2031–7A (Estate Tax Regulations) for use in ascertaining the value of an interest in property for estate tax purposes shall be used for purposes of this subdivision in determining a beneficiary's actuarial interest in an organization interest owned directly or indirectly by or for an estate or trust.

(ii) *Special rules for estates.* (A) For purposes of this paragraph (b)(3) with respect to an estate, property of a decedent shall be considered as owned by his or her estate if such property is subject to administration by the executor or administrator for the purposes of paying claims against the estate and expenses of administration notwithstanding that, under local law, legal title to such property vests in the decedent's heirs, legatees or devisees immediately upon death.

(B) For purposes of this paragraph (b)(3) with respect to an estate, the term ''beneficiary'' includes any person entitled to receive property of a decedent pursuant to a will or pursuant to laws of descent and distribution.

(C) For purposes of this paragraph (b)(3) with respect to an estate, a person shall no longer be considered a beneficiary of an estate when all the property to which he or she is entitled has been received by him or her, when he or she no longer has a claim against the estate arising out of having been a beneficiary, and when there is only a remote possibility that it will be necessary for the estate to seek the return of property from him or her or to seek payment from him or her by contribution or otherwise to satisfy claims against the estate or expenses of administration.

(iii) *Grantor trusts, etc.* An interest owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E, part I, subchapter J of the Code (relating to grantors and others treated as substantial owners) is considered as owned by such person.

(4) *Attribution from corporations*—(i) *General.* An interest owned, directly or indirectly, by or for a corporation shall be considered as owned by any person who owns (directly and, in the case of a parent-subsidiary group of trades or

businesses under common control, with the application of paragraph (b)(1) of this section, or in the case of a brother-sister group of trades or business under common control, with the application of this section), 5 percent or more in value of the stock in that proportion which the value of the stock which such person so owns bears to the total value of all the stock in such corporation.

(ii) *Example*. The provisions of paragraph (b)(4)(i) of this section may be illustrated by the following example:

Example. B, an individual, owns 60 of the 100 shares of the only class of outstanding stock of corporation P. C, an individual, owns 4 shares of the P stock, and corporation X owns 36 shares of the P stock. Corporation P owns, directly and indirectly, 50 shares of the stock of corporation S. Under this subparagraph, B is considered to own 30 shares of the S stock (60/100 × 50), and X is considered to own 18 shares of S stock (36/100 × 50). Since C does not own 5 percent or more in the value of P stock, he is not considered as owning any of the S stock owned by P. If in this example, C's wife had owned directly 1 share of the P stock, C and his wife would each be considered as owning 5 shares of the P stock, and therefore C and his wife would be considered as owning 2.5 shares of the S stock (5/100 × 50).

(5) *Spouse*—(i) *General rule*. Except as provided in paragraph (b)(5)(ii) of this section, an individual shall be considered to own an interest owned, directly or indirectly, by or for his or her spouse, other than a spouse who is legally separated from the individual under a decree of divorce, whether interlocutory or final, or a decree of separate maintenance.

(ii) *Exception*. An individual shall not be considered to own an interest in an organization owned, directly or indirectly, by or for his or her spouse on any day of a taxable year of such organization, provided that each of the following conditions are satisfied with respect to such taxable year:

(A) Such individual does not, at any time during such taxable year, own directly any interest in such organization;

(B) Such individual is not a member of the board of directors, a fiduciary, or an employee of such organization and does not participate in the management of such organization at any time during such taxable year;

(C) Not more than 50 percent of such organization's gross income for such taxable year was derived from royalties, rents, dividends, interest, and annuities; and

(D) Such interest in such organization is not, at any time during such taxable year, subject to conditions which substantially restrict or limit the spouse's right to dispose of such interest and which run in favor of the individual or the individual's children who have not attained the age of 21 years. The principles of §1.414(c)–3(d)(6)(i) shall apply in determining whether a condition is a condition described in the preceding sentence.

(iii) *Definitions*. For purposes of paragraph (b)(5)(ii)(C) of this section, the gross income of an organization shall be determined under section 61 and the regulations thereunder. The terms ''interest'', ''royalties'', ''rents'', ''dividends'', and ''annuities'' shall have the same meaning such terms are given for purposes of section 1244(c) and §1.1244(c)–1(e)(1).

(6) *Children, grandchildren, parents, and grandparents*—(i) *Children and parents*. An individual shall be considered to own an interest owned, directly or indirectly, by or for the individual's children who have not attained the age of 21 years, and if the individual has not attained the age of 21 years, an interest owned, directly or indirectly, by or for the individual's parents.

(ii) *Children, grandchildren, parents, and grandparents*. If an individual is in effective control (within the meaning of §1.414(c)–2(c)(2)), directly and with the application of the rules of this paragraph without regard to this subdivision, of an organization, then such individual shall be considered to own an interest in such organization owned, directly or indirectly, by or for the individual's parents, grandparents, grandchildren, and children who have attained the age of 21 years.

(iii) *Adopted children*. For purposes of this section, a legally adopted child of an individual shall be treated as a child of such individual.

(iv) *Example*. The provisions of this subparagraph (6) may be illustrated by the following example:

Example: (A) *Facts.* Individual F owns directly 40 percent of the profits interest of the DEF Partnership. His son, M, 20 years of age, owns directly 30 percent of the profits interest of DEF, and his son, A, 30 years of age, owns directly 20 percent of the profits interest of DEF. The 10 percent remaining of the profits interest and 100 percent of the capital interest of DEF is owned by an unrelated person.

(B) *F's ownership.* F owns 40 percent of the profits interest in DEF directly and is considered to own the 30 percent profits interest owned directly by M. Since, for purposes of the effective control test contained in paragraph (b)(6)(ii) of this section, F is treated as owning 70 percent of the profits interest of DEF, F is also considered as owning the 20 percent profits interest of DEF owned by his adult son, A. Accordingly, F is considered as owning a total of 90 percent of the profits interest in DEF.

(C) *M's ownership.* Minor son, M. owns 30 percent of the profits interest in DEF directly, and is considered to own the 40 percent profits interest owned directly by his father, F. However, M is not considered to own the 20 percent profits interest of DEF owned directly by his brother, A, and constructively by F, because an interest constructively owned by F by reason of family attribution is not considered as owned by him for purposes of making another member of his family the constructive owner of such interest. (See paragraph (c)(2) of this section.) Accordingly, M is considered as owning a total of 70 percent of the profits interest of the DEF Partnership.

(D) *A's ownership.* Adult son, A, owns 20 percent of the profits interest in DEF directly. Since, for purposes of determining whether A effectively controls DEF under paragraph (b)(6)(ii) of this section, A is treated as owning only the percentage of profits interest he owns directly, he does not satisfy the condition precedent for the attribution of the DEF profits interest from his father. Accordingly, A is considered as owning only the 20 percent profits interest in DEF which he owns directly.

(c) *Operating rules*—(1) *In general.* Except as provided in paragraph (c)(2) of this section, an interest constructively owned by a person by reason of the application of paragraph (b) (1), (2), (3), (4), (5), or (6) of this section shall, for the purposes of applying such paragraph, be treated as actually owned by such person.

(2) *Members of family.* An interest constructively owned by an individual by reason of the application of paragraph (b) (5) or (6) of this section shall not be treated as owned by such individual for purposes of again applying such subparagraphs in order to make another the constructive owner of such interest.

(3) *Precedence of option attribution.* For purposes of this section, if an interest may be considered as owned under paragraph (b)(1) of this section (relating to option attribution) and under any other subparagraph of paragraph (b) of this section, such interest shall be considered as owned by such person under paragraph (b)(1) of this section.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example 1. A, 30 years of age, has a 90 percent interest in the capital and profits of DEF Partnership. DEF owns all the outstanding stock of corporation X and X owns 60 shares of the 100 outstanding shares of corporation Y. Under paragraph (c)(1) of this section, the 60 shares of Y constructively owned by DEF by reason of paragraph (b)(4) of this section are treated as actually owned by DEF for purposes of applying paragraph (b)(2) of this section. Therefore, A is considered as owning 54 shares of the Y stock (90 percent of 60 shares).

Example 2. Assume the same facts as in example (1). Assume further that B, who is 20 years of age and the brother of A, directly owns 40 shares of Y stock. Although the stock of Y owned by B is considered as owned by C (the father of A and B) under paragraph (b)(6)(i) of this section, under paragraph (c)(2) of this section such stock may not be treated as owned by C for purposes of applying paragraph (b)(6)(ii) of this section in order to make A the constructive owner of such stock.

Example 3. Assume the same facts as in example (2), and further assume that C has an option to acquire the 40 shares of Y stock owned by his son, B. The rule contained in paragraph (c)(2) of this section does not prevent the reattribution of such 40 shares to A because, under paragraph (c)(3) of this section, C is considered as owning the 40 shares by reason of option attribution and not by reason of family attribution. Therefore, since A is in effective control of Y under paragraph (b)(6)(ii) of this section, the 40 shares of Y stock constructively owned by C are reattributed to A. A is considered as owning a total of 94 shares of Y stock.

[T.D. 8179, 53 FR 6609, Mar. 2, 1988; 53 FR 8302, Mar. 14, 1988, as amended by T.D. 8540, 59 FR 30102, June 10, 1994]

§ 1.414(c)–5 Certain tax-exempt organizations.

(a) *Application.* This section applies to an organization that is exempt from tax under section 501(a). The rules of this section only apply for purposes of determining when entities are treated as the same employer for purposes of section 414(b), (c), (m), and (o) (including the sections referred to in section 414(b), (c), (m), (o), and (t)), and are in addition to the rules otherwise applicable under section 414(b), (c), (m), and (o) for determining when entities are treated as the same employer. Except to the extent set forth in paragraphs (d), (e), and (f) of this section, this section does not apply to any church, as defined in section 3121(w)(3)(A), or any qualified church-controlled organization, as defined in section 3121(w)(3)(B).

(b) *General rule.* In the case of an organization that is exempt from tax under section 501(a) (an exempt organization) whose employees participate in a plan, the employer with respect to that plan includes the exempt organization whose employees participate in the plan and any other organization that is under common control with that exempt organization. For this purpose, common control exists between an exempt organization and another organization if at least 80 percent of the directors or trustees of one organization are either representatives of, or directly or indirectly controlled by, the other organization. A trustee or director is treated as a representative of another exempt organization if he or she also is a trustee, director, agent, or employee of the other exempt organization. A trustee or director is controlled by another organization if the other organization has the general power to remove such trustee or director and designate a new trustee or director. Whether a person has the power to remove or designate a trustee or director is based on facts and circumstances. To illustrate the rules of this paragraph (b), if exempt organization A has the power to appoint at least 80 percent of the trustees of exempt organization B (which is the owner of the outstanding shares of corporation C, which is not an exempt organization) and to control at least 80 percent of the directors of exempt organization D, then, under this paragraph (b) and § 1.414(b)–1, entities A, B, C, and D are treated as the same employer with respect to any plan maintained by A, B, C, or D for purposes of the sections referenced in section 414(b), (c), (m), (o), and (t).

(c) *Permissive aggregation with entities having a common exempt purpose*—(1) *General rule.* For purposes of this section, exempt organizations that maintain a plan to which section 414(c) applies that covers one or more employees from each organization may treat themselves as under common control for purposes of section 414(c) (and, thus, as a single employer for all purposes for which section 414(c) applies) if each of the organizations regularly coordinates their day-to-day exempt activities. For example, an entity that provides a type of emergency relief within one geographic region and another exempt organization that provides that type of emergency relief within another geographic region may treat themselves as under common control if they have a single plan covering employees of both entities and regularly coordinate their day-to-day exempt activities. Similarly, a hospital that is an exempt organization and another exempt organization with which it coordinates the delivery of medical services or medical research may treat themselves as under common control if there is a single plan covering employees of the hospital and employees of the other exempt organization and the coordination is a regular part of their day-to-day exempt activities.

(2) *Authority to permit aggregation.* (i) For determining when entities are treated as the same employer under section 414(b), (c), (m), and (o), the Commissioner may issue rules of general applicability, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter), permitting other types of combinations of entities that include exempt organizations to elect to be treated as under common control for one or more specified purposes if:

(A) There are substantial business reasons for maintaining each entity in a separate trust, corporation, or other form; and

(B) Such treatment would be consistent with the anti-abuse standards in paragraph (f) of this section.

(ii) For example, this authority might be exercised in any situation in which the organizations are so integrated in their operations as to effectively constitute a single coordinated employer for purposes of section 414(b), (c), (m), and (o), including common employee benefit plans.

(d) *Permissive disaggregation between qualified church controlled organizations and other entities.* In the case of a church plan (as defined in section 414(e)) to which contributions are made by more than one common law entity, any employer may apply paragraphs (b) and (c) of this section to those entities that are not a church (as defined in section 403(b)(12)(B) and §1.403(b)–2) separately from those entities that are churches. For example, in the case of a group of entities consisting of a church (as defined in section 3121(w)(3)(A)), a secondary school (that is treated as a church under §1.403(b)–2), and several nursing homes each of which receives more than 25 percent of its support from fees paid by residents (so that none of them is a qualified church-controlled organization under §1.403(b)–2 and section 3121(w)(3)(B)), the nursing homes may treat themselves as being under common control with each other, but not as being under common control with the church and the school, even though the nursing homes would be under common control with the school and the church under paragraph (b) of this section.

(e) *Application to certain church entities under section 3121(w)(3).* [Reserved]

(f) *Anti-abuse rule.* In any case in which the Commissioner determines that the structure of one or more exempt organizations (which may include an exempt organization and an entity that is not exempt from income tax) or the positions taken by those organizations has the effect of avoiding or evading any requirements imposed under section 401(a), 403(b), or 457(b), or any applicable section (as defined in section 414(t)), or any other provision for which section 414(c) applies, the Commissioner may treat an entity as under common control with the exempt organization.

(g) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. (i) *Facts.* Organization A is a tax-exempt organization under section 501(c)(3) which owns 80% or more of the total value of all classes of stock of corporation B, which is a for profit organization.

(ii) *Conclusion.* Under paragraph (a) of this section, this section does not alter the rules of section 414(b) and (c), so that organization A and corporation B are under common control under §1.414(c)–2(b).

Example 2. (i) *Facts.* Organization M is a hospital which is a tax-exempt organization under section 501(c)(3) and organization N is a medical clinic which is also a tax-exempt organization under section 501(c)(3). N is located in a city and M is located in a nearby suburb. There is a history of regular coordination of day-to-day activities between M and N, including periodic transfers of staff, coordination of staff training, common sources of income, and coordination of budget and operational goals. A single section 403(b) plan covers professional and staff employees of both the hospital and the medical clinic. While a number of members of the board of directors of M are also on the board of directors of N, there is less than 80% overlap in board membership. Both organizations have approximately the same percentage of employees who are highly compensated and have appropriate business reasons for being maintained in separate entities.

(ii) *Conclusion.* M and N are not under common control under this section, but, under paragraph (c) of this section, may chose to treat themselves as under common control, assuming both of them act in a manner that is consistent with that choice for purposes of §1.403(b)–5(a), sections 401(a), 403(b), and 457(b), and any other applicable section (as defined in section 414(t)), or any other provision for which section 414(c) applies.

Example 3. (i) *Facts.* Organizations O and P are each tax-exempt organizations under section 501(c)(3). Each organization maintains a qualified plan for its employees, but one of the plans would not satisfy section 410(b) (or section 401(a)(4)) if the organizations were under common control. The two organizations are closely related and, while the organizations have several trustees in common, the common trustees constitute fewer than 80 percent of the trustees of either organization. Organization O has the power to remove any of the trustees of P and to select the slate of replacement nominees.

(ii) *Conclusion.* Under these facts, pursuant to paragraphs (b) and (f) of this section, the Commissioner treats the entities as under common control.

(h) *Applicable date*. This section applies for plan years beginning after December 31, 2008.

[T.D. 9340, 72 FR 41158, July 26, 2007; 72 FR 54352, Sept. 25, 2007]

§ 1.414(c)–6 Effective date.

(a) *General rule*. Except as provided in paragraph (b), (c), (e), or (f) of this section, the provisions of § 1.414(b)–1 and §§ 1.414(c)–1 through 1.414 (c)–4 shall apply for plan years beginning after September 2, 1974.

(b) *Existing plans*. In the case of a plan in existence on January 1, 1974, unless paragraph (c) of this section applies, the provisions of ''§ 1.414 (b)–1 and §§ 1.414(c)–1 through 1.414(c)–4 shall apply for plan years beginning after December 31, 1975. For definition of the term ''existing plan'', see § 1.410(a)–2(c).

(c) *Existing plans electing new provisions*. In the case of a plan in existence on January 1, 1974, for which the plan administrator makes an election under § 1.410 (a)–2(d), the provisions of § 1.414(b)–1 and §§ 1.414 (c)–1 through 1.414(c)–4 shall apply to the plan years elected under § 1.410 (a)–2 (d).

(d) *Application*. For purposes of the Employee Retirement Income Security Act of 1974, the provisions of § 1.414(b)–1 and §§ 1.414(c)–1 through 1.414(c)–4 do not apply for any period of time before the plan years described in paragraph (a), (b), or (c) of this section, whichever is applicable.

(e) *Special rule*. Notwithstanding paragraph (a), (b), or (c) of this section, § 1.414(c)–3 (f) is effective April 1, 1988.

(f) *Transitional rule*—(1) *In general*. The amendments made by T.D. 8179 apply to the plan years or period described in paragraphs (a), (b), or (c) of this section, whichever is applicable.

(2) *Exception*. In the case of a plan year or period beginning before March 2, 1988, if an organization—

(i) Is a member of a brother-sister group of trades or businesses under common control under § 11.414(c)–2(c), as in effect before removal by T.D. 8179 (''old group''), for such plan year or period, and

(ii) Is not such a member for such plan year or period because of the amendments made by such Treasury decision,

such member (whether or not a corporation) nevertheless will be treated as a member of such old group for purposes of section 414(c) for that plan year or period to the extent provided in § 1.1563–1 (d)(2). Also, such member will be treated as a member of an old group for all purposes of the Code for such plan year or period if all the organizations (whether or not corporations) that are members of the old group meet all the requirements of § 1.1563–1(d)(3) with respect to such plan year or period.

[T.D. 8179, 53 FR 6611, Mar. 2, 1988. Redesignated by T.D. 9340, 72 FR 41158, July 26, 2007]

§ 1.414(e)–1 Definition of church plan.

(a) *General rule*. For the purposes of part I of subchapter D of chapter 1 of the Code and the regulations thereunder, the term ''church plan'' means a plan established and at all times maintained for its employees by a church or by a convention or association of churches (hereinafter included within the term ''church'') which is exempt from tax under section 501(a), provided that such plan meets the requirements of paragraphs (b) and (if applicable) (c) of this section. If at any time during its existence a plan is not a church plan because of a failure to meet the requirements set forth in this section, it cannot thereafter become a church plan.

(b) *Unrelated businesses*—(1) *In general*. A plan is not a church plan unless it is established and maintained primarily for the benefit of employees (or their beneficiaries) who are not employed in connection with one or more unrelated trades or businesses (within the meaning of section 513).

(2) *Establishment or maintenance of a plan primarily for persons not employed in connection with one or more unrelated trades or businesses*. (i) (A) A plan, other than a plan in existence on September 2, 1974, is established primarily for the benefit of employees (or their beneficiaries) who are not employed in connection with one or more unrelated trades or businesses if on the date the plan is established the number of employees employed in connection with the unrelated trades or businesses eligible to participate in the plan is less than 50 percent of the total number of

employees of the church eligible to participate in the plan.

(B) A plan in existence on September 2, 1974, is to be considered established as a plan primarily for the benefit of employees (or their beneficiaries) who are not employed in connection with one or more unrelated trades or businesses if it meets the requirements of both paragraphs (b)(2)(ii) (A) and (B) (if applicable) in either of its first 2 plan years ending after September 2, 1974.

(ii) For plan years ending after September 2, 1974, a plan will be considered maintained primarily for the benefit of employees of a church who are not employed in connection with one or more unrelated trades or businesses if in 4 out of 5 of its most recently completed plan years—

(A) Less than 50 percent of the persons participating in the plan (at any time during the plan year) consist of and in the same year

(B) Less than 50 percent of the total compensation paid by the employer during the plan year (if benefits or contributions are a function of compensation) to employees participating in the plan is paid to,

employees employed in connection with an unrelated trade or business. The determination that the plan is not a church plan will apply to the second year (within a 5 year period) for which the plan fails to meet paragraph (b)(2)(ii) (A) or (B) (if applicable) and to all plan years thereafter unless, taking into consideration all of the facts and circumstances as described in paragraph (b)(2)(iii) of this section, the plan is still considered to be a church plan. A plan that has not completed 5 plan years ending after September 2, 1974, shall be considered maintained primarily for the benefit of employees not employed in connection with an unrelated trade or business unless it fails to meet paragraphs (b)(2)(ii) (A) and (B) in at least 2 such plan years.

(iii) Even though a plan does not meet the provisions of paragraph (b)(2)(ii) of this section, it nonetheless will be considered maintained primarily for the benefit of employees who are not employed in connection with one or more unrelated trades or businesses if the church maintaining the plan can demonstrate that based on all of the facts and circumstances such is the case. Among the facts and circumstances to be considered in evaluating each case are:

(A) The margin by which the plan fails to meet the provisions of paragraph (b)(2)(ii) of this section, and

(B) Whether the failure to meet such provisions was due to a reasonable mistake as to what constituted an unrelated trade or business or whether a particular person or group of persons were employed in connection with one or more unrelated trades or businesses.

(iv) For purposes of this section, an employee will be considered eligible to participate in a plan if such employee is a participant in the plan or could be a participant in the plan upon making mandatory employee contributions to the plan.

(3) *Employment in connection with one or more unrelated trades or businesses.* An employee is employed in connection with one or more unrelated trades or businesses of a church if a majority of such employee's duties and responsibilities in the employ of the church are directly or indirectly related to the carrying on of such trades or businesses. Although an employee's duties and responsibilities may be insignificant with respect to any one unrelated trade or business, such employee will nonetheless be considered as employed in connection with one or more unrelated trades or businesses if such employee's duties and responsibilities with respect to all of the unrelated trades or businesses of the church represent a majority of the total of such person's duties and responsibilities in the employ of the church.

(c) *Plans of two or more employers.* The term ''church plan'' does not include a plan which, during the plan year, is maintained by two or more employers unless—

(1) Each of the employers is a church that is exempt from tax under section 501(a), and

(2) With respect to the employees of each employer, the plan meets the provisions of paragraph (b)(2)(ii) of this section or would be determined to be a church plan based on all the facts and circumstances described in paragraph (b)(2)(iii) of this section.

Thus, if with respect to a single employer the plan fails to meet any provision of this paragraph, the entire plan ceases to be a church plan unless that employer ceases maintaining the plan for all plan years beginning after the plan year in which it receives a final notification from the Internal Revenue Service that it does not meet the provisions of this paragraph. If the employer does cease maintaining the plan in accordance with this paragraph, the fact that the employer formerly did maintain the plan will not prevent the plan from being a church plan for prior years.

(d) *Special rule.* (1) Notwithstanding paragraph (c)(1) of this section, a plan maintained by a church and one or more agencies of such church for the employees of such church and of such agency or agencies, that is in existence on January 1, 1974, shall be treated as a church plan for plan years ending after September 2, 1974, and beginning before January 1, 1983, provided that the plan is described in paragraph (c) of this section without regard to paragraph (c)(1) of this section, and the plan is not maintained by an agency which did not maintain the plan on January 1, 1974.

(2) For the purposes of section 414(e) and this section, an agency of a church means an organization which is exempt from tax under section 501 and which is either controlled by, or associated with, a church. For example, an organization, a majority of whose officers or directors are appointed by a church's governing board or by officials of a church, is controlled by a church within the meaning of this paragraph. An organization is associated with a church if it shares common religious bonds and convictions with that church.

(e) *Religious orders and religious organizations.* For the purpose of this section the term ''church'' includes a religious order or a religious organization if such order or organization (1) is an integral part of a church, and (2) is engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise.

(f) *Separately incorporated fiduciaries.* A plan which otherwise meets the provisions of this section shall not lose its status as a church plan because of the fact that it is administered by a separately incorporated fiduciary such as a pension board or a bank.

(g) *Cross reference.* (1) For rules relating to treatment of church plans, see section 410(c), 411(e), 412(h), 4975(g), and the regulations thereunder.

(2) For rules relating to church plan elections, see section 410(d) and the regulations thereunder.

[T.D. 7688, 45 FR 20797, Mar. 31, 1980]

§ 1.414(f)–1 Definition of multiemployer plan.

(a) *General rule.* For purposes of part I of subchapter D of chapter 1 of the Code and the regulations thereunder, a plan is a multiemployer plan for a plan year if all of the following requirements are satisfied:

(1) *Number of contributing employers.* More than one employer is required by the plan instrument or other agreement to contribute (or to have contributions made on its behalf) to the plan for the plan year.

(2) *Collective bargaining agreement.* The plan is maintained for the plan year pursuant to one or more collective bargaining agreements between employee representatives and more than one employer.

(3) *Amount of contributions.* Except as provided by paragraph (c) of this section (relating to the special rule for contributions exceeding 50 percent), the amount of contributions made under the plan for the plan year by or on behalf of each employer is less than 50 percent of the total amount of contributions made under the plan for such plan year by or on behalf of all employers.

(4) *Benefits.* The plan provides that the amount of benefits payable with respect to each employee participating in the plan is determined without regard to whether or not his employer continues as a member of the plan. If benefits accrued as a result of the participant's service with his employer during a period before such employer was a member of the plan, this requirement does not apply to the amount of those benefits, except that this requirement does apply to the amount of those benefits (i) which are accrued benefits derived from employee contributions, or

(ii) which are accrued under a plan maintained by an employer prior to the time such employer became a member of the plan to which the requirements of this paragraph (a) are applied.

(5) *Other requirements*. The plan satisfies such other requirements as the Secretary of Labor by regulations prescribes under the authority of section 414(f)(1)(E) of the Code and section 3(37) of the Employee Retirement Income Security Act of 1974 (Pub. L. 93–406, 88 Stat. 839). See 29 CFR 2510.3–37.

(b) *Special rules*—(1) *Amount of contributions*. For purposes of paragraphs (a)(3) and (c) of this section, the amount of contributions made under the plan for the plan year by or on behalf of each employer shall be the sum of such contributions made on or before the last day of the plan year. For purposes of determining whether contributions are made on or before the last day of the plan year, the rule of section 412(c)(10) and the regulations thereunder (relating to the treatment of certain contributions made after the last day of the plan year as made on such last day) shall apply.

(2) *Benefits*. (i) For purposes of paragraph (a)(4) of this section, certain benefit amounts are treated as accrued as a result of the participant's service with an employer during a period before such employer was a member of the plan. The amount of such a benefit so treated is the difference (if any) between two calculated amounts. The first calculated amount is the participant's total accrued benefit calculated under the plan as of the date the employer ceased to be a member of the plan. The second calculated amount is the participant's accrued benefit calculated without regard to his service with such employer during the period before such employer was a member of the plan. However, under a special limitation, this difference may not exceed the benefit a participant accrued from service before his employer became a member of the plan. For purposes of this limitation, this benefit is the benefit accrued as of the date the employer ceases to be a member of the plan. An employer shall be deemed to be a member of the plan in a plan year if the employer is required by the plan instrument or other agreement to contribute (or to have contributions made on its behalf) to the plan for such plan year or if an employee of the employer accrues a benefit, on account of service with the employer during such plan year, under the plan for that plan year.

(ii) The provisions of paragraphs (a)(4) and (b)(2)(i) of this section are illustrated by the following example:

Example. On January 1, 1976, employer W became a member of the noncontributory XYZ pension plan which uses the calendar year as the plan year. W did not maintain any plan prior to that date. The plan provided for benefits of $4 per month per year of service (including service with W before January 1, 1976). On January 1, 1980, following adoption of a new collective bargaining agreement, the benefits were increased to $12 per month per year of service for all years of service (including service with W before January 1, 1976). On January 1, 1991, W ceased to be a member of the plan.

A, an employee of W, had 15 years of service before January 1, 1976, 4 years of service between January 1, 1976, and December 31, 1979, and 11 years of service between January 1, 1980, and December 31, 1990. On December 31, 1990, A's accrued benefit was $360 per month ($12 per month × 30). On January 1, 1991, the portion of A's accrued benefit retained and the portion forfeited under the terms of the XYZ pension plan were determined as follows:

Years	Monthly accrued benefit retained	Monthly accrued benefit forfeited
Before Jan. 1, 1976		$12 × 15 years = $180
Jan. 1, 1976 to Dec. 31, 1979	$4 × 4 years = $16	$8 × 4 years = $32
Jan. 1, 1980 to Dec. 31, 1990	$12 × 11 years = $132	
Total	$148	$212

The XYZ plan does not satisfy the requirements of paragraphs (a)(4) and (b)(2)(i) of this section because no benefit can be forfeited with respect to service after W began participating in the plan. Thus, the maximum accrued benefit that may be forfeited is $180 per month (the accrued benefit with respect to A's service prior to January 1, 1976).

Therefore, in order for the plan to meet the requirements of paragraphs (a)(4) and (b)(2)(i) of this section, the plan must provide for A's accrued benefit after W ceased to be a member of the plan to be at least $180 per month ($360 per month total accrued benefit less $180 per month benefit accrued for service prior to W's membership in the plan).

(iii) For purposes of paragraphs (a)(4) and (b)(2) of this section, if an employer for a period employs two or more individuals who, solely by reason of their employment, are participants in the plan and who do not belong to the same collective bargaining unit, the dates on which the employer became and ceased to be a member of the plan shall be determined separately on a class basis for individuals who belong to separate collective bargaining units, as separate classes, and for individuals who do not belong to a collective bargaining unit, as a further single separate class. Thus, such dates shall be determined with respect to individuals as a class who belong to the same collective bargaining unit (or who do not belong to a collective bargaining unit) without consideration of the employment by the employer of, or the participation in the plan by, other individuals (who do not belong to such collective bargaining unit and who may belong to another collective bargaining unit) or whether the employer is a member of the plan with respect to such other individuals. In no event, however, may service not attributable to service with a particular collective bargaining unit be disregarded under paragraphs (a)(4) and (b)(2) of this section merely because the employer ceases to maintain the plan with respect to such unit. Thus, for example, paragraphs (a)(4) and (b)(2) of this section do not permit the disregard of a period of service of an individual belonging to a collective bargaining unit prior to the time the employer became a member of the plan with respect to such unit to the extent that, during such period of service, the individual belonged to another collective bargaining unit with respect to which the employer was a member of the plan.

(3) *Controlled groups*. For purposes of section 414(f) and this section, all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a) and the regulations thereunder, but determined without regard to section 1563(e)(3)(C) and the regulations thereunder) are deemed to be one employer.

(c) *Contributions exceeding 50 percent*. If a plan was a multiemployer plan as defined in this section for any plan year (including plan years ending prior to September 3, 1974), ''75 percent'' shall be substituted for ''50 percent'' in applying paragraph (a)(3) of this section for subsequent plan years until the first plan year following a plan year in which the amount contributed by or on behalf of one employer is 75 percent or more of the total amount of contributions made under the plan for that plan year by or on behalf of all of the employers making contributions. In such case ''75 percent'' shall not again be substituted for ''50 percent'' until the plan has met the requirements of paragraph (a) of this section (determined without regard to this paragraph) for one plan year.

(d) *Examples*. The application of this section is illustrated by the following examples. For purposes of these examples, assume that the plan meets the requirements of paragraphs (a) (1), (2), (4), and (5) of this section for each plan year.

Example 1. On January 1, 1970, U, V, and W, three employers none of which is a member of a controlled group of corporations with any of the other two employers, establish a plan with a plan year corresponding to the calendar year. U, V, and W each contribute less than one-half of the total contributions made under the plan for each of the years 1970, 1971, and 1972. For the years 1973, 1974, and 1975, U contributes 70 percent and V and W each contribute 15 percent of the total contributions made under the plan for each year. The plan is a multiemployer plan under section 414(f) and this section for 1975 because no employer has contributed 75 percent or more of the total amount contributed for each of the plan years subsequent to 1972.

Example 2. (i) *First plan year*. On January 1, 1975, X, Y, and Z, three employers none of which is a member of a controlled group of corporations with any of the other two employers, establish a plan with a plan year corresponding to the calendar year. X, Y, and Z each contribute less than one-half of the total contributions made under the plan for 1975. The plan is a multiemployer plan for 1975 because it meets the 50 percent contribution requirement of paragraph (a)(3) of this section.

(ii) *Second plan year*. For the second plan year, 1976, X contributes 70 percent and Y and Z each contribute 15 percent of the total contributions made under the plan. The plan is a multiemployer plan for 1976 because it was a multiemployer plan for the preceding plan year and satisfies the 75 percent contribution requirement of paragraph (c) of this section.

(iii) *Third plan year*. For the third plan year, 1977, X contributes 80 percent and Y and Z each contribute 10 percent of the total contributions made under the plan. The plan is not a multiemployer plan for 1977 because it fails to satisfy the 75 percent contribution requirement of paragraph (c) of this section.

(iv) *Fourth plan year*. For the fourth plan year, 1978, Y contributes 60 percent and X and Z each contribute 20 percent of the total contributions made under the plan. The 75 percent contribution requirement of paragraph (c) of this section does not apply. The plan is not a multiemployer plan for 1978 because it fails to satisfy the 50 percent contribution requirement of paragraph (a)(3) of this section.

(v) *Fifth plan year*. For the fifth plan year, 1979, X, Y, and Z each contribute less than one-half of the total contributions made under the plan. The 75 percent contribution requirement of paragraph (c) of this section does not apply. The plan is a multiemployer plan for 1979 because it again meets the 50 percent contribution requirement of paragraph (a)(3) of this section.

(vi) *Sixth plan year*. For the sixth plan year, 1980, the plan will continue to be a multiemployer plan, provided that no employer contributes 75 percent or more of the total amount of contributions made under the plan for the plan year.

(e) *Retention of records*. (1) For plan years ending prior to September 3, 1974, a plan may be required to furnish proof that it met the requirements of section 414(f) and this section for each plan year ending prior to that date to the extent necessary to show the applicability of the 75 percent test provided in paragraph (c) of this section.

(2) For plan years ending after September 2, 1974, a plan may be required to furnish proof that it met the requirements of section 414(f) and this section for 6 immediately preceding plan years.

(Secs. 414(f) and 7805 of the Internal Revenue Code of 1954 (88 Stat. 927, 26 U.S.C. 414(f); 68A Stat. 917; 26 U.S.C. 7805))

[T.D. 7552, 43 FR 29940, July 12, 1978]

§ 1.414(g)–1 Definition of plan administrator.

(a) *In general*. For purposes of part I of subchapter D of chapter 1 of the Code and the regulations thereunder, if the instrument under which the plan is operated for a plan year specifically designates a person or a group of persons as plan administrator, the person or group of persons collectively is the plan administrator for the plan year. The instrument may specifically designate a plan administrator—

(1) By name,

(2) By reference to the person or group of persons holding a named position or positions,

(3) By reference to a procedure established under the terms of the instrument pursuant to which a plan administrator is designated, or

(4) By reference to the person or group of persons charged with specific responsibilities of plan administrator. Consistent with the provisions of section 405 (c) (1) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1105 (c) (1)), a plan may provide for the allocation of specific responsibilities of plan administrator among named persons and for named persons to designate others to carry out such responsibilities. A person or group of persons may be designated as plan administrator in accordance with the rules of this paragraph even though the person or group of persons does not carry the specific title ''plan administrator''. In the absence of a person or group of persons designated as the plan administrator (individually, collectively, or by designation of different specific administrative responsibilities), the plan administrator for the plan year is the person or group of persons specified in paragraph (b) of this section.

(b) *Plan administrator not specifically designated*. If no person or group of persons is specifically designated as the plan administrator for a plan year by the instrument under which the plan is operated, the plan administrator for such year is the person or group of persons determined under the following rules:

(1) *Single employer*. In the case of a plan maintained by a single employer, the employer is the plan administrator.

If the employer is a corporation, the corporation is the plan administrator. However, the corporation's board of directors may authorize a person or group of persons to fulfill responsibilities of the corporation as plan administrator. In the absence of such authorization, any corporate officer authorized under law, corporate by-laws, or resolution of the board of directors to act on behalf of the corporation with respect to contracts of a value equivalent to the fair market value of the assets of the plan shall be presumed to have authority to fulfill responsibilities of the corporation as plan administrator. For purposes of this paragraph (b) (1), ''employer'' means the ''employer'' as defined in section 3 (5) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1003 (5)).

(2) *Employee organization*. In the case of a plan maintained by an employee organization, the employee organization is the plan administrator.

(3) *Group representing the parties*. In the case of a plan maintained by two or more employers, or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties who maintain the plan, as the case may be, is the plan administrator. For purposes of this subparagraph (3), a plan shall be considered maintained by two or more employers or jointly by one or more employers and one or more employee organizations only if none of the parties has the express power, under the terms of the instrument under which the plan is operated, to terminate the plan unilaterally.

(4) *Person in control of assets*. In any case where a plan administrator may not be determined by application of paragraphs (a) and (b), (1), (2), and (3) of this section, the plan administrator is the person or persons actually responsible, whether or not under the terms of the plan, for the control, disposition, or management of the cash or property received by or contributed to the plan, irrespective of whether such control, disposition, or management is exercised directly by such person or persons or indirectly through an agent or trustee designated by such person or persons.

(Secs. 414(g) and 7805 of the Internal Revenue Code of 1954 (88 Stat. 927, 68A Stat 917; 26 U.S.C. 414(g), 7805))

[T.D. 7618, 44 FR 27657, May 11, 1979]

§ 1.414(l)–1 Mergers and consolidations of plans or transfers of plan assets.

(a) *In general*—(1) *Scope of the regulations*. Sections 401(a)(12) and 414(l) apply only to plans to which section 411 applies without regard to section 411(e)(2). Thus, for example, these sections do not apply to a governmental plan within the meaning of section 414(d); a church plan, within the meaning of section 414(e), for which there has not been made the election under section 410(d) to have the participation, vesting, funding, etc. requirements apply; or a plan which at no time after September 2, 1974, provided for employer contributions.

(2) *General rule*. Under section 414(l),

(i) A trust which forms a part of a plan will not constitute a qualified trust under section 401, and

(ii) A plan will not be treated as being qualified under section 403 (a) and 405 (a), unless, in the case of a merger or consolidation (as defined in paragraph (b)(2) of this section), or a transfer of assets or liabilities (as defined in paragraph (b)(3) of this section), the following condition is satisfied. This condition requires that each participant receive benefits on a termination basis (as defined in paragraph (b)(5) of this section) from the plan immediately after the merger, consolidation or transfer which are equal to or greater than the benefits the participant would receive on a termination basis immediately before the merger, consolidation, or transfer.

(b) *Definitions*. For purposes of this section:

(1) *Single plan*. A plan is a ''single plan'' if and only if, on an ongoing basis, all of the plan assets are available to pay benefits to employees who are covered by the plan and their beneficiaries. For purposes of the preceding sentence, all the assets of a plan will not fail to be available to provide all the benefits of a plan merely because the plan is funded in part or in whole with allocated insurance instruments.

A plan will not fail to be a single plan merely because of the following:

(i) The plan has several distinct benefit structures which apply either to the same or different participants,

(ii) The plan has several plan documents,

(iii) Several employers, whether or not affiliated, contribute to the plan,

(iv) The assets of the plan are invested in several trusts or annuity contracts, or

(v) Separate accounting is maintained for purposes of cost allocation but not for purposes of providing benefits under the plan.

However, more than one plan will exist if a portion of the plan assets is not available to pay some of the benefits. This will be so even if each plan has the same benefit structure or plan document, or if all or part of the assets are invested in one trust with separate accounting with respect to each plan.

(2) *Merger or consolidation*. The terms ''merger'' or ''consolidation'' means the combining of two or more plans into a single plan. A merger or consolidation will not occur merely because one or more corporations undergo a reorganization (whether or not taxable). Furthermore, a merger or consolidation will not occur if two plans are not combined into a single plan, such as by using one trust which limits the availability of assets of one plan to provide benefits to participants and beneficiaries of only that plan.

(3) *Transfer of assets or liabilities*. A ''transfer of assets or liabilities'' occurs when there is a diminution of assets or liabilities with respect to one plan and the acquisition of these assets or the assumption of these liabilities by another plan. For example, the shifting of assets or liabilities pursuant to a reciprocity agreement between two plans in which one plan assumes liabilities of another plan is a transfer of assets or liabilities. However, the shifting of assets between several funding media used for a single plan (such as between trusts, between annuity contracts, or between trusts and annuity contracts) is not a transfer of assets or liabilities.

(4) *Spinoff*. The term ''spinoff'' means the splitting of a single plan into two or more plans.

(5) *Benefits on a termination basis*. (i) The term ''benefits on a termination basis'' means the benefits that would be provided exclusively by the plan assets pursuant to section 4044 of the Employee Retirement Income Security Act of 1974 (''ERISA'') and the regulations thereunder if the plan terminated. Thus, the term does not include benefits that are guaranteed by the Pension Benefit Guaranty Corporation, but not provided by the plan assets.

(ii) For purposes of determining the benefits on a termination basis, the allocation of assets to various priority categories under section 4044 of ERISA must be made on the basis of reasonable actuarial assumptions. The assumptions used by the Pension Benefit Guaranty Corporation as of the date of the merger or spinoff are deemed reasonable for this purpose.

(iii) If a change in the benefit structure of a plan in conjunction with a merger, consolidation, or transfer of assets or liabilities alters the benefits on a termination basis, the change should be designated, at the time the merger, consolidation, or transfer occurs, to be effective either immediately before or immediately after that occurrence. In the event that no designation is made, the change in the benefit structure will be deemed to occur immediately after the merger, consolidation, or transfer of assets or liabilities.

(6) *Lower funded plan*. (i) The term ''lower funded plan'' generally means the plan which, immediately prior to the merger, would have its assets exhausted in a higher priority category than the other plan.

(ii) Where two plans, immediately prior to the merger, would have their assets exhausted in the same priority category of section 4044 of ERISA in the event of termination, the lower funded plan is the one in which the assets would satisfy a lesser proportion of the liability allocated to that priority category.

(7) *Priority category*. The term ''priority category'' means the category of benefits described in each paragraph of section 4044(a) of ERISA. References to higher or highest priority categories refer to those priority categories which receive the first allocation of asserts,

i.e. the lowest paragraph numbers in section 4044(a).

(8) *Separate accounting of assets.* The term ''separate accounting of assets'' means the maintenance of an asset account with respect to a given group of participants which is:

(i) Credited with contributions made to the plan on behalf of the participants and with its allocable share of investment income, if any, and

(ii) Charged with benefits paid to the participants, and with its allocable share of investment losses or expenses.

(9) *Present value of accrued benefit.* For purposes of this section, the present value of an accrued benefit must be determined on the basis of reasonable actuarial assumptions. For this purpose, the assumptions used by the Pension Benefit Guaranty Corporation as of the date of the merger or spinoff are deemed reasonable.

(10) *Valuation of plan assets.* In determining the value of a plan's assets, the standards set forth in regulations prescribed by the Pension Benefit Guaranty Corporation (29 CFR Part 2611) shall be applied.

(11) *Date of merger or spinoff.* The actual date of a merger or spinoff shall be determined on the basis of the facts and circumstances of the particular situation. For purposes of this determination, the following factors, none of which is necessarily controlling, are relevant:

(i) The date on which the affected employees stop accruing benefits under one plan and begin coverage and benefit accruals under another plan.

(ii) The date as of which the amount of assets to be eventually transferred is calculated.

(iii) If the merger or spinoff agreement provides that interest is to accrue from a certain date to the date of actual transfer, the date from which such interest will accrue.

(c) *Application of section 414(l)*—(1) *Two or more plans.* (i) Section 414(l) does not apply unless more than a single plan is involved. It also does not apply unless at least a single plan assumes liabilities from another plan or obtains assets from another plan (as in a merger or spinoff). For purposes of section 414(l), a transfer of assets or liabilities will not be deemed to occur merely because a defined contribution plan is amended to become a defined benefit plan. This rule will apply even if, under the facts and circumstances of a particular case, a termination of the defined contribution plan will be considered to have occurred for purposes of other provisions of the Code.

(ii) The requirements of this subparagraph may be illustrated as follows:

Example. After acquiring Corporation B, Corporation A amends Corporation B's defined benefit plan (Plan B) to provide the same benefits as Corporation A's defined benefit plan (Plan A). The assets of Plan B are transferred to the trust containing the assets of Plan A in such a manner that the assets of each plan: (1) are separately accounted for, and (2) are not available to pay benefits of the other plan. Because of condition (2) there are still two plans and, therefore, a merger did not occur. As a result, section 414(l) does not apply. If at some later date Corporation A were to sell Corporation B and transfer the assets of Plan B that were separately accounted for to another trust or to an annuity contract solely for the purpose of providing Plan B's benefits, this transfer would also not involve section 414(l). This is so because Plan B was a separate plan before the entire transaction and because no plan assumed liabilities or obtained assets from another plan. If, on the other hand, Corporation A merged Plan A and Plan B at the time of the acquisition of Corporation B by deleting condition (2) above, then section 414(l) would apply both to the merger of Plan A and Plan B and to the spinoff of Plan B from the merged plan. The spinoff would have to satisfy the requirements of paragraph (n) of this section, even if the assets attributable to Plan A and Plan B were separately accounted for in order to allocate funding costs.

(2) *Multiemployer plans.* Except to the extent provided by regulations of the Pension Benefit Guaranty Corporation, section 114(l) does not apply to any transaction to the extent that participants either before or after that transaction are covered under a multiemployer plan within the meaning of section 414(f). Until these regulations are issued, section 414(l) does not apply to any of the following situations:

(i) A multiemployer plan is split into two or more plans, one or more of which are not multiemployer plans, or

(ii) A single employer plan is merged into a multiemployer plan.

Therefore, if some (but not all) of the participants in a single employer plan

become participants in a multiemployer plan under an agreement in which the multiemployer plan assumes all the liabilities of the single employer plan with respect to these participants and in which some or all of the assets of the single employer plan are transferred to the multiemployer plan, section 414(l) applies, but only with respect to the participants in the single employer plan who did not transfer to the multiemployer plan.

(d) *Merger of defined contribution plans*. In the case of a merger of two or more defined contribution plans, the requirements of section 414(l) will be satisfied if all of the following conditions are met:

(1) The sum of the account balances in each plan equals the fair market value (determined as of the date of the merger) of the entire plan assets.

(2) The assets of each plan are combined to form the assets of the plan as merged.

(3) Immediately after the merger, each participant in the plan as merged has an account balance equal to the sum of the account balances the participant had in the plans immediately prior to merger.

(e) *Merger of defined benefit plans*—(1) *General rule*. Section 414(l) compares the benefits on a termination basis before and after the merger. If the sum of the assets of all plans is not less than the sum of the present values of the accrued benefit (whether or not vested) of all plans, the requirements of section 414(l) will be satisfied merely by combining the assets and preserving each participant's accrued benefits. This is so because all the accrued benefits of the plan as merged are provided on a termination basis by the plan as merged. However, if the sum of the assets of all plans is less than the sum of the present values of the accrued benefits (whether or not vested) in all plans, the accrued benefits in the plan as merged are not provided on a termination basis.

(2) *Special schedule of benefits*. Generally, for some participants, the benefits provided on a termination basis for the plan as merged would be different from the benefits provided on a termination basis in the plans prior to merger if the assets were merely combined and if each participant retained his accrued benefit. Some participants would, therefore, receive greater benefits on a termination basis as a result of the merger and some other participants would receive smaller benefits. Accordingly, the requirements of section 414(l) would not be satisfied unless the distribution on termination were modified in some manner to prevent any participant from receiving smaller benefits on a termination basis as a result of the merger. This is accomplished through modifying the application of section 4044 of ERISA by inserting a special schedule of benefits.

(f) *Operational rules for the special schedule*. The application of section 4044 of ERISA as modified by the schedule of benefits is accomplished by the following steps:

(1) Section 4044 is applied in the plan as merged through the priority categories fully satisfied by the assets of the lower funded plan immediately prior to the merger.

(2) The assets in the plan as merged are then allocated to the next priority category as a percentage of the value of the benefits that would otherwise be allocated to that priority category. That percentage is the ratio of (i) the assets allocated to the first priority category not fully satisfied by the lower funded plan immediately prior to the merger to (ii) the assets that would have been allocated had that priority category been fully satisfied.

(3) A schedule of benefits is formed listing participants and scheduled accrued benefits. The scheduled accrued benefit is the excess of the benefits provided on a termination basis with respect to any participant from the plans immediately prior to the merger, over the benefits provided on a termination basis in subparagraphs (1) and (2) of this paragraph immediately after the merger. After allocating the assets in accordance with subparagraph (2) of this paragraph, the assets are allocated to the schedule of benefits as follows:

(i) First the assets are allocated to the scheduled benefits to the extent that the participant would have benefits provided in subparagraph (4) of this paragraph if there were no scheduled benefits.

(ii) Then the assets are allocated to the scheduled benefits to the extent that the participant would have benefits provided pursuant to subparagraph (5) of this paragraph if there were no scheduled benefits.

These assets should be allocated first to those scheduled benefits that are in the highest priority category under section 4044.

(4) The assets are then allocated to those benefits in the priority category described in subparagraph (2) of this paragraph with respect to which assets were not allocated. This allocation is made to the extent that these benefits are not associated with benefits in the schedule.

(5) Finally, the assets are allocated in accordance with section 4044 with respect to priority categories lower than the priority category described in subparagraph (4) of this paragraph. This allocation is made to the extent that these benefits are not associated with benefits in the schedule.

(g) *Successive mergers*—(1) *In general*. In the case of a current merger of a defined benefit plan with another defined benefit plan which as a result of a previous merger has a special schedule, the rules of paragraphs (e) and (f) of this section apply as if the schedule were considered a category described in section 4044 of ERISA. Thus, a second schedule may be formed as a result of the current merger. The second schedule will be inserted in the priority category of section 4044 described in paragraph (f)(2) of this section as of the date of the current merger. This priority category may be higher, lower, or within the schedule of benefits existing on account of a previous merger. If this priority schedule is inserted within a schedule of benefits, a new single schedule of benefits replacing the old schedule of benefits would in effect be created.

(2) *Allocation of assets*. Assets in the new schedule of benefits are allocated as follows:

(i) First to the benefits remaining in the old schedule to the extent that there are assets immediately prior to the second merger to satisfy the original benefits,

(ii) Then to the benefits provided on a termination basis from the plans immediately prior to the second merger to the extent that they are not provided before the schedule after the second merger or in subdivision (i) of this subparagraph,

(iii) Then to benefits remaining in the original schedule not included in subdivision (i) of this subparagraph.

(h) *De minimis rule for merger of defined benefit plan*—(1) *In general*. In the case of a merger of a defined benefit plan (''smaller plan'') whose liabilities (*i.e.*, the present value of accrued benefits, whether or not vested) are less than 3 percent of the assets of another defined benefit plan (''larger plan'') as of at least one day in the larger plan's plan year in which the merger of the two plans occurs, section 414(l) will be deemed to be satisfied if the following condition is met. The condition requires that a special schedule of benefits (consisting of all the benefits that would be provided by the smaller plan on a termination basis just prior to the merger) be payable in a priority category higher than the highest priority category in section 4044 of ERISA. Assets will be allocated to that schedule in accordance with the allocation of assets to scheduled benefits in paragraph (f)(3) of this section.

(2) *Application to a series of mergers*. In the case of a series of such mergers in a given plan year of the larger plan, the rule described in subparagraph (1) of this paragraph will apply only if the sum of the liabilities (whether or not vested) assumed by the larger plan are less than 3 percent of the assets of the larger plan as of at least one day in the plan year of the larger plan in which the mergers occurred.

(3) *Application to a merger occurring over more than one plan year*. In the case of a merger of a smaller plan or a portion thereof with a larger plan designed to occur in steps over more than one plan year of the larger plan, the entire transaction will be deemed to occur in the plan year of the larger plan which contains the first of these steps.

(4) *Liabilities of the smaller plan*. For purposes of subparagraphs (2) and (3) of this paragraph, mergers satisfying paragraphs (e), (f) or (g) of this section will be ignored in determining the sum of the liabilities assumed by the larger plan.

(i) *Data maintenance*—(1) *Alternative to the special schedule.* In the case of a merger which would require the creation of a special schedule in order to satisfy section 414(l), the schedule need not be created at the time of the merger if data sufficient to create the schedule is maintained. The schedule would only have to be created in the event of a subsequent plan termination or a subsequent spinoff. In that case the schedule must be determined as of the date of the merger.

(2) *Required data.* The data that must be maintained depends on the plan, and care should be taken to ensure that all necessary data is maintained. Furthermore, in order to take advantage of the data maintenance alternative provided in this paragraph, an enrolled actuary must certify to the plan administrator that each element of data necessary to determine the schedule as of the date of the merger is maintained. This certification must be based either upon the enrolled actuary's independent examination of the data, or upon his reliance, which under the circumstances of the particular situation must be reasonable, upon a written statement of the plan administrator concerning what data is actually being maintained.

(j) *Five year rule*—(1) *Limitation on the required use of the special schedule.* A plan will not fail to satisfy the requirements of section 414(l) merely because the effects of the special schedule created pursuant to paragraphs (e)(2) or (h) of this section are ignored 5 years after the date of a merger. Furthermore, the date maintained pursuant to paragraph (i) of this section need not be maintained for more than 5 years after the merger, if the plan does not have a spinoff or a termination within 5 years.

(2) *Illustration.* If Plans A and B merge to form Plan AB and if Plan AB merges with Plan C 3 years later to form Plan ABC and if Plan ABC terminates 4 years later, the data relating to the merger of Plans A and B need not be maintained for more than 5 years after the merger of Plans A and B. In addition, after 5 years have elapsed after the merger of Plans A and B, the effect of any special schedule created by the merger of Plans A and B on the schedule created by the merger of Plans AB and C may be ignored in determining the later schedule.

(k) *Examples.* The provisions of paragraphs (e) through (j) of this section may be illustrated by the following examples:

Example 1. Plan A, whose assets are $220,000, is to be merged with Plan B, whose assets are $200,000. Plan A has three employees. Plan B has two employees. If Plans A and B were to terminate just prior to the merger, the benefits provided on a termination basis would be as follows:

PLAN A

Priority category of section 4044 of ERISA	(1)—Annual accrued benefits			(2)—Present value of accrued benefits			(3)—Fair market value of assets allocated to priority category	(4)—Benefits on a termination basis		
	EE_1	EE_2	EE_3	EE_1	EE_2	EE_3		EE_1	EE_2	EE_3
3	$10,000	.....	.....	$120,000	.....	.....	$120,000	$10,000		
4	2,000	$4,000	.....	24,000	$44,000	.....	68,000	2,000	$4,000	
5	.....	3,000	$4,000	.....	33,000	$40,000	32,000	.....	[1] 1,315	[2] $1,753
6	.....	.....	1,000	.....	.....	10,000				
Total	.....	.....	.....	.....	.....	.....	220,000	12,000	5,315	1,753

[1] $3,000 × $32,000 ÷ $73,000 i.e. accrued benefit × assets available for priority category 5—Total present value of accrued benefits in category 5.
[2] $4,000 × $32,000 ÷ $73,000.

PLAN B

Priority category of section 4044 of ERISA	(1)—Annual accrued benefits					(2)—Present value of accrued benefits					(3)—Fair market value of assets allocated to priority category	(4)—Benefits on a termination basis				
	EE_1	EE_2	EE_3	EE_4	EE_5	EE_1	EE_2	EE_3	EE_4	EE_5		EE_1	EE_2	EE_3	EE_4	EE_5
3	.....	.....	.....	$15,000	.....	.....	.....	.....	$195,000	.....	$195,000	.....	.....	.....	$15,000	
4	.....	.....	.....	.....	$5,000	.....	.....	.....	.....	$50,000	5,000	.....	.....	.....	.....	[1] $500
5	.....	.....	.....	.....	8,000	.....	.....	.....	.....	80,000						
Total	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	200,000	.....	.....	.....	15,000	500

[1] $5,000 ÷ $5,000 × $50,000.

Because Plan B's assets are exhausted in a higher priority category than Plan A's assets, Plan B is the lower funded plan. A schedule will, therefore, be inserted in Priority Category 4 of the plan as merged after providing 10% of the benefits provided in category 4, i.e. the ratio of $5,000 assets in Plan B allocated to category 4 to the $50,000 liability in category 4. The schedule would be constructed as follows:

EE	(1)—Benefits on a termination basis before merger	(2)—Benefits provided from priority categories higher than Category 4	(3)—10% of benefits provided in priority Category 4	(4)—Benefits provided before schedule (2) + (3)	(5)—Schedule of benefits (1) − (4)
1	$12,000	$10,000	$200	$10,200	$1,800
2	5,315		400	400	4,915
3	1,753				1,753
4	15,000	15,000		15,000	
5	500		500	500	

Example 2. The facts are the same as in Example 1. The plan, however, terminates one year later. Furthermore, no employee has accrued additional benefits during the year except that the $2,000 benefit for EE_1, that was originally in category 4 is now in category 3. The assets would be allocated to the priority categories to the extent that there are assets to cover the following benefits.

Priority termination category	EE_1	EE_2	EE_3	EE_4	EE_5
3	$12,000			$15,000	
10% of 4		$400			$500
Schedule of benefits included in balance of Category 4		3,600			
Schedule of benefits included in Category 5		1,315	$1,753		
Schedule of benefits included in Category 6.					
Balance of Category 4 not included in schedule					4,500
Balance of Category 5 not included in schedule		1,685	2,247		8,000
Balance of Category 6 not included in schedule			1,000		

(l) *Merger of defined benefit and defined contribution plan*. In the case of a merger of a defined benefit plan with a defined contribution plan, one of the plans before the merger should be converted into the other type of plan (*i.e.*, the defined benefit converted into a defined contribution or the defined contribution converted into a defined benefit) and either paragraph (d) or paragraphs (e) through (j) of this section, whichever is appropriate, should be applied.

(m) *Spinoff of a defined contribution plan*. In the case of a spinoff of a defined contribution plan, the requirements of section 414(l) will be satisfied if after the spinoff—

(1) The sum of the account balances for each of the participants in the resulting plans equals the account balance of the participant in the plan before the spinoff, and

(2) The assets in each of the plans immediately after the spinoff equals the sum of the account balances for all participants in that plan.

(n) *Spinoff of a defined benefit plan*—(1) *General rule*. In the case of a spinoff of a defined benefit plan, the requirements of section 414(l) will be satisfied if—

(i) All of the accrued benefits of each participant are allocated to only one of the spun off plans, and

(ii) The value of the assets allocated to each of the spun off plans is not less than the sum of the present value of the benefits on a termination basis in the plan before the spin off for all participants in that spun off plan.

(2) *De minimis rule*. In the case of a spin off the requirements of section 414(l) will be deemed to be satisfied if the value of the assets spun off—

(i) Equals the present value of the accrued benefits spun off (whether or not vested), and

(ii) In conjunction with other assets spun off during the plan year in which the spinoff occurs in accordance with this subparagraph, is less than 3 percent of the assets as of at least one day in that year.

Spinoffs occurring in previous or subsequent plan years are ignored if they are not part of a single spinoff designed to occur in steps over more than one plan year.

(3) *Special temporary rule*. In the case of a defined benefit plan maintained for different groups of employees, which is a single plan (as defined in paragraph (b)(l) of this section) and under which there has been separate accounting of assets for each group, a spinoff of the plan on or before July 1, 1978, into a separate plan for each group will be deemed to satisfy section 414 (l) if—

(i) All the liabilities with respect to each group of employees are allocated to a separate plan for that group of employees, and

(ii) The assets that are separately accounted for with respect to each group of employees are allocated to the separate plan for that group of employees.

For purposes of this subparagraph, a separate accounting of assets will not be considered to have occurred to the extent that the assets allocated to each single plan are determined by an historical re-creation of benefits, contributions, investment gains, etc.

(o) *Transfers of assets or liabilities*. Any transfer of assets or liabilities will for purposes of section 414 (l) be considered as a combination of separate mergers and spinoffs using the rules of paragraphs (d), (e) through (j), (l), (m), or (n) of this section, whichever is appropriate. Thus, for example, if in accordance with the transfer of one or more employees, a block of assets and liabilities are transferred from Plan A to Plan B, each of which is a defined benefit plan, the transaction will be considered as a spinoff from Plan A and a merger of one of the spinoff plans with Plan B. The spinoff and merger described in the previous sentence would be subject to the requirements of paragraphs (n) and (e) through (j) of this section respectively.

[T.D. 7638, 44 FR 48195, Aug. 17, 1979]

§ 1.414(q)–1 Highly compensated employee.

Q&A–1—Q&A–8: [Reserved]. See § 1.414(q)–1T, Q&A–1 through Q&A–8 for further guidance.

Q–9: How is the top-paid group determined?

A–9: (a) [Reserved]. See § 1.414(q)–1T, Q&A–9(a) for further guidance.

(b) *Number of employees in the top-paid group*—(1) *Exclusions*. The number of employees who are in the top-paid group for a year is equal to 20 percent of the total number of active employees of the employer for such year. However, solely for purposes of determining the total number of active employees in the top-paid group for a year, the employees described in § 1.414(q)–1T, A–9(b)(1) (i), (ii) and (iii)(B) are disregarded. Paragraph (g) of this A–9 provides rules for determining those employees who are excluded for purposes of applying section 414(r)(2)(A), relating to the 50-employee requirement applicable to a qualified separate line of business.

(i)–(iii) [Reserved]. See § 1.414(q)–1T, Q&A–9(b)(1) (i) through (iii) for further guidance.

(2) *Alternative exclusion provisions*—(i)–(ii) [Reserved]. See § 1.414(q)–1T, Q&A–9(b)(2) (i) and (ii) for further guidance.

(iii) *Method of election*. The elections in this paragraph (b)(2) must be provided for in all plans of the employer and must be uniform and consistent with respect to all situations in which the section 414(q) definition is applicable to the employer. Thus, with respect to all plan years beginning in the same calendar year, the employer must apply the test uniformly for purposes of determining its top-paid group with respect to all its qualified plans and employee benefit plans. If either election is changed during the determination year, no recalculation of the look-back year based on the new election is required, provided the change in election does not result in discrimination in operation.

(c)–(f) [Reserved]. See § 1.414(q)–1T, Q&A–9 (c) through (f) for further guidance.

(g) *Excluded employees under section 414(r)(2)(A)*—(1) *In general*. This paragraph (g) provides the rules for determining which employees are excluded employees for purposes of applying section 414(r)(2)(A), relating to the 50-employee requirement applicable to a qualified separate line of business.

(2) *Excluded employees*—(i) *Age and service exclusion*. All employees are excluded who are described in §1.414(q)–1T, A–9(b)(1)(i) (relating to exclusions based on age or service). For this purpose, the rules in §1.414(q)–1T, A–9 (e) and (f) (relating respectively to the 17½-hour rule and the 6-month rule) apply. However, the election in §1.414(q)–1T, A–9(b)(2)(i) (permitting the employer to elect reduced minimum age or service requirements) does not apply.

(ii) *Nonresident alien exclusion*. All employees are excluded who are described in §1.414(q)–1T, A–9(b)(1)(ii) (relating to the exclusion of nonresident aliens with no U.S.- source income from the employer).

(iii) *Inclusion of employees covered under a collective bargaining agreement*. All employees are included who are described in §1.414(q)–1T, A–9(b)(1)(iii)(A) (relating to employees covered under a collective bargaining agreement) and who are not otherwise described in paragraph (g)(2) (i) or (ii) of this A–9. For this purpose, the exclusion in §1.414(q)–1T, A–9(b)(1)(iii)(B) and the related election in §1.414(q)–1T, A–9(b)(2)(ii) do not apply.

(3) *Applicable period*. The determination of which employees are excluded employees is made on the basis of the testing year specified in the regulations under section 414(r) and not on the basis of the determination year or the look-back year under section 414(q).

(h) *Effective date*. The provisions of this A–9 apply to plan years and testing years beginning on or after January 1, 1994.

Q&A–10 through Q&A–15: [Reserved]. See §1.414(q)–1T, Q&A–10 through Q&A–15 for further guidance.

[T.D. 8548, 59 FR 32915, June 27, 1994]

§1.414(q)–1T Highly compensated employee (temporary).

The following questions and answers relate to the definition of ''highly compensated employee'' provided in section 414(q). The definitions and rules provided in these questions and answers are provided solely for purposes of determining the group of highly compensated employees.

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Q–1: To what employee benefit plans and statutory provisions is the definition of highly compensated employee contained in section 414(q) applicable?

A–1: (a) *In general*. This definition is applicable to statutory provisions that incorporate the definition by reference.

(b) *Qualified retirement plans*—(1) *In general*. Generally, this definition is incorporated in many of the nondiscrimination requirements applicable to pension, profit-sharing, and stock bonus plans qualified under section 401(a). *See, e.g.*, the nondiscrimination provisions of sections 401(a) (4) and (5), 401(k)(3), 401(l), 401(m), 406(b), 407(b), 408(k), 410(b) and 411(d)(1). The definition is also incorporated by certain other provisions with respect to such plans, including the aggregation rules of section 414(m) and section 4975 (tax on prohibited transactions).

(2) *Not applicable where not incorporated by reference*. This definition is not applicable to qualified plan provisions that do not incorporate it. *See, e.g.*, section 415 (limitations on contributions and benefits), with the exception of section 415(c)(3)(C) and 415(c)(6) (special rules for permanent and total disability and employee stock ownership plans respectively).

(c) *Other employee benefit plans or arrangements.* This definition is incorporated by various sections relating to employee benefit provisions. *See, e.g.*, section 89 (certain other employee benefit plans), section 106 (accident and health plans), 117(d) (qualified tuition reduction), section 125 (cafeteria plans), section 129 (dependent care assistance programs), section 132 (certain fringe benefits), section 274 (certain entertainment, etc. expenses), section 423(b) (employee stock purchase plan provisions), section 501(c) (17) and (18) (certain exempt trusts providing benefits to employees), and section 505 (certain exempt organizations or trusts providing benefits to individuals). See the respective sections for the applicable effective dates.

(d) *ERISA.* This definition is not determinative with respect to any provisions of title I of the Employee Retirement Income Security Act of 1974 (ERISA), unless it is explicitly incorporated by reference (e.g., section 408(b)(1)(B)).

Q–2: Who is a highly compensated employee?

A–2: The group of employees (including former employees) who are highly compensated employees consists of both highly compensated active employees (see A–3 of this §1.414(q)–1T) and highly compensated former employees (see A–4 of this §1.414(q)–1T). In many circumstances, highly compensated active employees and highly compensated former employees are considered separately in applying the provisions for which the definition of highly compensated employees in section 414(q) is applicable. Specific rules with respect to the treatment of highly compensated active employees and highly compensated former employees will be provided in the regulations with respect to the sections to which the definition of highly compensated employees is applicable.

Q–3: Who is a highly compensated active employee?

A–3: (a) *General rule.* For purposes of the year for which the determination is being made (the determination year), a highly compensated active employee is any employee who, with respect to the employer, performs services during the determination year and is described in any one or more of the following groups applicable with respect to the look-back year calculation and/or determination year calculation for such determination year. See A–14 for rules relating to the periods for which the look-back year calculation and determination year calculation are to be made.

(1) *Look-back year calculation.*

(i) *5-percent owner.* The employee is a 5-percent owner at any time during the look-back year (i.e., generally, the 12-month period immediately preceding the determination year; see A–14. (See A–8 of this §1.414(q)–1T.)

(ii) *Compensation above $75,000.* The employee receives compensation in excess of $75,000 during the look-back year.

(iii) *Compensation above $50,000 and top-paid group.* The employee receives compensation in excess of $50,000 during the look-back year and is a member of the top-paid group for the look-back year. (See A–9 of this §1.414(q)–1T.)

(iv) *Officer.* The employee is an ''includible officer'' during the look-back year. (See A–10 of this §1.414(q)–1T.)

(2) *Determination year calculation.*

(i) *5-percent owner.* The employee is a 5-percent owner at any time during the determination year. (See A–8 of this §1.414(q)–1T.)

(ii) *Top-100 employees.* The employee is both (A) described in paragraph (a)(1)(i), (ii) and/or (iv) of this A–3, when such paragraphs are modified to substitute the determination year for the look-back year, and (B) one of the 100 employees who receive the most compensation from the employer during the determination year.

(b) *Rounding and tie-breaking rules.* In making the look-back year and determination year calculations for a determination year, it may be necessary for an employer to adopt a rule for rounding calculations (e.g., in determining the number of employees in the top-paid group). In addition, it may be necessary to adopt a rule breaking ties among two or more employees (e.g., in identifying those particular employees who are in the top-paid group or who are among the 100 most highly compensated employees). In such cases, the employer may adopt any rounding or tie-breaking rules it desires, so long as

such rules are reasonable, nondiscriminatory, and uniformly and consistently applied.

(c) *Adjustments to dollar thresholds*—(1) *Indexing of dollar thresholds.* The dollar amounts in paragraph (a)(1) (i) and (ii) of this A–3 are indexed at the same time and in the same manner as the section 415(b)(1)(A) dollar limitation for defined benefit plans.

(2) *Applicable dollar threshold.* The applicable dollar amount for a particular determination year or look-back year is the dollar amount for the calendar year in which such determination year or look-back year begins. Thus, the dollar amount for purposes of determining the highly compensated active employees for a particular look-back year is based on the calendar year in which such look-back year begins, not the calendar year in which such look-back year ends or in which the determination year with respect to such look-back year begins.

(d) *Employees described in more than one group.* An individual who is a highly compensated active employee for a determination year, by reason of being described in one group in paragraph (a) of this A–3, under either the look-back year calculation or the determination year calculation, is not disregarded in determining whether another individual is a highly compensated active employee by reason of being described in another group under paragraph (a). For example, an individual who is a highly compensated active employee for a determination year, by reason of being a 5-percent owner during such year, who receives compensation in excess of $50,000 during both the look-back year and the determination year, is taken into account in determining the group of employees who are highly compensated active employees for such determination year by reason of receiving more than $50,000, and being in the top-paid group under either or both the look-back year calculation or determination year calculation for such determination year.

(e) *Examples.* The following examples, in which the determination year and look-back year are the calendar year, are illustrative of the rules in paragraph (a) of this A–3. For purposes of these examples, the threshold dollar amounts in paragraph (a)(1) (ii) and (iii) of this A–3 are not increased pursuant to paragraph (c) of this A–3.

Example 1. Employee A, who is not at any time a 5-percent owner, an officer, or a member of the top-100 within the meaning of paragraph (a)(1) (i), or (iv), or (a)(2) (i) or (ii), but who was a member of the top-paid group for each year, is included in or excluded from the highly compensated groups as specified below for the following years:

Year	Compensation	Status	Comments
1986	$45,000	N/A	Although prior to 414(q) effective date, 1986 constitutes the look-back year for purposes of determining the highly compensated group for the 1987 determination year.
1987	80,000	Excl	Excluded because A was not an employee described in paragraph (a)(1) (ii) or (iii) of this A–3 for the look-back year (1986).
1988	80,000	Incl	Included because A was an employee described in paragraph (a)(1) (ii) or (iii) of this A–3 for the look-back year (1987).
1989	45,000	Incl	Included because A was an employee described in paragraph (a)(1) (ii) or (iii) of this A–3 for the look-back year (1988).
1990	45,000	Excl	Excluded because A was not an employee described in paragraph (a)(1) (ii) or (iii) of this A–3 for the look-back year (1989).

Example 2. Assuming the same facts as those given in *Example 1,* except that A is a member of the top-100 employees within the meaning of paragraph (a)(2)(ii) of this A–3 for the 1987 year and 1990 year, the results are as follows:

Year	Compensation	Status	Comments
1986	$45,000	N/A	Although prior to 414(q) effective date, 1986 constitutes the look-back year for purposes of determining the highly compensated group for the 1987 determination year.
1987	80,000	Incl	Included because A was an employee described in paragraph (a)(1)(ii) or (iii) of this A–3 for the determination year (1987) and was described in paragraph (a)(2)(ii) of this A–3 in that year.

Year	Compensation	Status	Comments
1988	80,000	Incl	Included because A was an employee described in paragraph (a)(1)(ii) or (iii) of this A–3 for the look-back year (1987).
1989	45,000	Incl	Included because A was an employee described in paragraph (a)(1)(ii) or (iii) of this A–3 for the look-back year (1988).
1990	45,000	Excl	Excluded even though in top-100 employees during 1990 determination year because A was not an employee described in paragraph (a)(1)(ii) or (iii) of this A–3 for the look-back year (1989) or for the determination year (1990).

A–4: Who is a highly compensated former employee?

Q–4: (a) *General rule*. Except to the extent provided in paragraph (d) of this A–4, a highly compensated former employee for a determination year is any former employee who, with respect to the employer, had a separation year (as defined in A–5 of this §1.414(q)–1T) prior to the determination year and was a highly compensated active employee as defined in A–3 of this §1.414(q)–1T for either such employee's separation year or any determination year ending on or after the employee's 55th birthday. Thus, for example, an employee who is a highly compensated active employee for such employee's separation year, by reason of receiving over $75,000 during the look-back year, is a highly compensated former employee for determination years after such employee's separation year.

(b) *Special rule for employees who perform no services for the employer in the determination year*. For purposes of this rule, employees who perform no services for an employer during a determination year are treated as former employees. Thus, for example, an employee who performed no services for the employer during a determination year, by reason of a leave of absence during such year, is treated as a former employee for such year.

(c) *Dollar amounts for pre-1987 determination years*. For determination years beginning before January 1, 1987, the dollar amounts in paragraph (a)(1)(B) and (C) of A–2 of this §1.414(q)–1T are $75,000 and $50,000 respectively.

(d) *Special rule for employees who separated from service before January 1, 1987*—(1) *Election of special rule*. Employers may elect to apply paragraph (d)(2) of this A–4 in lieu of paragraph (a) of this A–4 in determining whether former employees who separated from service prior to January 1, 1987, are highly compensated former employees. If this election is made with respect to any qualified plan, it must be provided for in the plan. If the employer makes this election with respect to any employee benefit plan, such election must be used uniformly for all purposes for which the section 414(q) definition is applicable. The election, once made, cannot be changed without the consent of the Commissioner.

(2) *Special definition of highly compensated former employee*. A highly compensated former employee includes any former employee who separated from service with the employer prior to January 1, 1987, and was described in any one or more of the following groups during either the employee's separation year (or the year preceding such separation year) or any year ending on or after such individual's 55th birthday (or the last year ending before such employee's 55th birthday):

(i) *5-percent owner*. The employee was a 5-percent owner of the employer at any time during the year.

(ii) *Compensation amount*. The employee received compensation is excess of $50,000 during the year.

The determinations provided for in this paragraph (b)(2) may be made on the basis of the calendar year, the plan year, or any other twelve month period selected by the employer and applied on a reasonable and consistent basis.

(e) *Rules with respect to former employees*—(1) *In general*. For specific provisions with respect to the treatment of former employees and of highly compensated former employees, refer to the rules with respect to which the section 414(q) definition of highly compensated employee is applicable.

(2) *Former employees excluded in determining top-paid group, top-100 employees and includible officers*. Former employees are not included in the top-paid group, the group of the top-100 employees, or the group of includible officers for purposes of applying section 414(q)

to active employees. In addition, former employees are not counted as employees for purposes of determining the number of employees in the top-paid group.

Q–5: What is a separation year for purposes of section 414(q)?

A–5: (a) *Separation year*—(1) *In general*. The separation year generally is the determination year during which the employee separates from service with the employer. For purposes of this rule, an employee who performs no services for the employer during a determination year will be treated as having separated from service with the employer in the year in which such employee last performed services for the employer. Thus, for example, an employee who performs no services for the employer by reason of being on a leave of absence throughout the determination year is considered to have separated from service with the employer in the year in which such employee last performed services prior to beginning the leave of absence.

(2) *Deemed separation*. An employee who performs services for the employer during a determination year may be deemed to have separated from service with the employer during such year pursuant to the rules in paragraph (a)(3) of this A–5. Such deemed separation year is relevant for purposes of determining whether such employee is a highly compensated former employee after such employee actually separates from service, not for purposes of identifying such employee as either an active or former employee. Because employees to whom the provisions of paragraph (a)(2) of this A–5 apply are still performing services for the employer during the determination year, they are treated as active employees. Thus, for example, an employee who has a deemed separation year in 1989, a year during which he was a highly compensated employee, who continues to work for the employer until he retires from employment in 1995, is an active employee of the employer until 1995 and is either highly compensated or not highly compensated for any determination year during such period based on the rules with respect to highly compensated active employees. For determination years after the year of such employee's retirement, such employee is a highly compensated former employee because such employee was a highly compensated active employee for the deemed separation year.

(3) *Deemed separation year*. An employee will be deemed to have a separation year if, in a determination year prior to attainment of age 55, the employee receives compensation in an amount less than 50% of the employee's average annual compensation for the three consecutive calendar years preceding such determination year during which the employee received the greatest amount of compensation from the employer (or the total period of the employee's service with the employer, if less).

(4) *Leave of absence*. The deemed separation rules contained in paragraph (a)(2) and (3) of this A–5 apply without regard to whether the reduction in compensation occurs on account of a leave of absence.

(b) *Deemed resumption of employment*. An employee who is treated as having a deemed separation year by reason of the provisions of paragraph (a) of this A–5 will not be treated as a highly compensated former employee (by reason of such deemed separation year) after such employee actually separates from service with the employer if, after such deemed separation year, and before the year of actual separation, such employee's services for and compensation from the employer for a determination year increase significantly so that such employee is treated as having a deemed resumption of employment. The determination of whether an employee who has incurred a deemed separation year has an increase in services and compensation sufficient to result in a deemed resumption of employment will be made on the basis of all the surrounding facts and circumstances pertaining to each individual case. At a minimum, there must be an increase in compensation from the employer to the extent that such compensation would not result in a deemed separation year under the tests in paragraph (a)(2) of this A–5 using the same three-year period taken into account in such paragraph.

(c) *Examples.* Paragraphs (a) and (b) of this A–5 are illustrated by the following examples based on calendar years. For purposes of these examples the threshold dollar amounts in A–5(a) of this §1.414(q)–1T have not been increased pursuant to A–5(b) of this §1.414(q)–1T.

Example 1. Assume that in 1990 A is a highly compensated employee of X by reason of having earned more than $75,000 during the 1989 look-back year. In 1987, 1988 and 1989, A's years of greatest compensation received from X, A received $76,000, $80,000 and $79,000 respectively. In February of 1990, A received $30,000 in compensation. Because A's compensation during the 1990 determination year is less than 50% of A's average annual compensation from X during A's high three prior determination years, A is deemed to have a separation year during the 1990 determination year pursuant to the provisions of paragraph (a) of this A–5. Since A is a highly compensated employee for X in 1990, A's deemed separation year, A will be treated as a highly compensated former employee after A actually separates from service with the employer unless A experiences a deemed resumption of employment within the meaning of paragraph (b) of this A–5.

Example 2. Assume that in 1990 A is a highly compensated employee by reason of having been an officer (with annual compensation in excess of the section 415(c)(1)(A) dollar limitation) during the 1989 look-back year. A's compensation from X during 1990 is $37,000. A's average compensation from X for the three-year period ending with or within January, 1990, was $60,000. A's compensation during the 1990 determination year is not less than 50% of the compensation earned during the test period. Therefore, A is not deemed to have a separation year under paragraph (a)(2)(i) of this A–5.

Example 3. Assume that in 1990 C is 35 and a highly compensated employee of Z for the reasons given in *Example 1* with the same compensation set forth in that example. During 1990, C leaves C's 40 hour a week position as director of the actuarial division of Z and starts working as an actuary for the same division, producing actuarial reports approximately 15 to 20 hours a week, approximately half of these hours at home. C contemplates returning to full-time employment with Z when C's child enters school. During the 1990 determination year, C's compensation is less than 50% of C's compensation during her high three preceding determination years. Therefore, C has a deemed separation year during the 1990 determination year. In 1991 C commences working 32 hours a week for X at X's place of business and receives compensation in an amount equal to 80 percent of her average annual compensation during her high three prior determination years. The C's increased compensation, considered in conjunction with the reasons for the reduction in service, the nature and extent of the services performed before and after the reduction in services, and the lack of proximity of C's age to age 55 at the time of the reduction are sufficient to establish that C has a deemed resumption of employment within the meaning of paragraph (b) of this A–5. Therefore, when C separates from service with the employer, C will not be treated as a highly compensated former employee by reason of C's deemed separation year in 1990.

Q–6: Who is the employer?

A–6: (a) *Aggregation of certain entities.* The employer is the entity employing the employees and includes all other entities aggregated with such employing entity under the aggregation requirements of section 414(b), (c), (m) and (o). Thus, the following entities must be taken into account as a single employer for purposes of determining the employees who are ''highly compensated employees'' within the meaning of section 414(q):

(1) All corporations that are members of a controlled group of corporations (as defined in section 414(b)) that includes the employing entity.

(2) All trades or businesses (whether or not incorporated) that are under common control (as defined in section 414(c)) which group includes the employing entity.

(3) All organizations (whether or not incorporated) that are members of an affiliated service group (as defined in section 414(m)) that includes the employing entity.

(4) Any other entities required to be aggregated with the employing entity pursuant to section 414(o) and the regulations thereunder.

(b) *Priority of aggregation provisions.* The aggregation requirements of paragraph (a) of this A–6 and of A–7(b) of this section with respect to leased employees are applied before the application of any of the other provisions of section 414(q) and this section.

(c) *Line of business rules.* The section 414(r) rules with respect to separate lines of business are not applicable in determining the group of highly compensated employees.

Q–7: Who is an employee for purposes of section 414(q)?

A–7: (a) *General rule.* Except as provided in paragraph (b) of this A–7, the term ''employee'' for purposes of section 414(q) refers to individuals who perform services for the employer and are either common-law employees of the employer or self-employed individuals who are treated as employees pursuant to section 401(c)(1). This rule with respect to the inclusion of certain self-employed individuals in the group of highly compensated employees is applicable whether or not such individuals are eligible to participate in the plan or benefit arrangement being tested.

(b) *Leased employees*—(1) *In general.* The term ''employee'' includes a leased employee who is treated as an employee of the recipient pursuant to the provisions of section 414(n)(2) or 414(o)(2). Employees that an employer treats as leased employees under section 414(n), pursuant to the requirements of section 414(o), are considered to be leased employees for purposes of this rule.

(2) *Safe-harbor exception.* For purposes of qualified retirement plans, if an employee who would be a leased employee within the meaning of section 414(n)(2) is covered in a safe-harbor plan described in section 414(n)(5) (a qualified money purchase pension plan maintained by the leasing organization), and not otherwise covered under a qualified retirement plan of the employer, then such employee is excluded from the term ''employee'' unless the employer elects to include such employee pursuant to the provisions of paragraph (4) of this paragraph (b).

(3) *Other employee benefit plans.* The exception in paragraph (b)(2) of this A–7 is not applicable to the determination of the highly compensated employee group for purposes of the sections enumerated in section 414(n)(3)(C). Thus, for example, a leased employee covered by a safe-harbor plan is considered to be an employee in applying the nondiscrimination provisions of section 89 to statutory benefit plans. Consequently, an employer with leased employees covered in a safe-harbor plan may have 2 groups of highly compensated employees, one with respect to its retirement plans and another with respect to its statutory benefit plans.

(4) *Election with respect to leased employee exclusion.* An employer may elect to include the employees excepted under the provisions of paragraph (b)(2) of this A–7 in determining the highly compensated group with respect to an employer's retirement plans. Thus, for example, by electing to forego the exception in paragraph (b)(2) of this A–7, an employer may achieve more uniform highly compensated employee groups for purposes of its retirement plans and welfare benefit plans. The election to include such employees must be made on a reasonable and consistent basis and must be provided for in the plan.

Q–8: Who is a 5-percent owner of the employer?

A–8: An employee is a 5-percent owner of the employer for a particular year if, at any time during such year, such employee is a 5-percent owner as defined in section 416(i)(B)(i) and §1.416–1 A T–17&18. Thus, if the employer is a corporation, a 5-percent owner is any employee who owns (or is considered as owning within the meaning of section 318) more than 5 percent of the value of the outstanding stock of the corporation or stock possessing more than 5 percent of the total combined voting power of all stock of the corporation. If the employer is not a corporation, a 5-percent owner is any employee who owns more than 5 percent of the capital or profits interest in the employer. The rules of subsections (b), (c), and (m) of section 414 do not apply for purposes of determining who is a 5-percent owner. Thus, for example, an individual who is a 5-percent owner of a subsidiary corporation that is part of a controlled group of corporations within the meaning of section 414(b) is treated as a 5-percent owner for purposes of these rules.

Q–9: How is the ''top-paid group'' determined?

A–9: (a) *General rule.* An employee is in the top-paid group of employees for a particular year if such employee is in the group consisting of the top 20 percent of the employer's employees when ranked on the basis of compensation received from the employer during such year. The identification of the

particular employees who are in the top-paid group for a year involves a two-step procedure:

(1) The determination of the number of employees that corresponds to 20 percent of the employer's employees, and

(2) The identification of the particular employees who are among the number of employees who receive the most compensation during this year.

Employees who perform no services for the employer during a year are not included in making either of these determinations for such year.

(b) *Number of employees in the top-paid group*—(1) *Exclusions.* [Reserved]. See §1.414(q)–1, Q&A–9(b)(1) for further information.

(i) *Age and service exclusion.* The following employees are excluded on the basis of age or service absent an election by the employer pursuant to the rules in paragraph (b)(2) of this A–9:

(A) Employees who have not completed 6 months of service by the end of such year. For purposes of this paragraph (A), an employee's service in the immediately preceding year is added to service in the current year in determining whether the exclusion is applicable with respect to a particular employee in the current year. For example, given a plan with a calendar determination year, if employee A commences work August 1, 1989, and terminates employment May 31, 1990, A may be excluded under this paragraph (b)(1)(i)(A) in 1989 because A completed only 5 months of service by December 31, 1989. However, A cannot be excluded pursuant to this rule in 1990 because A has completed 10 months of service, for purposes of this rule, by the end of 1990.

(B) Employees who normally work less than 17½ hours per week as defined in paragraph (d) of this A–9 for such year.

(C) Employees who normally work during less than 6 months during any year as defined in paragraph (e) of this A–9 for such year.

(D) Employees who have not had their 21st birthdays by the end of such year.

(ii) *Nonresident alien exclusion.* Employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(d)(2)) from the employer that constitutes income from sources within the United States (within the meaning of section 861(a)(3)) are excluded.

(iii) *Collective bargaining exclusion*—(A) *In general.* Except as provided in paragraph (B) of this paragraph (b)(1)(iii), employees who are included in a unit of employees covered by an agreement that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and the employer, which agreement satisfies section 7701(a)(46) and §301.7701–17T (Temporary), are included in determining the number of employees in the top-paid group.

(B) *Percentage exclusion provision.* If 90 percent or more of the employees of the employer are covered under collective bargaining agreements that the Secretary of Labor finds to be collective bargaining agreements between employee representatives and the employer, which agreements satisfy section 7701(a)(46) and §301.7701–17T (Temporary), and the plan being tested covers only employees who are not covered under such agreements, then the employees who are covered under such collective bargaining agreements are not counted in determining the number of noncollective bargaining employees who will be included in the top-paid group for purposes of testing such plan. In addition, such employees are not included in the top-paid group for such purposes. Thus, if the conditions of this paragraph (b)(1)(iii)(B) are satisfied, a separate calculation is required to determine the number and identity of noncollective bargaining employees who will be highly compensated employees by reason of receiving over $50,000 and being in the top-paid group of employees for purposes of testing those plans that cover only noncollective bargaining employees.

(2) *Alternative exclusion provisions*—(i) *Age and service exclusion election.* An employer may elect, on a consistent and uniform basis, to modify the permissible exclusions set forth in paragraph (b)(1)(i) (A), (B), (C), and (D) of this A–9 by substituting any shorter period of service or lower age than that specified in such paragraph. These exclusions may be modified to substitute a zero service or age requirement.

(ii) *Election not to apply percentage exclusion provision.* An employer may elect not to exclude employees under the rules in paragraph (b)(1)(iii)(B) of this A–9.

(iii) *Method of election.* [Reserved]. See §1.414(q)–1, Q&A–9(b)(2)(iii) for further information.

(c) *Identification of top-paid group members.* With the exception of the paragraph (b)(1)(iii) of this A–9 exclusion for certain employees covered by collective bargaining agreements, the exclusions in paragraph (b)(1) of this A–9 are not applicable for purposes of identifying the particular employees in the top-paid group. Thus, for example, even if an employee who normally works for less than 17½ hours is excluded in determining the number of employees in the top-paid group such employee may be a member of the top-paid group. Similarly, if during a determination year, employee A receives over $75,000 and is one of the top-100 employees ranked by compensation, then employee A is a highly compensated active employee for such determination year. This is true even though employee A has worked less than six months and thus may be excluded in determining the number of persons in the top-paid group for the determination year.

(d) *Example.* Paragraphs (b) and (c) of this A–9 are illustrated by the following example:

Example. Employer X has 200 active employees during the 1989 determination year, 100 of whom normally work less than 17½ hours per week during such year and 80 of whom normally work less than 15 hours per week during such year. X elects to exclude all employees who normally work less than 15 hours per week in determining the number of employees in the top-paid group. Thus, X excludes 80 employees in determining the number of employees in the top-paid group. X's top-paid group for the 1989 determination year consists of 20% of 120 or 24 employees. All 200 of X's employees must then be ranked in order by compensation received during the year, and the 24 employees X paid the greatest amount of compensation during the year are top-paid employees with respect to X for the 1989 determination year.

(e) *17½ hour rule*—(1) *In general.* The determination of whether an employee normally works less than 17½ hours per week is made independently for each year based on the rules in paragraph (e)(2) and (3) of this A–9. In making this determination, weeks during which the employee did not work for the employer are not considered. Thus, for example, if an employee normally works twenty hours a week for twenty-five weeks during the fall and winter school quarters, 10 hours a week for the 12 week spring quarter, and does not work for the employer during the three-month summer quarter, such employee is treated as normally working more than 17½ hours per week under the rule of this paragraph (e).

(2) *Deemed above 17½.* An employee who works 17½ hours a week or more, for more than fifty percent of the total weeks worked by such employee during the year, is deemed to normally work more than 17½ hours a week for purposes of this rule.

(3) *Deemed below 17½.* An employee who works less than 17½ hours a week for fifty percent or more of the total weeks worked by such employee during the year is deemed to normally work less than 17½ hours a week for purposes of this rule.

(4) *Application.* The determination provided for in paragraph (e)(1), (2), and (3) of this A–9 may be made separately with respect to each employee, or on the basis of groups of employees who fall within particular job categories as established by the employer on a reasonable basis. For example, under the rule of this paragraph (e)(4) an employer may exclude all office cleaning personnel if, for the year in question, the employees performing this function normally work less than 17½ hours a week. This is true even though one or more employees within this group normally work in excess of 17½ hours. The election to make this determination on the basis of individuals or groups is operational and does not require a plan provision.

(5) *Application based on groups.* (i) Groups of employees who perform the same job are not required to be considered as one category for purposes of the rule in paragraph (e)(4) of this A–9. Thus, for example, an employer supermarket may determine its highly compensated employees by excluding part-time grocery checkers if such personnel normally work less than 17½

hours a week while continuing to include full-time personnel performing this function. In general, 80 percent of the positions within a particular job category must be filled by employees who normally work less than 17½ hours a week before any employees may be excluded under this rule on the basis of their membership in that job category.

(ii) Alternatively, an employer may exclude employees who are members of a particular job category if the median number of hours of service credited to employees in that category during a determination or look-back year is 500 or less.

(f) *6-month rule*—(1) *In general.* The determination of whether employees normally work during not more than 6 months in any year is made on the basis of the facts and circumstances of the particular employer as evidenced by the employer's customary experience in the years preceding the determination year. An employee who works on one day during a month is deemed to have worked during that month.

(2) *Application of prior year experience.* In making the determination under this paragraph (f), the experience for years immediately preceding the determination year will generally be weighed more heavily than that of earlier years. However, this emphasis on more recent years is not appropriate if the data for a particular year reflects unusual circumstances. For example, if fishermen working for employer X worked 9 months in 1987 and 1988, 8 months in 1989, and then, because of abnormal ice conditions, worked only 5 months in 1990, such fishermen could not be excluded under this rule in 1990. Furthermore, the data with respect to 1990 would not be weighed more heavily in making a determination with respect to subsequent years.

(3) *Individual or group basis.* This determination may be made separately with respect to each employee or on the basis of groups of employees who fall within particular job categories in the manner set forth in paragraph (e)(4) of this A–8.

Q–10. For purposes of determining the group of highly compensated employees, which employees are officers and which officers must be included in the highly compensated group?

A–10: (a) *In general.* Subject to the limitations set forth in paragraph (b) of this A–10 and the top-100 employee rule set forth in A–2, an employee is an includible officer for purposes of this section and is a member of the group of highly compensated employees if such employee is an officer of the employer (within the meaning of section 416(i) and §1.416–1 A-T 13 & A-T 15) at any time during the determination year or look-back year and receives compensation during such year that is greater than 150 percent of the dollar limitation in effect under section 415(c)(1)(A) for the calendar year in which the determination or look-back year begins. In addition, an officer who does not meet the 415(c)(1)(A) dollar limitation requirement may be an includible officer based on the minimum inclusion rules set forth in paragraph (c) of this A–10.

(b) *Maximum limitation*—(1) *In general.* Nor more than 50 employees (or, if lesser, the greater of 3 employees or 10 percent of the employees without regard to any exclusions) shall be treated as officers for purposes of this provision in determining the group of highly compensated employees for any determination year or look-back year.

(2) *Total number of employees.* The total number of employees for purposes of the limitation in this paragraph (b) is the number of employees the employer has during the particular determination year or look-back year. For purposes of this A–10, employees include only those individuals who perform services for the employer during the determination or look-back year. The exclusions applicable for purposes of determining the number of employees in the top-paid group are not applicable for purposes of the limitations in this paragraph (b).

(3) *Inclusion ranking.* If the number of the employer's officers who satisfy paragraph (a) of this A–10 during either the determination year or the look-back year exceeds the limitation under this paragraph (b), then the officers who will be considered as includible officers for purposes of this rule are those who receive the greatest compensation from the employer during such determination or look-back year.

The definition of compensation in A–13 is to be used for this purpose.

(c) *Minimum inclusion rule.* This paragraph (c) is applicable when no officer of the employer satisfies the compensation requirements of paragraph (a) of this A–10 during either a determination year or look-back year. In such case, the highest paid officer of the employer for such year is treated as a highly compensated employee by reason of being an officer, without regard to the amount of compensation paid to such officer in relation to the section 415(c)(1)(A) dollar amount for the year. This is true whether or not such employee is also a highly compensated employee on any other basis. Thus, for example, if no officer of employer X meets the compensation requirements of paragraph (a) of this A–10 during the 1989 look-back year, and employee A is both the highest paid officer during such year and a 5-percent owner, employee A is treated as an includible officer satisfying the minimum inclusion rules of this paragraph.

(d) *Separate application.* The maximum and minimum officer inclusion rules of paragraphs (b) and (c) of this A–10 apply separately with respect to the determination year calculation and the look-back year calculation. Thus, for example, if no officer of employer X receives compensation above the threshold amount in paragraph (a) of this A–10 during either the determination year or look-back year, application of the minimum inclusion rule would result in the officer of employer X who received the greatest compensation during the look-back year being treated as a highly compensated employee and, in addition, the officer of employer X who receives the most compensation during the determination year would be included in the highly compensated group if such officer is also in the top-100 employees of employer X for such year. Thus, two officers may be treated as highly compensated active employees for a determination year by reason of the provisions of the minimum inclusion rule.

Q–11: To what extent must family members who are employed by the same employer be aggregated for purposes of section 414(q)?

A–11: (a) *Family aggregation*—(1) *In general.* Aggregation is required with respect to an employee who is, during a particular determination year or look-back year, a family member (as defined in A–12) of either (i) a 5-percent owner who is an active or former employee or (ii) a highly compensated employee who is one of the ten most highly compensated employees ranked on the basis of compensation paid by the employer during such year.

(2) *Aggregation of contributions or benefits.* As prescribed in regulations under the provisions to which section 414(q) is applicable, a family member and a 5-percent owner or top-10 highly compensated employee aggregated under this rule are generally treated as a single employee receiving an amount of compensation and a plan contribution or benefit that is based on the compensation, contributions, and benefits of such family member and 5-percent owner or top-10 highly compensated employee.

(b) *Exclusion status irrelevant.* Family members are subject to this aggregation rule whether or not they fall within the categories of employees that may be excluded for purposes of determining the number of employees in the top-paid group and whether or not they are highly compensated employees when considered separately.

(c) *Order of determination*—(1) *Determination of highly compensated employees.* The determination of which employees are highly compensated employees and which highly compensated employees are among the ten most highly compensated employees in making the look-back year calculation or the determination year calculation for a determination year will be made prior to the application of the rules in paragraph (a) of this A–11.

(2) *Determination of top-paid group and top-100 employees.* The determination of the number and identity of employees in the top-paid group under the look-back year calculation or the determination year calculation for a determination year and the identity of individuals in the top-100 employees under the determination year calculation for a determination year is made prior to application of the rules in paragraph (a) of this A–11.

(d) *Determination period*. The rules under paragraph (a) of this A–11 apply separately to the determination year and the look-back year. Thus, assuming there are no 5-percent owners, if employees A, B, C, D, E, F, G, H, I and J are the top 10 highly compensated employees in the 1988 look-back year, and employees F, G, H, I, J, K, L, M, N and O are the top 10 highly compensated employees in the 1989 determination year, then family aggregation would be required with respect to all fifteen of such employees (i.e. employees A, B, C, D, E, F, G, H, I, J, K, L, M, N, and O).

Q–12: Which individuals are family members for purposes of the aggregation rules in section 414(a)(6)(A) and A–11?

A–12: (a) *Definition of family member*. Individuals who are family members for purposes of these provisions include, with respect to any employee or former employee, such employee's or former employee's spouse and lineal ascendants or descendants and the spouses of such lineal ascendants and descendants. In determining whether an individual is a family member with respect to an employee or former employee, legal adoptions shall be taken into account.

(b) *Test period*. If an individual is a family member with respect to an employee or former employee on any day during the year, such individual is treated as a family member for the entire year. Thus, for example, if an individual is a family member with respect to an employee on the first day of a year, such individual continues to be a family member with respect to such employee throughout the year even though their relationship changes as a result of death or divorce.

Q–13: How is ''compensation'' determined for purposes of determining the group of ''highly compensated employees.''

A–13: (a) *In general*. For purposes of section 414(q), the term ''compensation'' means compensation within the meaning of section 415(c)(3) without regard to sections 125, 402(a)(8), and 402(h)(1)(B) and, in the case of employer contributions made pursuant to a salary reduction agreement, without regard to section 403(b). Thus, compensation includes elective or salary reduction contributions to a cafeteria plan, cash or deferred arrangement or tax-sheltered annuity.

(b) *Determination period*. For purposes of determining the group of highly compensated employees, compensation must be calculated on the basis of the applicable period for the determination year and look-back year respectively.

(c) *Compensation taken into account*. Only compensation received by an employee during the determination year or during the look-back year is considered in determining whether such employee is a highly compensated active employee under either the look-back year calculation or determination year calculation for such determination year. Thus, compensation is not annualized for purposes of determining an employee's compensation in the determination year or the look-back year in applying the rules of paragraph (a) of this A–13.

Q–14: What periods must be used for determining who is a highly compensated employee for a determination year?

A–14: (a) *Determination year and look-back year*—(1) *In general*. For purposes of determining the group of highly compensated employees for a determination year, the determination year calculation is made on the basis of the applicable year of the plan or other entity for which a determination is being made and the look-back year calculation is made on the basis of the twelve month period immediately preceding such year. Thus, in testing plans X and Y of an employer, if plan X has a calendar year plan year and plan Y has a July 1 to June 30 plan year, the determination year calculation and look-back year calculation for plan X must be made on the basis of the calendar year. Similarly, the determination year calculation and look-back year calculation for plan Y must be made on the basis of the July 1 to June 30 year.

(2) *Applicable year*. For purposes of this A–14, the applicable year is the plan year of the qualified plan or other employee benefit arrangement to which the definition of highly compensated employees is applicable as defined in the written plan document or

otherwise identified in regulations pursuant to sections to which the definition of highly compensated employees is applicable. To the extent that the definition of highly compensated employees is applicable to entities of other arrangements that do not have an otherwise identified plan year, then either the calendar year of the employer's fiscal year may be treated as the plan year.

(3) *Look-back year*. The look-back year is never less than a twelve month period.

(b) *Calendar year calculation election*—(1) *In general*. An employer may elect to make the look-back year calculation for a determination year on the basis of the calendar year ending with or within the applicable determination year (or, in the case of a determination year that is shorter than twelve months, the calendar year ending with or within the twelve-month period ending with the end of the applicable determination year). In such case, the employer must make the determination year calculation for the determination year on the basis of the period (if any) by which the applicable determination year extends beyond such calendar year (i.e., the lag period). If the applicable year for which the determination is being made is the calendar year, the employer still may elect to make the calendar year calculation election under this A–14(b). In such case, the look-back year calculation is made on the basis of the calendar year determination year and, because there is no lag period, a separate determination year calculation under A–3(a)(2) of this §1.414(q)–1 is not required.

(2) *Lag period calculation*. In making the determination year calculation under A–3(a)(2) of this §1.414(q)–1 on the basis of the lag period, the dollar amounts applicable under A–3(a)(1) (B) and (C) of this §1.414(q)–1 are to be adjusted by multiplying such dollar amounts by a fraction, the numerator of which is the number of calendar months that are included in the lag period and the denominator of which is twelve.

(3) *Determination of active employees*. An employee will be considered an active employee for purposes of a determination year for which the calendar year calculation election is in effect so long as such employee performs services for the employer during the applicable year for which the determination is being made. This is the case even if such employee does not perform services for the employer during the lag-period for such determination year.

(4) *Election requirement*. If the employer elects to make the calendar year calculation election with respect to one plan, entity, or arrangement, such election must apply with respect to all plans, entities, and arrangements of the employer. In addition, such election must be provided for in the plan.

(c) *Change in applicable years*. Where there is a change in the applicable year for which a determination is being made with respect to a plan entity, or other arrangement that is not subject to the calendar year calculation election, the look-back year calculation for the short applicable year is to be made on the basis of the twelve month period preceding the short applicable year (i.e., generally, the old applicable year) and the determination year calculation for the short applicable year is to be made on the basis of the short applicable year. In addition, the dollar amounts under A–3(a)(1) (B) and (C) are to be adjusted for such determination year calculation as if the short applicable year were a lag period under paragraph (b)(2) of this A–14.

(d) *Example*. The following examples illustrates the rules of this A–14:

Example 1. Employer X has a single plan (Plan A) with an April 1 to March 31 plan year. Employer X makes no election to use the calendar year for the determination period. Therefore, in determining the group of highly compensated employees for the April 1, 1989 to March 31, 1990 plan year, the determination year is the plan year ending March 31, 1990 and the look-back year is the plan year ending March 31, 1989.

Example 2. Assume the same facts given above. With respect to the plan year beginning in 1990, employer X elects to use the calendar year for the determination period. Therefore, in determining the group of highly compensated employees for the April 1, 1990 to March 31, 1991 plan year, the lag-period determination year is the period from January 1, 1991, through March 31, 1991, and the applicable look-back year is the 1990 calendar year.

Example 3. Employer Y has a single plan (Plan B) with a calendar plan year. With respect to the plan year beginning in 1990, employer Y elects to make the look-back year calculation for the 1990 determination year on the basis of the calendar year ending with or within the 1990 determination year. Because employer Y's determination year is the 1990 calendar year there is no lag period and employer Y determines the group of highly compensated employees for purposes of the 1990 calendar plan year on the basis of such plan year alone.

Q–15: Is there any transition rule in determining the group of highly compensated employees for 1987 and 1988?

A–15: (a) *In general.* Solely for purposes of section 401(k)(3) and (m)(2) and solely for twelve-month plan years beginning in 1987 and 1988, an eligible employer may elect to define the group of highly compensated employees as the group consisting of 5-percent owners of the employer at any time during the plan year and employees who receive compensation in excess of $50,000 during the plan year. This rule would apply in lieu of the look-back year calculation and determination year calculation otherwise applicable under A–3(a) of this § 1.44(q)–1. In addition, an eligible employer may elect to make the determinations permitted under this transition rule on the basis of the calendar year ending in the plan year and the period by which such plan year extends beyond such calendar year, in accordance with the rules of A–14(b), in lieu of making the determinations under this transition rule on the basis of the plan year for which the determinations are being made.

(b) *Eligible employers.* An employer is an eligible employer under this A–15 if such employer satisfies both of the following requirements:

(1) The employer does not maintain any top-heavy plan within the meaning of section 416 at any time during 1987 and 1988; and

(2) Under each plan of the employer to which section 401(k)(3) or 401(m)(2) is applicable, the group of eligible employees that comprises the highest 25% of eligible employees ranked on the basis of compensation includes at least one employee whose compensation is $50,000 or below. This requirement must be met separately with respect to each such plan of the employer.

(c) *Uniformity requirement.* An eligible employer may not make the election under paragraph (a) of this A–15 unless the election applies to all of the plans maintained by the employer to which section 401(k)(3) or 401(m)(2) applies.

(d) *Election requirements.* This election is operational and does not require a plan provision.

[T.D. 8173, 53 FR 4967, Feb. 19, 1988, as amended by T.D. 8334, 56 FR 3977, Feb. 1, 1991; T.D. 8548, 59 FR 32916, June 27, 1994]

§ 1.414(r)–0 Table of contents.

(a) *In general.* Sections 1.414(r)–1 through 1.414(r)–11 provide rules for determining whether an employer is treated as operating qualified separate lines of business under section 414(r) of the Internal Revenue Code of 1986 as added to the Code by section 1115(a) of the Tax Reform Act of 1986 (Pub. L. No. 99–514), as well as rules for applying the requirements of sections 410(b), 401(a)(26), and 129(d)(8) separately with respect to the employees of each qualified separate line of business of an employer. Paragraph (b) of this section contains a listing of the headings of §§ 1.414(r)–1 through 1.414(r)–11. Paragraph (c) of this section provides a flowchart showing how the major provisions of §§ 1.414(r)–1 through 1.414(r)–6 are applied.

(b) *Table of contents.* The following is a listing of the headings of §§ 1.414(r)–1 through 1.414(r)–11.

§ 1.414(r)–1 Requirements applicable to qualified separate lines of business.

(a) In general.
(b) Conditions under which an employer is treated as operating qualified separate lines of business.
(1) In general.
(2) Qualified separate line of business.
(i) In general.
(ii) Line of business.
(iii) Separate line of business.
(iv) Qualified separate line of business.
(A) In general.
(B) Fifty-employee requirement.
(C) Notice requirement.
(D) Requirement of administrative scrutiny.
(3) Determining the employees of a qualified separate line of business.
(c) Separate application of certain Code requirements to employees of a qualified separate line of business.
(1) In general.
(2) Separate application of section 410(b).

(i) General rule.
(ii) Special rule for employer-wide plans.
(3) Separate application of section 401(a)(26).
(i) General rule.
(ii) Special rule for employer-wide plans.
(4) Separate application of section 129(d)(8). [Reserved]
(5) Separate application of other Code requirements.
(d) Application of requirements.
(1) In general.
(2) Interpretation.
(3) Separate operating units.
(4) Certain mergers and acquisitions.
(5) Governmental and tax-exempt employers.
(i) General rule.
(ii) Additional rules. [Reserved]
(6) Testing year basis of application.
(i) Section 414(r).
(ii) Sections 410(b), 401(a)(26), and 129(d)(8).
(7) Averaging rules.
(8) Definitions.
(9) Effective dates.
(i) General rule.
(ii) Reasonable compliance.
(A) In general.
(B) Determination of reasonable compliance.
(C) Effect on other plans.
(e) Additional rules.

§ 1.414(r)–2 Line of business.

(a) General rule.
(b) Employer determination of its lines of business.
(1) In general.
(2) Property and services provided to customers.
(i) In general.
(ii) Timing of provision of property or services.
(3) Employer designation.
(i) In general.
(ii) Ability to combine unrelated types of property or services in a single line of business.
(iii) Ability to separate related types of property or services into two or more lines of business.
(iv) Affiliated service groups.
(c) Examples.
(1) In general.
(2) Examples illustrating employer designation.
(3) Examples illustrating property and services provided to customers.

§ 1.414(r)–3 Separate line of business.

(a) General rule.
(b) Separate organization and operation.
(1) In general.
(2) Separate organizational unit.
(3) Separate financial accountability.
(4) Separate employee workforce.
(5) Separate management.
(c) Supplementary rules.
(1) In general.
(2) Determination of separate employee workforce.
(3) Determination of separate management.
(4) Employees taken into account.
(5) Services taken into account.
(i) Provision of services to a separate line of business.
(ii) Period for which services are provided.
(iii) Optional rule for employees who change status.
(A) In general.
(B) Change in employee's status.
(6) Examples of the separate employee workforce requirement.
(7) Examples of the separate management requirement.
(d) Optional rule for vertically integrated lines of business.
(1) In general.
(2) Requirements.
(3) Optional rule.
(i) Treatment of employees.
(ii) Purposes for which optional rule applies.
(4) Examples.

§ 1.414(r)–4 Qualified separate line of business—fifty-employee and notice requirements.

(a) In general.
(b) Fifty-employee requirement.
(c) Notice requirement.
(1) General rule.
(2) Effect of notice.

§ 1.414(r)–5 Qualified separate line of business—administrative scrutiny requirement—safe harbors.

(a) In general.
(b) Statutory safe harbor.
(1) General rule.
(2) Highly compensated employee percentage ratio.
(3) Employees taken into account.
(4) Ten-percent exception.
(5) Determination based on preceding testing year.
(6) Examples.
(c) Safe harbor for separate lines of business in different industries.
(1) In general.
(2) Optional rule for foreign operations.
(3) Establishment of industry categories.
(4) Examples.
(d) Safe harbor for separate lines of business that are acquired through certain mergers and acquisitions.
(1) General rule.
(2) Employees taken into account.
(3) Transition period.
(4) Examples.
(e) Safe harbor for separate lines of business reported as industry segments.

(1) In general.
(2) Reported as an industry segment in conformity with Form 10–K or Form 20–F.
(3) Timely filing of Form 10–K or 20–F.
(4) Examples.
(f) Safe harbor for separate lines of business that provide same average benefits as other separate lines of business.
(1) General rule.
(2) Separate lines of business benefiting disproportionate number of nonhighly compensated employees.
(i) Applicability of safe harbor.
(ii) Requirement.
(3) Separate lines of business benefiting disproportionate number of highly compensated employees.
(i) Applicability of safe harbor.
(ii) Requirement.
(4) Employees taken into account.
(5) Example.
(g) Safe harbor for separate lines of business that provide minimum or maximum benefits.
(1) In general.
(2) Minimum benefit required.
(i) Applicability.
(ii) Requirement.
(iii) Defined benefit minimum.
(A) In general.
(B) Normal form and equivalent benefits.
(C) Compensation definition.
(D) Average compensation requirement.
(E) Special rules.
(iv) Defined contribution minimum.
(A) In general.
(B) Modified allocation definition for averaging.
(3) Maximum benefit permitted.
(i) Applicability.
(ii) Requirement.
(iii) Defined benefit maximum.
(A) In general.
(B) Determination of defined benefit maximum.
(C) Adjustment for different compensation definitions.
(D) Adjustment for certain subsidies.
(iv) Defined contribution maximum.
(4) Duplication of benefits or contributions.
(i) Plans of the same type.
(ii) Plans of different types.
(iii) Special rule for floor-offset arrangements.
(5) Certain contingency provisions ignored.
(6) Employees taken into account.

§ 1.414(r)–6 Qualified separate line of business—administrative scrutiny requirement—individual determinations.

(a) In general.
(b) Authority to establish procedures.

§ 1.414(r)–7 Determination of the employees of an employer's qualified separate lines of business.

(a) Introduction.
(1) In general.
(2) Purposes for which this section applies.
(b) Assignment procedure.
(1) In general.
(2) Assignment for the first testing day.
(3) Assignment of new employees for subsequent testing days.
(4) Special rule for employers using annual option under section 410(b).
(c) Assignment and allocation of residual shared employees.
(1) In general.
(2) Dominant line of business method of allocation.
(i) In general.
(ii) Dominant line of business.
(iii) Employee assignment percentage.
(A) Determination of percentage.
(B) Employees taken into account.
(iv) Option to apply reduced percentage.
(v) Examples.
(3) Pro-rata method of allocation.
(i) In general.
(ii) Allocation procedure.
(iii) Examples.
(4) HCE percentage ratio method of allocation.
(i) In general.
(ii) Highly compensated employee percentage assignment ratio.
(iii) Allocation procedure.
(5) Small group method.
(i) In general.
(ii) Size of group.
(iii) Composition of qualified separate line of business.
(iv) Reasonable allocation.

§ 1.414(r)–8 Separate application of section 410(b).

(a) General rule.
(b) Rules of separate application.
(1) In general.
(2) Satisfaction of section 410(b)(5)(B) on an employer-wide basis.
(i) General rule.
(ii) Application of facts and circumstances requirements under nondiscriminatory classification test.
(iii) Modification of unsafe harbor percentage for plans satisfying ratio percentage test at 90 percent level.
(A) General Rule.
(B) Facts and circumstances alternative.
(3) Satisfaction of section 410(b) on a qualified-separate-line-of-business basis.
(4) Examples.
(c) Coordination of section 401(a)(4) with section 410(b).
(1) General rule.
(2) Examples.
(d) Supplementary rules.

(1) In general.
(2) Definition of plan.
(3) Employees of a qualified separate line of business.
(4) Consequences of failure.

§ 1.414(r)–9 Separate application of section 401(a)(26).

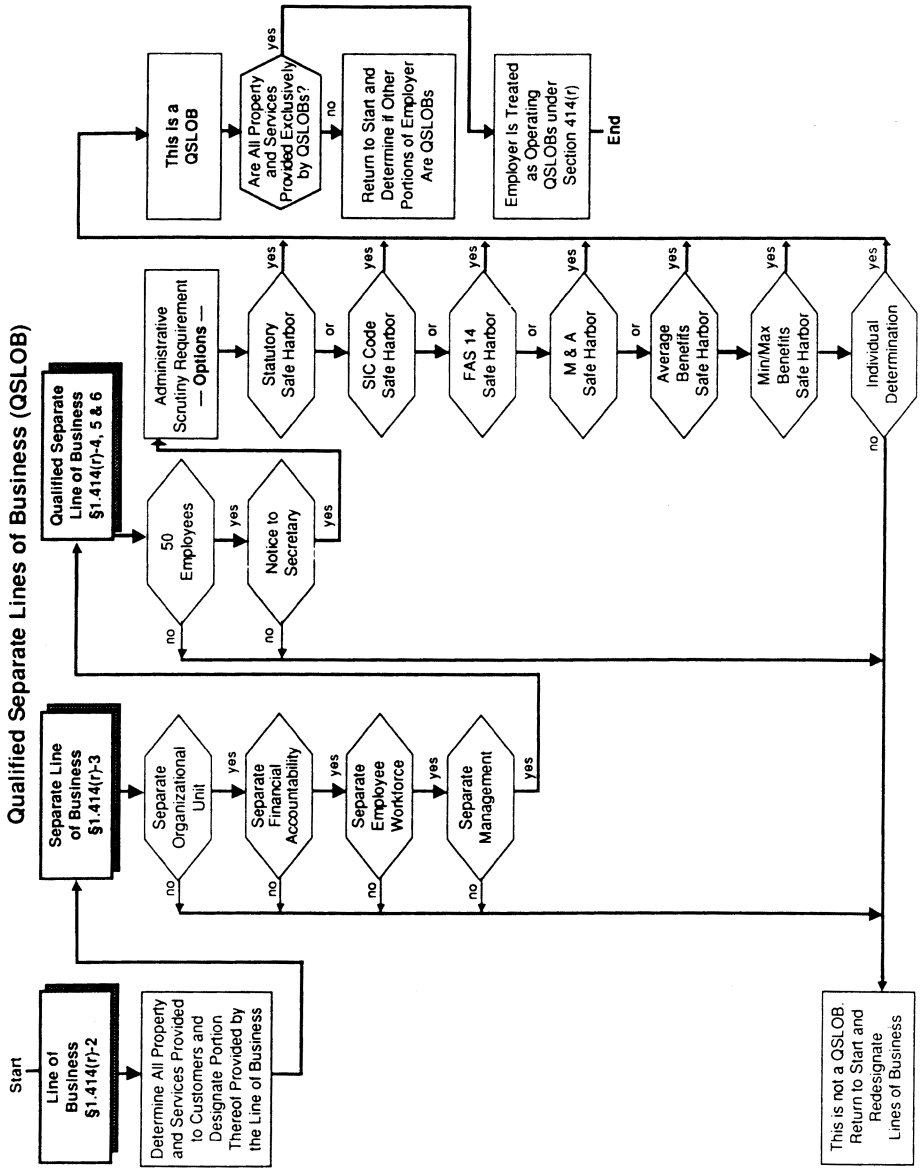
(a) General rule.
(b) Requirements applicable to a plan.
(c) Supplementary rules.
(1) In general.
(2) Definition of plan.
(3) Employees of a qualified separate line of business.
(4) Consequences of failure.

§ 1.414(r)–10 Separate application of section 129(d)(8). [Reserved]

§ 1.414(r)–11 Definitions and special rules.

(a) In general.
(b) Definitions.
(1) In general.
(2) Substantial-service employee.
(3) Top-paid employee.
(4) Residual shared employee.
(5) Testing year.
(6) Testing day.
(7) First testing day.
(8) Section 401(a)(26) testing day.
(c) Averaging rules.
(1) In general.
(2) Specified provisions.
(3) Averaging of large fluctuations not permitted.
(4) Consistency requirements.

(c) *Flowchart.* The following is a flowchart showing how the major provisions of §§1.414(r)–1 through 1.414(r)–6 are applied.



[T.D. 8376, 56 FR 63434, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32916, June 27, 1994]

§ 1.414(r)–1 Requirements applicable to qualified separate lines of business.

(a) *In general.* Section 414(r) prescribes the conditions under which an employer is treated as operating qualified separate lines of business. If an employer is treated as operating qualified separate lines of business under section 414(r), certain requirements

under the Code may be applied separately with respect to the employees of each qualified separate line of business. These requirements are limited to the minimum coverage requirements of section 410(b) (including the nondiscrimination requirements of section 401(a)(4)), the minimum participation requirements of section 401(a)(26), and the 55-percent average benefits test of section 129(d)(8). This section provides the exclusive rules for determining whether an employer is treated as operating qualified separate lines of business under section 414(r), as well as rules for applying the requirements of sections 410(b), 401(a)(26), and 129(d)(8) separately with respect to the employees of a qualified separate line of business.

(b) *Conditions under which an employer is treated as operating qualified separate lines of business*—(1) *In general.* An employer is treated as operating qualified separate lines of business under section 414(r) only if all property and services provided by the employer to its customers are provided exclusively by qualified separate lines of business. Thus, once an employer has determined its qualified separate lines of business under paragraph (b)(2) of this section, no portion of the employer may remain that is not included in a qualified separate line of business. In addition, once the employer has determined the employees of its qualified separate lines of business under paragraph (b)(3) of this section, every employee must be treated as an employee of a qualified separate line of business, and no employee may be treated as an employee of more than one qualified separate line of business.

(2) *Qualified separate line of business*—(i) *In general.* A qualified separate line of business is a portion of the employer that is a line of business within the meaning of paragraph (b)(2)(ii) of this section, that is also a separate line of business within the meaning of paragraph (b)(2)(iii) of this section, and, finally, that satisfies the requirements of section 414(r)(2) in accordance with paragraph (b)(2)(iv) of this section.

(ii) *Line of business.* A line of business is a portion of an employer that is identified by the property or services it provides to customers of the employer. For this purpose, the employer is permitted to determine the lines of business it operates by designating the property and services that each of its lines of business provides to customers of the employer. Rules for determining an employer's lines of business are provided in § 1.414(r)–2.

(iii) *Separate line of business.* A separate line of business is a line of business that is organized and operated separately from the remainder of the employer. The determination of whether a line of business is organized and operated separately from the remainder of the employer is made on the basis of objective criteria. These criteria generally require that the line of business be organized into one or more separate organizational units (e.g., corporations, partnerships, or divisions), that the line of business constitute one or more distinct profit centers within the employer, and that no more than a moderate overlap exist between the employee workforce and management employed by the line of business and those employed by the remainder of the employer. Rules for determining whether a line of business is organized and operated separately from the remainder of the employer and thus constitutes a separate line of business are provided in § 1.414(r)–3. These rules include an optional rule for vertically integrated lines of business.

(iv) *Qualified separate line of business*—(A) *In general.* A qualified separate line of business must satisfy the three statutory requirements in section 414(r)(2). A separate line of business that satisfies these three statutory requirements in accordance with paragraphs (b)(2)(iv)(B) through (b)(2)(iv)(D) of this section constitutes a qualified separate line of business.

(B) *Fifty-employee requirement.* Under section 414(r)(2)(A), a separate line of business must have at least 50 employees. Rules for determining whether this requirement is satisfied are provided in § 1.414(r)–4(b).

(C) *Notice requirement.* Under section 414(r)(2)(B), the employer must notify the Secretary that it treats itself as operating qualified separate lines of business under section 414(r) for purposes of applying the requirements of section 410(b), 401(a)(26), or 129(d)(8)

separately with respect to the employees of the separate line of business. Rules and procedures for complying with this requirement are provided in §1.414(r)–4(c).

(D) *Requirement of administrative scrutiny*. Under section 414(r)(2)(C), a separate line of business must pass administrative scrutiny. A separate line of business may satisfy this requirement in one of two ways. First, a separate line of business that satisfies any of the safe harbors in §1.414(r)–5 satisfies the requirement of administrative scrutiny. These safe harbors implement the statutory safe harbor of section 414(r)(3) as well as the guidelines prescribed under section 414(r)(2)(C). Second, a separate line of business that does not satisfy any of the safe harbors in §1.414(r)–5 nonetheless satisfies the requirement of administrative scrutiny if the employer requests and receives an individual determination from the Commissioner that the separate line of business satisfies the requirement of administrative scrutiny. Rules and procedures applicable to requesting and receiving an individual determination are provided in §1.414(r)–6. A separate line of business is permitted to satisfy the requirement of administrative scrutiny in any manner permitted under this paragraph (b)(2)(iv)(D), regardless of how any other separate line of business of the employer satisfies the requirement.

(3) *Determining the employees of a qualified separate line of business*. In order to apply certain provisions under these regulations, it is necessary to determine the employees of a qualified separate line of business. For these purposes, the employees of a qualified separate line of business consist of all employees who are substantial-service employees with respect to the qualified separate line of business, and all other employees who are assigned to the qualified separate line of business. Rules for making these determinations are provided in §1.414(r)–7. These rules apply solely for the purposes specified in these regulations (see §1.414(r)–7(a)(2) for a comprehensive listing of these purposes). These rules do not apply for any other purpose (e.g., the determination under §1.414(r)–3 of whether a line of business is organized and operated separately from the remainder of the employer).

(c) *Separate application of certain Code requirements to employees of a qualified separate line of business*—(1) *In general*. If an employer is treated as operating qualified separate lines of business under section 414(r) in accordance with paragraph (b) of this section, the requirements of sections 410(b), 401(a)(26), and 129(d)(8) may be applied separately with respect to the employees of each qualified separate line of business. Paragraphs (c)(2) through (c)(4) of this section provide for the separate application of these requirements. In general, the requirements of a Code section are applied separately with respect to the employees of a qualified separate line of business by treating those employees as if they were the only employees of the employer. Paragraph (c)(5) of this section prescribes the limited conditions under which other Code requirements may be applied separately with respect to the employees of a qualified separate line of business.

(2) *Separate application of section 410(b)*—(i) *General rule*. Except as provided in paragraph (c)(2)(ii) of this section, an employer is permitted to apply the requirements of section 410(b) separately with respect to the employees of each qualified separate line of business operated by the employer only if the employer does so with respect to all its plans, all its employees, and all its qualified separate lines of business. For this purpose, the requirements of section 410(b) encompass the requirements of section 401(a)(4) (including, but not limited to, the permitted disparity rules of section 401(*l*), the actual deferral percentage test of section 401(k)(3) and the actual contribution percentage test of section 401(m)(2)). Rules for applying section 410(b) separately with respect to the employees of a qualified separate line of business are provided in §1.414(r)–8. An employer may apply the rules of section 414(r) for purposes of section 410(b) even if it does not apply the rules of section 414(r) for purposes of section 401(a)(26).

(ii) *Special rule for employer-wide plans*. Notwithstanding paragraph (c)(2)(i) of this section, an employer that is treated as operating qualified

separate lines of business for purposes of section 410(b) in accordance with paragraph (b) of this section may apply the requirements of section 410(b) on an employer-wide rather than a qualified-separate-line-of-business basis with respect to any plan (within the meaning of §1.414(r)–8(d)(2), but without regard to the mandatory disaggregation rule of §1.410(b)–7(c)(4) for portions of a plan that benefit employees of different qualified separate lines of business) that benefits a group of employees that satisfies the percentage test of section 410(b)(1)(A) (i.e., benefits at least 70 percent of the employer's nonexcludable nonhighly compensated employees). If section 401(a)(4) requires that a group of employees under the plan described in the preceding sentence satisfy section 410(b) for purposes of satisfying section 401(a)(4), the percentage test of section 410(b)(1)(A) must be satisfied by each such group of employees. See §1.414(r)–8(c). The rules of this paragraph (c)(2)(ii) are illustrated by the following example.

Example. Employer A maintains a single profit-sharing plan, Plan W, and three pension plans, Plans X, Y and Z, each benefiting employees of a different one of Employer A's three qualified separate lines of business. Contributions to the profit-sharing plan are made pursuant to a cash or deferred arrangement in which all employees of Employer A are eligible to participate. Assume that, as a result, Plan W satisfies the requirements to be tested under this paragraph (c)(2)(ii). None of the pension plans benefits more than 70 percent of the nonexcludable nonhighly compensated employees of Employer A. Employer A is treated as operating qualified separate lines of business for purposes of applying section 410(b) to its qualified plans. The requirements of sections 410(b) and 401(a)(4) must therefore be applied to Plans X, Y and Z separately with respect to the employees of each of the three qualified separate line of business operated by Employer A. Since Plan W benefits at least 70 percent of the nonexcludable nonhighly compensated employees of Employer A, however, the requirements of sections 410(b) and 401(a)(4) (including section 401(k)) may be applied to Plan W on an employer-wide basis.

(3) *Separate application of section 401(a)(26)*—(i) *General rule*. Except as provided in paragraph (c)(3)(ii) of this section, an employer is permitted to apply the requirements of section 401(a)(26) separately with respect to the employees of each qualified separate line of business operated by the employer only if the employer does so with respect to all its plans, all its employees, and all its qualified separate lines of business. Rules for applying the requirements of section 401(a)(26) separately with respect to the employees of a qualified separate line of business are provided in §1.414(r)–9. An employer may apply the rules of section 414(r) for purposes of section 401(a)(26) even if it does not apply the rules of section 414(r) for purposes of section 410(b).

(ii) *Special rule for employer-wide plans*. Notwithstanding the first sentence of paragraph (c)(3)(i) of this section, an employer that is treated as operating qualified separate lines of business in accordance with paragraph (b) of this section for purposes of both sections 410(b) and 401(a)(26) may apply the requirements of section 401(a)(26) on an employer-wide rather than a qualified-separate-line-of-business basis with respect to any plan (within the meaning of §1.414(r)–9(c)(2), but without regard to the mandatory disaggregation rule of §1.401(a)(26)–2(d)(1)(iv) for portions of a plan that benefit employees of different qualified separate lines of business), but only if the special rule for employer-wide plans in paragraph (c)(2)(ii) of this section is applied to the same plan for the same plan year.

(4) *Separate application of section 129(d)(8)*. [Reserved]

(5) *Separate application of other Code requirements*. Under no circumstance may the requirements of any section of the Code (other than a section described in paragraphs (c)(2) through (c)(4) of this section) be applied separately with respect to the employees of a qualified separate line of business unless the section specifically cross-references, or is specifically cross-referenced by, section 414(r). The Code sections whose requirements may not be applied separately with respect to the employees of a qualified separate line of business include, but are not limited to, sections 79(d)(3), 105(h), 117(d)(3), 120(c)(2), 125(g)(3), 127(b)(2), 129(d)(3), 132, 195, 401(a)(3) (as in effect on September 1, 1974), 414(q)(4),

501(c)(17)(A)(ii), 501(c)(17)(B)(iii), 501(c)(18)(B), and 505(b)(1)(A).

(d) *Application of requirements*—(1) *In general*. The requirements of paragraphs (b) and (c) of this section must be applied in accordance with the rules in this paragraph (d).

(2) *Interpretation*. The provisions of this section and of §§ 1.414(r)–2 through 1.414(r)–11 are to be interpreted in a reasonable manner consistent with the purpose of section 414(r) to recognize an employer's operation of qualified separate lines of business for bona fide business reasons and not for reasons of evading the requirements of any section of the Code, including sections 410(b), 401(a)(26), and 129(d)(8). See section 414(r)(1) and (r)(7). Thus, for example, an employer is not permitted to apply these regulations in a manner that may literally comply with the other provisions of this section and of §§ 1.414(r)–2 through 1.414(r)–11, but that does not reflect the employer's operation of qualified separate lines of business for bona fide business reasons.

(3) *Separate operating units*. No additional requirements beyond those provided in these regulations apply to a separate operating unit. Thus, a separate operating unit that satisfies the requirements of paragraph (b)(2) of this section is deemed to satisfy the geographic separation requirement of section 414(r)(7) and accordingly is treated as a qualified separate line of business for all purposes under this section, including the separate application of section 401(a)(26).

(4) *Certain mergers and acquisitions*. A portion of an employer that is acquired in a transaction described in section 410(b)(6)(C) and § 1.410(b)–2(f) (i.e., an asset or stock acquisition, merger, or other similar transaction involving a change in the employer of the employees of a trade or business) is deemed to satisfy the requirements to be a qualified separate line of business, other than the 50-employee requirement and the notice requirement of pararaphs (b)(2)(iv)(R) and (b)(2)(iv)(C) of this section, respectively. In addition, the acquired employees are not taken into account, and the property and services provided by the acquired portion to customers of the employer are disregarded, for purposes of determining whether the employer's remaining lines of business satisfy the requirements of §§ 1.414(r)–3 through 1.414(r)–6. The rules in this paragraph (d)(4) apply only for those testing years with first testing days that fall within the transition period described in section 410(b)(6)(C). For this purpose, the transition period described in section 410(b)(6)(C) lasts only for so long as the conditions in that section are satisfied. For the definition of ''first testing day,'' see § 1.414(r)–11(b)(7). See § 1.414(r)–5(d)(4), *Example 1*, for an example of the application of the rule in this paragraph (d)(4). See also § 1.414(r)–5(d) for an administrative scrutiny safe harbor applicable to certain separate lines of business acquired in a transaction described in this section.

(5) *Governmental and tax-exempt employers*—(i) *General rule*. Except as provided in paragraph (d)(5)(ii) of this section, the rules of this section are applicable in determining whether section 401(a)(26) is satisfied by a plan maintained by an employer that is exempt from tax under Subtitle A of the Internal Revenue Code (including a governmental plan within the meaning of section 414(d)). Similarly, except as provided in paragraph (d)(5)(ii) of this section, the rules of this section are applicable in determining whether section 410(b) is satisfied by a plan that is subject to section 410(b) (including by virtue of § 1410(b)–2(e)) and is maintained by an employer that is exempt from tax under Subtitle A of the Internal Revenue Code (including a governmental plan within the meaning of section 414(d)).

(ii) *Additional rules*. [Reserved]

(6) *Testing year basis of application*—(i) *Section 414(r)*. Whether an employer is treated as operating qualified separate lines of business under section 414(r) in accordance with paragraph (b) of this section is determined on a year-by-year basis with respect to the testing year. It is therefore possible for an employer to satisfy paragraph (b) of this section for one testing year and to fail to satisfy it for another testing year. It is also possible for an employer to satisfy paragraph (b) of this section for two testing years but to have designated its lines of business differently in each of those two testing years. In determining

whether an employer satisfies paragraph (b) of this section for a testing year, the requirements of that paragraph are applied solely with respect to the testing year. Thus, all property and services provided by the employer to its customers during the testing year must be provided exclusively by portions of the employer that for the testing year constitute qualified separate lines of business. Furthermore, each employee of the employer must respectively be treated as an employee of one and only one of those qualified separate lines of business for all purposes with respect to the testing year.

(ii) *Sections 410(b), 401(a)(26), and 129(d)(8).* For purposes of paragraph (c) of this section, relating to the separate application of sections 410(b), 401(a)(26), and 129(d)(8) to the employees of a qualified separate line of business, the determination whether an employer operates qualified separate lines of business in accordance with paragraph (b) of this section for a testing year generally applies for all plan years beginning in the testing year. Rules for the separate application of sections 410(b), 401(a)(26), and 129(d)(8) are respectively provided in §§ 1.414(r)–8, 1.414(r)–9, and 1.414(r)–10.

(7) *Averaging rules.* The employer is permitted to apply certain provisions of these regulations on the basis of a consecutive-year average (not to exceed five consecutive years) under the averaging rules of § 1.414(r)–11(c).

(8) *Definitions.* In applying the provisions of this section and of §§ 1.414(r)–2 through 1.414(r)–11, the definitions in §§ 1.414(r)–11(b) and 1.410(b)–9 govern, unless otherwise provided.

(9) *Effective*—(i) *General rule.* The provisions of this section and of §§ 1.414(r)–2 through 1.414(r)–11 apply to plan years and testing years beginning on or after January 1, 1994 (or January 1, 1996, in the case of plans maintained by organizations exempt from income taxation under section 501(a), including plans subject to section 403(b)(12)(A)(i) (nonelective plans)).

(ii) *Reasonable compliance*—(A) *In general.* With respect to plan years beginning before the date on which the Commissioner begins issuing determinations under section 414(r)(2)(C), and on or after the first day of the first plan year to which section 414(r) applies under section 1112(a) of the Tax Reform Act of 1986, an employer is treated as operating qualified separate lines of business if the employer reasonably determines that it meets the requirements of section 414(r) (other than the requirement of administrative scrutiny under section 414(r)(2)(C)).

(B) *Determination of reasonable compliance.* Whether an employer reasonably determines that it meets the requirements of section 414(r) generally will be determined on the basis of all relevant facts and circumstances, including the extent to which the employer has resolved unclear issues in its favor. For the period described in paragraph (d)(9)(ii)(A) of this section, the Internal Revenue Service will consider the employer's compliance with the terms of these final regulations (other than the requirement of administrative scrutiny under paragraph (b)(2)(iv)(D) of this section) to constitute a reasonable determination that the employer meets the requirements of section 414(r) (other than the requirement of administrative scrutiny under section 414(r)(2)(C)).

(C) *Effect on other plans.* If an employer sponsors a plan that has a plan year beginning within the period decribed in paragraph (d)(9)(ii)(A) of this section, the employer's reasonable determination of its qualified separate lines of business for the testing year in which that plan year begins, and the allocation of employees to those qualified separate lines of business, must also be used for purposes of applying § 1.414(r)–8 and § 1.414(r)–9 for plan years that begin in that testing year but after the end of the period described in paragraph (d)(9)(ii)(A) of this section.

(e) *Additional rules.* The Commissioner may, in revenue rulings, notices, and other guidance of general applicability, provide any additional rules that may be necessary or appropriate in applying the qualified separate line of business requirements of section 414(r). These additional rules may include, for example, new safe harbors in § 1.414(r)–5.

[T.D. 8376, 56 FR 63437, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32916, June 27, 1994]

§ 1.414(r)–2 Line of business.

(a) *General rule.* A line of business is a portion of an employer that is identified by the property or services it provides to customers of the employer. For this purpose, an employer is permitted to determine its lines of business by designating the property or services that each of its lines of business provides to customers of the employer. Paragraph (b) of this section explains how an employer determines its lines of business for a testing year. Paragraph (c) of this section provides examples illustrating the application of this section.

(b) *Employer determination of its lines of business*—(1) *In general.* An employer determines its lines of business for a testing year first by identifying all the property and services it provides to its customers during the testing year, and then by designating which portion of the property and services is provided by each of its lines of business.

(2) *Property and services provided to customers*—(i) *In general.* Property, whether real or personal, tangible or intangible, is provided by an employer to a customer if the employer provides the property to or on behalf of the customer for consideration. Similarly, services are provided by an employer to a customer if the employer renders the services to or on behalf of the customer for consideration. An individual item of property or service is taken into account under this paragraph (b)(2) only if the employer provides the item to a person other than the employer in the ordinary course of a trade or business conducted by the employer and the person to whom the employer provides the item is acting in the capacity of a customer of the employer. A type of tangible property is deemed to be provided to customers of the employer for purposes of this section if, with respect to a business that produces or manufactures that type of tangible property, the employer satisfies the special rule in § 1.414(r)–3(d)(2)(iii)(B) for vertically integrated businesses.

(ii) *Timing of provision of property or services.* Generally an employer determines its lines of business on the basis of the property and services it provides to its customers for consideration during the testing year. However, it is not necessary both that property or services actually be provided, and that consideration for the property or services actually be paid, during the current testing year. For an employer to be considered to provide property or services to customers for consideration during a testing year under this paragraph (b)(2), it is sufficient that the property or services actually be provided to customers during the testing year, the consideration actually be paid during the testing year, or the employer actually incur significant costs during the testing year associated with the provision of the property or services to a specified customer or specified customers.

(3) *Employer designation*—(i) *In general.* Once the employer has identified all the property and services it provides to its customers during the testing year under paragraph (b)(2) of this section, the employer determines its lines of business for the testing year by designating which portion of those property and services is provided by each of its lines of business. For this purpose, the employer must apportion all the property and services identified under paragraph (b)(2) of this section among its lines of business. An employer generally is not required to designate its lines of business for the testing year in the same manner as it designates its lines of business for any other testing year.

(ii) *Ability to combine unrelated types of property or services in a single line of business.* For purposes of this paragraph (b)(3), there is no requirement that a line of business provide only one type of property or service, or only related types of property or services. Nor is there any requirement that a line of business provide solely property or solely services. Thus, the employer is permitted to combine in a single line of business dissimilar types of property or services that are otherwise unrelated to one another.

(iii) *Ability to separate related types of property or services into two or more lines of business.* For purposes of this paragraph (b)(3), there is no requirement that all property or services of related types or the same type be provided by a single line of business. Thus, the employer is permitted to designate two or

more lines of business that provide related types of property or services, or the same type of property or service. An employer might designate two or more lines of business that provide property or services of related types or the same type, for example, where the lines of business manufacture, prepare, or provide the property or services in different geographic areas (e.g., in different regions of the country or the world), or at different levels in the chain of commercial distribution (e.g., wholesale versus retail), or in different types of transactions (e.g, sale versus lease), or for different types of customers (e. g., governmental versus private), or subject to different legal constraints (e. g., regulated versus unregulated), or if the lines of business have developed differently (e.g., one line of business was acquired while another line of business developed internally). Notwithstanding the foregoing, an employer is not permitted to designate two or more lines of business that provide property or services of related types or the same type, if the employer's designation is unreasonable. An employer's designation would be unreasonable, for example, if the designation separated two types of property or services in different lines of business, but the employer did not provide those types of property or services separately from one another to its customers. Similarly, an employer's designation would be unreasonable if it separated two types of property or services in different lines of business, but the provision of one type of property or service was merely ancillary or incidental to, or regularly associated with, the provision of the other type of property or service. See generally §1.414(r)–1(d)(2) (requiring an employer's operation of qualified separate lines of business to be for bona fide business reasons).

(iv) *Affiliated service groups*. An employer is not permitted to designate its lines of business in a manner that results in separating employees of an affiliated service group (within the meaning of section 414(m)) from other employees of the employer. See section 414(r)(8).

(c) *Examples*—(1) *In general*. Paragraphs (c)(2) and (c)(3) of this section provide examples that illustrate the application of this section.

(2) *Examples illustrating employer designation*. The following examples illustrate the application of paragraph (b)(3) of this section relating to an employer's designation of the property or services provided to customers by each of its lines of business.

Example 1. Employer A is a domestic conglomerate engaged in the manufacture and sale of consumer food and beverage products and the provision of data processing services to private industry. Employer A provides no other property or services to its customers. Pursuant to paragraph (b)(3) of this section, Employer A apportions all the property and services it provides to its customers among three lines of business, one providing all its consumer food products, a second providing all its consumer beverage products, and a third providing all its data processing services. Employer A has three lines of business for purposes of this section.

Example 2. The facts are the same as in *Example 1*, except that Employer A determines that neither the consumer food products line of business nor the consumer beverage products line of business would satisfy the separateness criteria of §1.414(r)–3 for recognition as a separate line of business. Accordingly, pursuant to paragraph (b)(3) of this section, Employer A apportions all the property and services it provides to its customers between only two lines of business, one providing all its consumer food and beverage products, and a second providing all its data processing services. Employer A has two lines of business for purposes of this section.

Example 3. The facts are the same as in *Example 2*, except that Employer A also owns and operates a regional commuter airline, a professional basketball team, a pharmaceutical manufacturer, and a leather tanning company. Pursuant to paragraph (b)(3) of this section, Employer A apportions all the property and services it provides to its customers among three lines of business, one providing all its consumer food and beverage products, a second providing all its data processing services, and a third providing all the other property and services provided to customers through Employer A's regional commuter airline, professional basketball team, pharmaceutical manufacturer, and leather tanning company. Even though the third line of business includes dissimilar types of property and services that are otherwise unrelated to one another, paragraph (b)(3)(ii) of this section permits Employer A to combine these property and services in a single line of business. Employer A has three lines of business for purposes of this section.

Example 4. The facts are the same as in *Example 2*, except that Employer A has recently

acquired Corporation L, whose only product is a well-known brand of gourmet ice cream. Although Employer A manufactures and sells other ice cream products, it does not manufacture or market the newly acquired brand of gourmet ice cream except through Corporation L. Pursuant to paragraph (b)(3) of this section, Employer A apportions all the property and services it provides to its customers among three lines of business, one providing only the newly acquired brand of gourmet ice cream, a second providing all its other consumer food and beverage products (including the other ice cream products manufactured and sold by Employer A) and a third providing all its data processing services. Even though the gourmet ice cream line of business provides the same type of property as the consumer food and beverage line of business (i.e., ice cream), paragraph (b)(3)(iii) of this section permits Employer A to separate its ice cream products between two different lines of business. Employer A has three lines of business for purposes of this section.

Example 5. The facts are the same as in *Example 2,* except that Employer A operates the data processing services portion of its business in two separate subsidiaries, one serving customers in the eastern half of the United States and the other serving customers in the western half of the United States. Pursuant to paragraph (b)(3) of this section, Employer A apportions all the property and services it provides to its customers among three lines of business, one providing all its consumer food and beverage products, a second providing data processing services to customers in the eastern half of the United States, and a third providing data processing services to customers in the western half of the United States. Even though the second and third lines of business provide the same type of service (i.e., data processing services), paragraph (b)(3)(iii) of this section permits Employer A to separate its data processing services into two lines of business. Employer A has three lines of business for purposes of this section.

Example 6. Employer B is a diversified engineering firm offering civil, chemical, and aeronautical engineering services to government and private industry. Employer B provides no other property or services to its customers. Employer B operates the aeronautical engineering services portion of its business as two separate divisions, one serving federal government customers and the other serving customers in private industry. Pursuant to paragraph (b)(3) of this section, Employer B apportions all the property and services it provides to its customers among four lines of business, one providing all its civil engineering services, a second providing all its chemical engineering services, a third providing aeronautical engineering services to federal government customers, and a fourth providing aeronautical engineering services to customers in private industry. Even though the third and fourth lines of business include the same type of service (i.e., aeronautical engineering services), paragraph (b)(3)(iii) of this section permits Employer B to separate its aeronautical engineering services into two lines of business. Employer B has four lines of business for purposes of this section.

Example 7. Among its other business activities, Employer C manufacturers industrial diesel generators. At no additional cost to its buyers, Employer C warrants the proper functioning of its diesel generators for a one-year period following sale. Pursuant to its warranty, Employer C provides labor and parts to repair or replace any components that malfunction within the one-year warranty period. Because Employer C does not provide the industrial diesel generators, on the one hand, and the warranty repair services and replacement parts, on the other hand, separately from one another to its customers, under paragraph (b)(3)(iii) of this section it would be unreasonable for Employer C to separate these property and services in different lines of business.

Example 8. Among its other business activities, Employer D leases office photocopying equipment. Employer D also provides photocopying supplies and repair services to its lessees for a separate charge. Employer D generally does not provide such supplies and repair services to persons other than its lessees. Lessees of Employer D's equipment are permitted to use photo-copying supplies and repair services from suppliers other than Employer D. Because the provision of the photo-copying supplies and repair services are merely ancillary or incidental to the provision of the leased photo-copiers, under paragraph (b)(3)(iii) of this section it would be unreasonable for Employer D to separate these property and services in different lines of business.

Example 9. Employer E operates a medical clinic. The employees of the clinic include physicians, nurses, and laboratory technicians, all of whom participate in providing medical and related services to patients of the clinic. Under paragraph (b)(3)(iii) of this section, it would be unreasonable for Employer E to separate the services of the physicians, nurses, and laboratory technicians in different lines of business.

Example 10. Employer F is a law firm. The employees of the firm include lawyers, paralegals, and secretaries, all of whom participate in rendering legal and related services to clients of the firm. Under paragraph (b)(3)(iii) of this section, it would be unreasonable for Employer F to separate the services of the lawyers, paralegals, and secretaries in different lines of business.

Example 11. Employer G is a management consulting firm. The employees of the firm

include management consultants, secretaries, and other support staff personnel, all of whom participate in rendering management consulting and related services to clients of the firm. Under paragraph (b)(3)(iii) of this section, it would be unreasonable for Employer G to separate the services of the management consultants, secretaries, and other support staff personnel in different lines of business.

(3) *Examples illustrating property and services provided to customers.* The following examples illustrate the application of paragraph (b)(2) of this section relating to property and services provided to customers of the employer.

Example 1. Employer H operates several dairy farms and dairy product processing plants. The dairy farms provide part of their output of milk and milk by-products to Employer H's dairy product processing plants and also sell part to retail distributors unrelated to Employer H. The dairy farms' provision of milk and milk by-products to Employer H's dairy product processing plants does not constitute the provision of property or services to customers of Employer H because the milk and milk by-products are not provided to a person other than employer H. However, the dairy farms' provision of milk and milk by-products to independent retail distributors does constitute the provision of property or services to customers of Employer H under paragraph (b)(2) of this section.

Example 2. The facts are the same as in *Example 1*, except that the dairy farms provide their entire output of milk and milk by-products to Employer H's dairy product processing plants. The dairy farms' provision of milk and milk by-products to the dairy product processing plants generally does not constitute the provision of property or services to customers of Employer H because the milk and milk by-products are not provided to a person other than Employer H. However, paragraph (b)(2)(i) of this section provides a special rule for vertically integrated businesses that satisfy §1.414(r)–3(d)(2)(iii)(B). If §1.414(r)–3(d)(2)(iii)(B) is satisfied, then, under the special rule of paragraph (b)(2)(i) of this section, the milk and milk by-products are deemed to be provided to customers of Employer H.

Example 3. Among its other business activities, Employer J manufactures automobiles. Employer J operates a cafeteria at one of its automobile manufacturing facilities. The cafeteria is intended primarily for use by employees of Employer J, but nonemployees are not prohibited from using the cafeteria. The cafeteria charges the same prices to employees and non-employees. Under paragraph (b)(2) of this section, the provision of cafeteria services to employees of Employer J does not constitute the provision of property or services to customers of Employer J, because the cafeteria services are provided to the employees in their capacity as employees of Employer J and not as customers of Employer J.

Example 4. Employer K sells books and periodicals to members of the public and provides telecommunications services to private industry. Employer K periodically acquires and disposes of businesses in both asset and stock transactions. In addition, for its own investment purposes, Employer K acquires and disposes of corporate and other securities. Under paragraph (b)(2) of this section, the sale by Employer K of businesses and investment securities does not constitute the provision of property or services to customers of Employer K, because the sales are not made in the ordinary course of a trade or business conducted by Employer K. However, the sale of published materials and the provision of telecommunications services to persons unrelated to Employer K does constitute the provision of property or services to customers of Employer K.

Example 5. Employer L is active in the financial services industry. Subsidiary 1 of Employer L is a brokerage firm that is regulated as a broker-dealer under applicable federal and state law. In its capacity as a dealer, Subsidiary 1 holds in its own inventory securities of unrelated corporations and regularly sells these securities to unrelated persons. Under paragraph (b)(2) of this section, the sale by Subsidiary 1 of the securities to unrelated persons constitutes the provision of property or services to customers of Employer L, because the sales are made in the ordinary course of Subsidiary 1's trade or business as a broker-dealer.

Example 6. The facts are the same as in *Example 5.* Subsidiary 2 of Employer L is an insurance company that is regulated under applicable state insurance laws. In managing its investments, Subsidiary 2 regularly makes use of the brokerage services of Subsidiary 1 (which Subsidiary 1 regularly provides to unrelated persons as well). Under paragraph (b)(2) of this section, Subsidiary 1's provision of brokerage services to Subsidiary 2 does not constitute the provision of property or services to customers of Employer L, because the brokerage services are not provided to a person other than Employer L. However, Subsidiary 1's provision of brokerage services to unrelated persons does constitute the provision of property or services to customers of Employer L.

Example 7. Employer M is a shipbuilder. In a testing year, Employer M enters into a contract with a customer to construct a new cargo ship for delivery two years later. Employer M incurs significant costs designing and planning for the production of the new ship during the testing year, but receives no payments from the customer during that

year. Under paragraph (b)(2) of this section, Employer M is treated as providing the cargo ship to the customer during the testing year.

Example 8. The facts are the same as in *Example 7*, except that, pursuant to a request from the customer, Employer M also incurred significant costs developing a prototype and submitting a bid on the new cargo ship in the prior testing year, and that these costs were not reimbursed by the customer. Under paragraph (b)(2) of this section, Employer M is also treated as providing the cargo ship to the customer in the prior testing year.

[T.D. 8376, 56 FR 63439, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32917, June 27, 1994]

§ 1.414(r)–3 Separate line of business.

(a) *General rule*. A separate line of business is a line of business (as determined under § 1.414(r)–2) that is organized and operated separately from the remainder of the employer. Paragraph (b) of this section sets forth the rules for determining whether a line of business is organized and operated separately from the remainder of the employer. Paragraph (c) of this section provides certain supplementary rules necessary to apply the requirements of paragraph (b) of this section, as well as examples illustrating the application of those requirements. Paragraph (d) of this section provides an optional rule for lines of business that are vertically integrated.

(b) *Separate organization and operation*—(1) *In general*. A line of business is organized and operated separately from the remainder of the employer for a testing year only if it satisfies all the requirements of paragraphs (b)(2) through (b)(5) of this section for the testing year.

(2) *Separate organizational unit*. The line of business must be formally organized as a separate organizational unit or group of separate organizational units within the employer. For this purpose, an organizational unit is a corporation, partnership, division, or other unit having a similar degree of organizational formality. This requirement must be satisfied on every day of the testing year.

(3) *Separate financial accountability*. The line of business must be a separate profit center or group of separate profit centers within the employer. This requirement must be satisfied on every day of the testing year. In addition, the employer must maintain books and records that provide separate revenue and expense information that is used for internal planning and control with respect to each profit center comprising the line of business.

(4) *Separate employee workforce*. The line of business must have its own separate employee workforce. A line of business has its own separate workforce only if at least 90 percent of the employees who provide services to the line of business, and who are not substantial-service employees with respect to any other line of business, are substantial-service employees with respect to the line of business. See paragraph (c)(2) of this section to determine how the percentage in the preceding sentence is calculated for the testing year.

(5) *Separate management*. The line of business must have its own separate management. A line of business has its own separate management only if at least 80 percent of the employees who are top-paid employees with respect to the line of business are substantial-service employees with respect to the line of business. See paragraph (c)(3) of this section to determine how the percentage in the preceding sentence is calculated for the testing year.

(c) *Supplementary rules*—(1) *In general*. This paragraph (c) provides certain supplementary rules necessary to apply the requirements of paragraph (b) of this section, as well as examples illustrating the application of those requirements.

(2) *Determination of separate employee workforce*. The percentage in paragraph (b)(4) of this section is the fraction (expressed as a percentage)—

(i) The numerator of which is the number of substantial-service employees with respect to the line of business within the meaning of § 1.414(r)–11(b)(2); and

(ii) The denominator of which is the total number of employees who provide services to the line of business within the meaning of paragraph (c)(5) of this section and who are not substantial-service employees with respect to any other line of business.

(3) *Determination of separate management*. The percentage in paragraph

(b)(5) of this section is the fraction (expressed as a percentage)—

(i) The numerator of which is the number of employees who are both top-paid employees and substantial-service employees with respect to the line of business within the meaning of §1.414(r)–11(b)(3) and (2), respectively; and

(ii) The denominator of which is the total number of top-paid employees with respect to the line of business within the meaning of §1.414(r)–11(b)(3).

(4) *Employees taken into account.* For purposes of applying this paragraph (c), only employees who are employees on the first testing day are taken into account. For this purpose, there are no excludable employees except nonresident aliens described in section 410(b)(3)(C). Consequently, all other employees who are employees on the first testing day are taken into account, including collectively bargained employees. For the definition of first testing day, see §1.414(r)–11(b)(7).

(5) *Services taken into account*—(i) *Provision of services to a line of business.* An employee provides services to a line of business if more than a negligible portion of the employee's services contributes to providing the property or services provided by the line of business to customers of the employer. All of the services of each employee who provides services to the employer contribute, whether directly or indirectly, to the provision of property or services to customers of the employer, and therefore each employee who provides services to the employer must be treated as providing more than a negligible portion of the employee's services to one or more lines of business operated by the employer.

(ii) *Period for which services are provided.* Only services performed by an employee during the testing year that contribute to providing the property or services provided by a line of business to customers are taken into account. An employee's services during the testing year are considered to contribute to providing the property or services provided by a line of business to customers of the employer if—

(A) The employee's services during the testing year contribute to providing such property or services to customers of the employer during the testing year; or

(B) It is reasonably anticipated that the employee's services during the testing year will contribute to providing such property and services to customers of the employer after the close of the testing year.

(iii) *Optional rule for employees who change status*—(A) *In general.* Solely for purposes of the separateness rules of this section and the assignment rules of §1.414(r)–7, if an employee changes status as described in paragraph (c)(5)(iii)(B) of this section, an employer may, for up to three consecutive testing years after the base year (within the meaning of paragraph (c)(5)(iii)(B) (*1*) or (*2*) of this section), treat the employee as providing the same level of service to its lines of business as the employee provided in the base year.

(B) *Change in employee's status.* An employee changes status as described in this paragraph (c)(5)(iii)(B) if—

(*1*) For a testing year (the base year), the employee was a substantial-service employee with respect to a qualified separate line of business of the employer (prior line of business) and, for the immediately succeeding testing year, the employee is not a substantial-service employee with respect to that prior line of business; or

(*2*) For a testing year (the base year), the employee was a residual shared employee and, for the immediately succeeding testing year, the employee is a substantial-service employee with respect to a qualified separate line of business.

(6) *Examples of the separate employee workforce requirement.* The following examples illustrate the application of the separate employee workforce requirement in paragraph (b)(4) of this section and the supplementary rules of this paragraph (c). Unless otherwise specified, it is assumed that the employees and their services described in these examples are taken into account under paragraphs (c) (4) and (5) of this section for the testing year and that the employer does not use the option under §1.414(r)–11(b)(2) to treat employees who provide less than 75 percent of their services to a line of business as

substantial-service employees with respect to the line of business.

Example 1. Employer A operates three lines of business as determined under §1.414(r)–2. One of Employer A's lines of business manufactures and sells tires and other automotive products. Employee M is a tire press operator in Employer A's tire factory. Employee N is the manager of the tire factory. Under these facts, the services of Employees M and N contribute to providing tires to customers of Employer A. Both employees therefore provide services to Employer A's tire and automotive products line of business within the meaning of paragraph (c)(5) of this section.

Example 2. The facts are the same as in *Example 1.* In addition, none of the services of Employees M and N that contribute to providing property or services to customers contribute to providing any property or service other than tires to customers of Employer A. Under these facts, Employees M and N provide at least 75 percent of their respective services to Employer A's tire and automotive products line of business. Therefore Employees M and N are substantial-service employees with respect to Employer A's tire and automotive products line of business within the meaning of §1.414(r)–11(b)(2), and do not provide any services within the meaning of paragraph (c)(5) of this section to any of Employer A's other lines of business. Moreover, because Employees M and N provide at least 75 percent of their services to Employer A's tire and automotive products line of business and are substantial-service employees with respect to that line, they are disregarded in applying paragraph (b)(4) of this section to any other line of business, even if they provide services to the other line.

Example 3. The facts are the same as in *Example 2.* Employer A's second line of business manufactures and sells construction machinery, and Employer A's third line of business manufactures and sells agricultural equipment. As part of these lines of business, Employer A operates a construction machinery factory and an agricultural equipment factory on the same site as the tire factory described in *Example 2.* Employer A's facilities at the site include a health clinic and a fitness center that serve the employees of the construction machinery factory, the agricultural equipment factory, and the tire factory. Employee O is a nurse in the health clinic, and Employee P is a fitness instructor in the fitness center. Both employees therefore provide services within the meaning of paragraph (c)(5) of this section to Employer A's tire and automotive products line of business, construction machinery line of business, and agricultural equipment line of business. In addition, under these facts, Employer A determines that approximately 33 percent of the services of Employees O and P are provided to each of Employer A's three lines of business. As a result, neither Employee O or P provide at least 75 percent of their respective services to any of Employer A's lines of business. Therefore, Employees O and P are not substantial-service employees with respect to any of Employer A's three lines of business within the meaning of §1.414(r)–11(b)(2).

Example 4. The facts are the same as in *Example 3.* Employee Q is the president and chief executive officer of Employer A and is responsible for reviewing the performance of all Employer A's lines of business. Under these facts, the services of Employee Q contributes to providing property and services to customers of each of Employer A's three lines of business. Employee Q therefore provides services to each of these three lines of business. Employer A determines that Employee Q provides the following percentages of his services to Employer A's three lines of business: tire and automotive products—40 percent; construction machinery—40 percent, and agricultural equipment—20 percent. Employee Q does not provide at least 75 percent of his services to any of Employer A's lines of business. Therefore, Employee Q is not a substantial-service employee with respect to any of Employer A's three lines of business within the meaning of §1.414(r)–11(b)(2).

Example 5. The facts are the same as in *Example 4,* except that Employer A also owns 75 percent of Corporation X. Corporation X is not treated as part of Employer A within the meaning of §1.410(b)–9. Employee R is an accountant in the accounting department of Employer A. Employee R devotes all of his time to maintaining the accounting books and records of the tire and automotive products line of business of Employer A and the accounting books and records of Corporation X. Employer A determines that Employee R provides 40 percent of his services directly to the tire and automotive products line of business. Employer A also determines that Employee R provides the following percentages of the remainder of Employee R's services (i.e., his provision of services of maintaining the accounting books and records of Corporation X) indirectly to Employer A's three lines of business by virtue of the services he provides to Corporation X: tire and automotive products—25 percent; construction machinery—20 percent, and agricultural equipment—15 percent. Therefore, Employee R provides 65 percent of his services to the tire and automotive products line of business of Employer A (i.e., 40 percent directly and 25 percent indirectly). Under the definition of substantial-service employee in §1.414(r)–11(b)(2), Employer A may treat Employee R as a substantial-service employee with respect to the tire and automotive products line of business because Employee R provides at least 50 percent of his services to that

line. In that case, Employee R would be disregarded in applying paragraph (b)(4) of this section to the construction machinery and agricultural equipment lines of business.

Example 6. The facts are the same as in *Example 5*. Employee S is a lawyer in the legal department located at the headquarters who devotes all her time to product liability suits filed against the construction machinery line of business. Under these facts, the services of Employee S contribute to providing property and services to customers of Employer A in the construction machinery line of business, and therefore Employee S provides services to that line of business. Because Employee S's services do not contribute to providing property or services in any other of Employer A's lines of business within the meaning of paragraph (c)(5) of this section, Employee S provides more than 75 percent of her services to the construction machinery line of business and therefore is a substantial-service employee with respect to Employer A's construction machinery line of business within the meaning of §1.414(r)–11(b)(2).

Example 7. The facts are the same as in *Example 6*. Employer A also maintains a separate facility that houses a centralized procurement, marketing, and billing operation for all of its lines of business. None of the procurement, marketing, or billing employees specializes in any particular line of business. Under these facts, the services of the procurement, marketing, and billing employees contribute to providing property and services to customers of Employer A in each of Employer A's three lines of business. Employer A determines that each of the procurement, marketing, and billing employees provides approximately an equal proportion of their services to each of Employer A's three lines of business. These employees therefore provide services to all of Employer A's lines of business within the meaning of paragraph (c)(5) of this section. However, none of them provides at least 75 percent of his services to any line of business. Therefore, these employees are not substantial-service employees with respect to any of Employer A's three lines of business within the meaning of §1.414(r)–11(b)(2).

Example 8. The facts are the same as in *Example 7*. Employee T works for the construction machinery line of business. During the testing year, he is temporarily detailed to the agricultural equipment line of business. His temporary detail lasts for one week, after which he returns to his regular duties with the construction machinery line of business. Under these facts, Employee T does not provide more than a negligible portion of his services during the testing year to the agricultural equipment line of business. Accordingly, Employee T does not provide services to the agricultural equipment line of business within the meaning of paragraph (c)(5) of this section. In addition, because Employee T provides at least 75 percent of his services to the construction machinery line of business, Employee T is a substantial-service employee with respect to Employer A's agricultural equipment line of business within the meaning of §1.414(r)–11(b)(2).

Example 9. The facts are the same as in *Example 8*, except that, during the testing year but before the first testing day, Employee T retires from employment with Employer A. Under paragraph (c)(5)(ii) of this section, Employee T is not taken into account in determining whether Employer A's construction machinery line of business has its own separate employee workforce within the meaning of paragraph (b)(4) of this section.

Example 10. Employer B is a multinational controlled group of corporations that engages in the exploration, production, refining, and marketing of petrochemical products. Employer B operates two lines of business as determined under §1.414(r)–2. The first line of business (the ''exploration, production, and refining line of business'') provides lubricating oil, gasoline, and other petrochemical products to wholesale customers of Employer B as well as to the second line of business. The wholesale customers of Employer B include independent jobbers, independent franchisees that operate retail filling stations under Employer B's trademark and tradename, as well as chemical and plastics manufacturers. The second line of business (the ''retail marketing line of business'') provides lubricating oil and gasoline products to retail customers of Employer B through filling stations owned and operated by Employer B. Employee U is an attendant at a filling station owned and operated by Employer B. Employee U performs no other services for Employer B, Under these facts, Employee U provides at least 75 percent of his services to Employer B's retail marketing line of business and therefore is a substantial-service employee with respect to that line of business within the meaning of §1.414(r)–11(b)(2), and does not provide any services within the meaning of paragraph (c)(5) of this section to any of Employer B's other lines of business.

Example 11. The facts are the same as in *Example 10*. Employer B operates a refinery that produces lubricating oil, gasoline, and other petrochemical products. Employee V is an operating engineer at the refinery who is involved at a stage in the refining process before lubricating oil and gasoline products have been separated from other types of petrochemical products. Employee V performs no other services for Employer B. Under these facts, Employee V's services contribute to providing property and services to customers of Employer B in both the exploration, production, and refining line of business and the retail marketing line of business. Employee V therefore provides services

to both lines of business within the meaning of paragraph (c)(5) of this section. See paragraph (d) of this section, however, for an optional rule for vertically integrated lines of business.

Example 12. The facts are the same as in *Example 11.* Employee W is a petroleum engineer who conducts geological studies of potential future drilling sites. Although Employee W's services during the testing year will not contribute to providing lubricating oil, gasoline, and other petrochemical products to customers of Employer B during the testing year, it is reasonably anticipated (in accordance with paragraph (c)(5)(ii)(B) of this section) that her services during the testing year will contribute to providing such products to customers of Employer B after the close of the testing year. Under these facts, Employee W provides her services to both of Employer B's lines of business within the meaning of paragraph (c)(5) of this section.

(7) *Examples of the separate management requirement.* The following examples illustrate the application of the separate management requirement in paragraph (b)(5) of this section and the supplementary rules of this paragraph (c). Unless otherwise specified, it is assumed that employees who provide services to a line of business are not substantial-service employees with respect to any other line of business and that, in determining the top-paid employees with respect to a line of business, the employer is using the option under §1.414(r)–11(b)(3) to disregard all employees who provide less than 25 percent of their services to that line of business.

Example 1. (a) Employer C operates three lines of business as determined under §1.414(r)–2. One of its lines of business is the operation of a chain of athletic equipment and apparel stores. Of Employer C's total workforce, 12,000 employees provide more than a negligible amount of the services they provide to Employer C to the athletic equipment and apparel stores line of business, within the meaning of paragraph (c)(5) of this section. Of the 1,200 employees who constitute the top ten percent by compensation of those 12,000 employees, 930 are substantial-service employees with respect to that line of business. Because 930 is 77.5 percent of 1,200, less than 80 percent of the top-paid employees with respect to the line of business are substantial-service employees with respect to that line of business. Therefore, Employer C's athletic equipment and apparel stores line of business does not have its own separate management under paragraph (b)(5) of this section.

(b) Assume that, in determining the top-paid employees with respect to the athletic equipment and apparel stores line of business, Employer C chooses to disregard all employees who provide less than 25 percent of their services to the line of business as permitted under the definition in §1.414(r)–11(b)(3). Of the 12,000 employees who provide more than a negligible amount of their services to the athletic equipment and apparel stores line of business, 10,000 provide at least 25 percent of their services to that line. Of the 1,000 employees who constitute the top ten percent by compensation of those 10,000 employees, 930 are substantial-service employees with respect to the athletic equipment and apparel stores line of business. Because 930 is 93 percent of 1,000, at least 80 percent of the top-paid employees with respect to the line of business are substantial-service employees with respect to that line of business. Therefore, Employer C's athletic equipment and apparel stores line of business has its own separate management and satisfies the requirement of paragraph (b)(5) of this section.

Example 2. The facts are the same as in *Example 1.* Employee X is a vice president of the accounting department located at the headquarters, who devotes all of his time supervising the staff of Employer C's accounting department. Employer C determines that 10 percent of Employee X's services contribute to providing property and services to customers of Employer C's athletic equipment and apparel stores line of business and 45 percent of Employee X's services contribute to providing property and services to customers to each of Employer C's other two lines of business. Because Employee X does not provide at least 25 percent of his services to Employer C's athletic equipment and apparel stores line of business, Employee X is not one of the 10,000 employees described in *Example 1* and therefore cannot be a top-paid employee within the meaning of §1.414(r)–11(b)(3) with respect to the athletic equipment and apparel stores line of business. Therefore, Employee X is not taken into account in determining whether the athletic equipment and apparel stores line of business satisfies the separate management requirement of paragraph (b)(5) of this section.

Example 3. The facts are the same as in *Example 2* except that Employee X provides 60 percent of his services to Employer C's second line of business, an athletic equipment factory, and 30 percent of his service to Employer C's third line of business, a fast-food chain. Because Employee X provides at least 50 percent of his services to the athletic equipment factory line of business, Employer C chooses to treat him as a substantial- service employee with respect to that line of business, as permitted under

§ 1.414(r)–11(b)(2). Thus, Employee X is taken into account as a substantial-service employee with respect to the athletic equipment factory line of business and is disregarded in applying the separate workforce and separate management requirements under paragraphs (b) (4) and (5) to the fast-food chain line of business.

Example 4. Employer D operates four lines of business as determined under § 1.414(r)–2. One of its lines of business is a machine tool shop. Sixty of Employer D's employees provide at least 25 percent of their services to the machine tool shop line of business. Of the six employees who constitute the top 10 percent by compensation of those 60 employees, four are substantial-service employees with respect to the line of business. Because four is 67 percent of six, 80 percent of the top-paid employees with respect to the machine tool shop line of business are not substantial-service employees with respect to that line of business. Therefore the machine tool shop line of business does not satisfy the separate management requirement of paragraph (b)(5) of this section.

Example 5. The facts are the same as in *Example 4*, except that, in addition, another of Employer D's lines of business is an automotive repair shop, and 80 of Employer D's employees provide at least 25 percent of their services to that line of business. Employer D combines the machine shop line of business with the automotive repair shop line of business and treats them as a single line of business. As a result, Employer D has three lines of business as determined under § 1.414(r)–2. Assume that 150 of Employer D's employees provide more than 25 percent of their services to the machine tool shop/automotive repair shop line of business within the meaning of paragraph (c)(5) of this section. Of the 15 employees who constitute the top 10 percent by compensation of these 150 employees, 12 are substantial-service employees with respect to that line of business. Because 12 is 80 percent of 15, at least 80 percent of the top-paid employees with respect to the machine tool shop/automotive repair shop line of business are substantial-service employees with respect to that line of business. Therefore, the machine tool shop/automotive repair shop line of business satisfies the separate management requirement of paragraph (b)(5) of this section.

(d) *Optional rule for vertically integrated lines of business*—(1) *In general.* If two lines of business satisfy the requirements of this paragraph (d) with respect to a type of property or service for a testing year, the employer is permitted to apply the optional rule in this paragraph (d) for the testing year.

(2) *Requirements.* Two lines of business satisfy the requirements of this paragraph (d) with respect to a type of property or service only if—

(i) One of the lines of business (the upstream line of business) provides a type of property or service to the other line of business (the downstream line of business);

(ii) The downstream line of business either—

(A) Uses, consumes, or substantially modifies the property or service in the course of itself providing property or services to customers of the employer; or

(B) Provides the same property or service to customers of the employer at a different level in the chain of commercial distribution from the upstream line of business (e.g., retail versus wholesale); and

(iii) The upstream line of business either—

(A) Provides the same type of property or service to customers of the employer, and at least 25 percent of the total number of units of the same type of property or service provided by the upstream line of business to all persons (including customers of the employer, the downstream line of business, and all other lines of business of the employer) are provided to customers of the employer by the upstream line of business, when measured on a uniform basis; or

(B) Provides to the downstream line of business property consisting primarily of a type of tangible property (i.e., goods, not services) that it produces or manufactures, and some entities outside the employer's controlled group that are engaged in a similar business as the upstream line of business provide the same type of tangible property to unrelated customers (i.e., customers outside those entities' respective controlled groups).

(3) *Optional rule*—(i) *Treatment of employees.* For purposes of determining the lines of business to which an employee provides services under paragraph (c)(5) of this section, an employee is not treated as providing services to the downstream line of business if—

(A) The employee is considered to provide services to the downstream line of business under paragraph (c)(5) of this section (applied without regard

to the optional rule in this paragraph (d)); and

(B) The employee is so considered solely because the employee's services contribute to providing the property or service from the upstream line of business to the downstream line of business.

(ii) *Purposes for which optional rule applies*. If an employee applies the optional rule in this paragraph (d), the treatment specified in paragraphs (d)(3)(i) (A) and (B) of this section applies for all the following purposes and only for the following purposes—

(A) The separate employee workforce and separate management requirements of paragraphs (b)(4) and (b)(5) of this section;

(B) The 50-employee requirement of §1.414(r)–4(b); and

(C) The determination of the employees of a qualified separate line of business under §1.414(r)–7.

(4) *Examples*. The following examples illustrate the application of the optional rule in this paragraph (d).

Example 1. Employer E operates two lines of business as determined under §1.414(r)–2, one engaged in upholstery textile manufacturing and the other in furniture manufacturing. During the testing year, the upholstery textile line of business provides its entire output of upholstery textiles to the furniture line of business. The furniture line of business uses the upholstery textiles in the manufacture of upholstered furniture for sale to customers of Employer E. The furniture line of business thus substantially modifies the upholstery textiles provided to it by the upholstery textile line of business in providing upholstered furniture products to customers of Employer E. In addition, although the upholstery textile line of business does not provide upholstery textiles to customers of Employer E, some entities engaged in upholstery textile manufacturing provide upholstery textiles to customers outside their controlled groups. Under these facts, Employer E's two lines of business satisfy the requirements of this paragraph (d) with respect to upholstery textiles for the testing year.

Example 2. Employer B is a multinational controlled group of corporations that engages in the exploration, production, refining, and marketing of petrochemical products. See *Example 10* under paragraph (c)(7) of this section. Employer B operates two lines of business as determined under §1.414(r)–(2). The first line of business (''the exploration, production, and refining line of business'') provides lubricating oil, gasoline, and other petrochemical products to wholesale customers of Employee B as well as the second line of business. The wholesale customers of Employee B include independent jobbers, independent franchisees that operate retail filling stations under Employee B's trademark and tradename, as well as chemical and plastics manufacturers. The second line of business (the ''retail marketing line of business'') provides lubricating oil and gasoline products to retail customers of Employee B through filing stations owned and operated by Employee B. During the testing year, the exploration, production and refining line of business provides 25,000 gallons of lubricating oil, 100,000 gallons of unleaded and 150,000 gallons of leaded gasoline to the retail marketing line of business, and 75,000 gallons of lubricating oil, 500,000 gallons of unleaded gasoline and 15,000 gallons of leaded gasoline to wholesale customers of Employer B. Thus, the exploration, production, and refining line of business provides 75 percent of its output of lubricating oil during the testing year to wholesale customers of Employer B. In addition, because unleaded and leaded gasoline is the same type of property (i.e., gasoline), the exploration, production, and refining line of business provides 67 percent of its output of gasoline products during the testing year to wholesale customers of Employer B. Furthermore, the retail line of business provides lubricating oil and gasoline products to customers of Employer B at different levels in the chain of commercial distribution than the exploration, production, and refining line of business. Under these facts, Employer B's two lines of business satisfy the requirements of this paragraph (d) with respect to both lubricating oil and gasoline products for the testing year.

Example 3. The facts are the same as in *Example 2*. Employer B operates a refinery that produces lubricating oil, gasoline, and other petrochemical products. Employee V is an operating engineer at the refinery who is involved at a stage in the refining process before lubricating oil and gasoline products have been separated from other types of petrochemical products. Employee V performs no other services for Employer B. Absent application of the optional rule in this paragraph (d), Employee V would be considered to provide services to both of Employer B's lines of business. See *Example 11* under paragraph (c)(7) of this section. However, because Employee V's services to the retail marketing line of business contribute solely to providing lubricating oil and gasoline products from the exploration, production, and refining line of business to the retail marketing line of business, under the optional rule in paragraph (d)(3)(i) of this section Employee V is not treated as providing services to the retail marketing line of business.

Example 4. The facts are the same as in *Example 3*. Employee W is a petroleum engineer

who conducts geological studies of potential future drilling sites. Employee W performs no other services for Employer B. Absent application of the optional rule in this paragraph (d), Employee W would be considered to provide services to both of Employer B's lines of business. See *Example 12* under paragraph (c)(7) of this Section. However, because Employee W's services to the retail marketing line of business contribute solely to providing lubricating oil and gasoline products from the exploration, production, and refining line of business to the retail marketing line of business, under the optional rule in paragraph (d)(3)(i) of this section Employee W is not treated as providing services to the retail marketing line of business.

Example 5. The facts are the same as in *Example 4.* Employee Y is a vice president in Employer B's home office. As part of his senior management responsibilities, Employee Y helps to set the rate of production at Employer B's refineries in the United States and also helps to set the price charged at the pump at the retail filling stations owned and operated by Employer B in this country. Absent application of the optional rule in this paragraph (d), Employee X would be considered to provide services to both of Employer B's lines of business within the meaning of paragraph (c)(5) of this section for purposes of satisfying the separate workforce requirement of paragraph (b)(4) of this section. Because Employee X helps to set the price charged at the pump by Employer B's retail marketing line of business, Employee X's services to the retail marketing line of business are not limited to contributing solely to providing lubricating oil and gasoline products from the exploration, production, and refining line of business to the retail marketing line of business, as required under paragraph (d)(3)(i)(B) of this section. Accordingly, even though Employer B's two lines of business satisfy the requirements of this paragraph (d) with respect to both lubricating oil and gasoline products for the testing year, and even though Employer B applies the optional rule in this paragraph (d), Employee X is still considered to provide services to both of Employer B's lines of business.

[T.D. 8376, 56 FR 63442, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32917, June 27, 1994]

§ 1.414(r)–4 Qualified separate line of business—fifty-employee and notice requirements.

(a) *In general.* This section sets forth the rules for determining whether a separate line of business (as determined under § 1.414(r)–3) satisfies the 50-employee and notice requirements of § 1.414(r–1(b)(2)(iv) (B) and (C), respectively.

(b) *Fifty-employee requirement.* A separate line of business satisfies the 50-employee requirement of § 1.414(r)–1(b)(2)(iv)(B) for a testing year only if on each day of the testing year there are at least 50 employees who provide services to the separate line of business for the testing year and do not provide services to any other separate line of business of the employer for the testing year within the meaning of § 1.414(r)–3(c)(5). For this purpose, all employees of the employer are taken into account (including collectively bargained employees), except employees described in § 1.414(q)–1, Q&A–9(g)(i.e., the same employees, subject to certain modifications, who are excluded in determining the number of employees in the top-paid group under section 414(q)(4)).

(c) *Notice requirement*—(1) *General rule.* A separate line of business satisfies the notice requirement of § 1.414(r)–1(b)(2)(iv)(C) for a testing year only if the employer notifies the Secretary that it treats itself as operating qualified separate lines of business for the testing year in accordance with § 1.414(r)–1(b). The employer's notice for the testing year must specify each of the qualified separate lines of business operated by the employer and the section or sections of the Code to be applied on a qualified-separate-line-of-business basis. See § 1.414(r)–1(c). The employer's notice must take the form, must be filed at the time and the place, and must contain any additional information prescribed by the Commissioner in revenue procedures, notices, or other guidance of general applicability. No other notice, whether actual or constructive, satisfies the requirement of this paragraph (c).

(2) *Effect of notice.* Once an employer has provided the notice prescribed in this paragraph (c) for a testing year, and the time for filing the notice for the testing year has expired without its being modified, withdrawn, or revoked, the employer is deemed to have irrevocably elected to apply the requirements of the section or sections of the Code specified in the notice separately with respect to the employees of each qualified separate line of business

specified in the notice for all plan years that begin in the testing year. The Commissioner may, in revenue procedures, notices, or other guidance of general applicability, provide for exceptions to the rule in this paragraph (c)(2) as well as for the effect that will be given to the employer's notice for purposes of any future testing year.

[T.D. 8376, 56 FR 63446, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32919, June 27, 1994]

§ 1.414(r)–5 Qualified separate line of business—administrative scrutiny requirement—safe harbors.

(a) *In general.* A separate line of business (as determined under § 1.414(r)–3 satisfies the administrative scrutiny requirement of § 1.414(r)–1(b)(2)(iv)(D) for a testing year if the separate line of business satisfies any of the safe harbors in paragraphs (b) through (g) of this section for the testing year. The safe harbor in paragraph (b) of this section implements the statutory safe harbor of section 414(r)(3). The safe harbors in paragraphs (c) through (g) of this section constitute the guidelines provided for under section 414(r)(2)(C). A separate line of business that does not satisfy any of the safe harbors in this section nonetheless satisfies the requirement of administrative scrutiny if the employer requests and receives an individual determination from the Commissioner under § 1.414(r)–6 that the separate line of business satisfies the requirement of administrative scrutiny.

(b) *Statutory safe harbor*—(1) *General rule.* A separate line of business satisfies the safe harbor in this paragraph (b) for the testing year only if the highly compensated employee percentage ratio of the separate line of business is—

(i) At least 50 percent; and

(ii) Non more than 200 percent.

(2) *Highly compensated employee percentage ratio.* For purposes of this paragraph (b), the highly compensated employee percentage ratio of a separate line of business is the fraction (expressed as a percentage), the numerator of which is the percentage of the employees of the separate line of business who are highly compensated employees, and the denominator of which is the percentage of all employees of the employer who are highly compensated employees.

(3) *Employees taken into account.* For purposes of this paragraph (b), the employees taken into account are the same employees who are taken into account for purposes of applying section 410(b) with respect to the first testing day. For this purpose, employees described in section 410 (b)(3) and (b)(4) are excluded. However, section 410(b)(4) is applied with reference to the lowest minimum age requirement applicable under any plan of the employer, and with reference to the lowest service requirement applicable under any plan of the employer, as if all the plans were a single plan under § 1.410(b)–6(b)(2). The employees of the separate line of business are determined by applying § 1.414(r)–7 to the employees taken into account under this paragraph (b)(3). An employee is treated as a highly compensated employee for purposes of this paragraph (b) if the employee is treated as a highly compensated employee for purposes of applying section 410(b) with respect to the first testing day. For the definition of ''first testing day,'' see § 1.414(r)–11(b)(7).

(4) *Ten-percent exception.* A separate line of business is deemed to satisfy paragraph (b)(1)(i) of this section for the testing year if at least 10 percent of all highly compensated employees of the employer provide services to the separate line of business during the testing year and do not provide services to any other separate line of business of the employer during the testing year within the meaning of § 1.414(r)–3(c)(5).

(5) *Determination based on preceding testing year.* A separate line of business that satisfied this safe harbor for the immediately preceding testing year (without taking into account the special rule in this paragraph (b)(5)) is deemed to satisfy the safe harbor for the current testing year. The preceding sentence applies to a separate line of business only if the employer designated the same line of business in the immediately preceding testing year as in the current testing year and either—

(i) The highly compensated employee percentage ratio of the separate line of business for the current testing year

does not deviate by more than 10 percent (not 10 percentage points) from the highly compensated employee percentage ratio of the separate line of business for the immediately preceding testing year; or

(ii) No more than five percent of the employees of the separate line of business for the current testing year were employees of a different separate line of business for the immediately preceding testing year, and no more than five percent of the employees of the separate line of business for the immediately preceding testing year are employees of a different separate line of business for the current testing year.

(6) *Examples*. The following examples illustrate the application of the safe harbor in this paragraph (b).

Example 1. (i) Employer A operates three separate lines of business as determined under §1.414(r)–3, that respectively consist of a railroad, an insurance company, and a newspaper. Employer A employs a total of 400 employees, 100 of whom are highly compensated employees. Thus, the percentage of all employees of Employer A who are highly compensated employees in 25 percent. After applying §1.414(r)–7, the distribution of highly and nonhighly compensated employees among Employer A's separate lines of business is as follows:

	Employer-wide	Railroad	Insurance company	Newspaper
Number of Employees	400	100	150	150
Number of HCEs	100	20	50	30
Number of Non-HCEs	300	80	100	120
HCE Percentage	25% (100/400)	20% (20/100)	33% (50/150)	20% (30/150)
HCE Percentage Ratio	N/A	80% (20%/25%)	133% (33%/25%)	80% (20%/25%)

(ii) Because the highly compensated employee percentage ratio of each separate line of business is at least 50 percent and no more than 200 percent, each of Employer A's separate lines of business satisfies the requirements of the safe harbor in this paragraph (b).

Example 2. (i) Employer B operates three separate lines of business as determined under §1.414(r)–3, that respectively consist of a dairy products manufacturer, a candy manufacturer, and a chain of housewares stores. Employer B employs a total of 1,000 employees, 100 of whom are highly compensated employees. Thus, the percentage of all employees of Employer B who are highly compensated employees is 10 percent. After applying §1.414(r)–7, the distribution of highly and nonhighly compensated employees among Employer B's separate lines of business is as follows:

	Employer-wide	Dairy products	Candy	Housewares stores
Number of Employees	1,000	200	500	300
Number of HCEs	100	5	50	45
Number of Non-HCEs	900	195	450	255
HCE Percentage	10% (100/1,000)	2.5% (5/200)	10% (50/500)	15% (45/300)
HCE Percentage Ratio	N/A	25% (2.5%/10%)	100% (10%/10%)	150% (15%/10%)

(ii) Because the highly compensated employee percentage ratio for the dairy products line of business is less than 50 percent, it does not satisfy the requirements of the statutory safe harbor in this paragraph (b). However, because Employer B's other two separate lines of business (candy manufacturing and housewares stores) each has a highly compensated employee percentage ratio that is no less than 50 percent and no greater than 200 percent, they each satisfy the statutory safe harbor in this paragraph (b).

Example 3. (i) The facts are the same as in *Example 2*, except that Employer B operates only two separate lines of business as determined under §1.414(r)–3, one consisting of the dairy products manufacturer and the candy manufacturer, and the other consisting of the chain of housewares stores. After applying §1.414(r)–7, the distribution of highly and nonhighly compensated employees among

Employer B's separate lines of business is as follows:

	Employer-Wide	Candy/Dairy Products	Housewares Stores
Number of Employees	1,000	700	300
Number of HCEs	100	55	45
Number of Non-HCEs	900	645	255
HCE Percentage	10% (100/1,000)	7.9% (55/700)	15% (45/300)
HCE Percentage Ratio	N/A	79% (7.9%/10%)	150% (15%/10%)

(ii) Because the highly compensated employee percentage ratio for both of Employer B's separate lines of business is at least 50 percent and no more than 200 percent, they each satisfy the requirements of the statutory safe harbor in this paragraph (b).

(c) *Safe harbor for separate lines of business in different industries*—(1) *In general*. A separate line of business satisfies the safe harbor in this paragraph (c) for the testing year if it is in a different industry or industries from every other separate line of business of the employer. For this purpose, a separate line of business is in a different industry or industries from every other separate line of business of the employer only if—

(i) The property or services provided to customers of the employer by the separate line of business (as designated by the employer for the testing year under §1.414(r)–2) fall exclusively within one or more industry categories established by the Commissioner for purposes of this paragraph (c); and

(ii) None of the property or services provided to customers of the employer by any of the employer's other separate lines of business (as designated by the employer for the testing year under §1.414(r)–2) falls within the same industry category or categories.

(2) *Optional rule for foreign operations*. For purposes of satisfying this paragraph (c), an employer is permitted to disregard any property or services provided to customers of the employer during the testing year by a foreign corporation or foreign partnership (as defined in section 7701(a)(5)), to the extent that income from the provision of the property or services is not effectively connected with the conduct of the trade or business within the United States within the meaning of section 864(c). Thus, for example, an employer is permitted to take into account only property and services provided to customers of the employer by its domestic subsidiaries and property and services provided by its foreign subsidiaries that generate income effectively connected with the conduct of a trade or business within the United States in determining whether the property or services provided to customers of the employer by a separate line of business fall exclusively within one or more industry categories and also whether the property or services provided by any other separate line of business fall within the same industry category or categories.

(3) *Establishment of industry categories*. The Commissioner shall, by revenue procedure or other guidance of general applicability, establish industry categories for purposes of this paragraph (c).

(4) *Examples*. The following examples illustrate the application of the safe harbor in this paragraph (c). For purposes of these examples, it is assumed that, pursuant to paragraph (c)(3) of this section, the Commissioner has established the following industry categories (among others): transportation equipment and services; banking, insurance, and finance; machinery and electronics; and entertainment, sports, and hotels.

Example 1. Among its other business activities, Employer C operates a commercial airline that constitutes a separate line of business under §1.414(r)–3. In addition, no other separate line of business of Employer C provides to customers of Employer C any property or services in the transportation equipment and services industry category. Under these facts, the separate line of business described in this example satisfies the safe harbor in this paragraph (c).

Example 2. The facts are the same as in *Example 1,* except that Employer C also operates a trucking company that constitutes another separate line of business of Employer C under §1.414(r)–3. Because the commercial airline and the trucking company both provide to customers of Employer C services in the transportation equipment and services industry category, neither separate line of business satisfies the safe harbor in this paragraph (c).

Example 3. Among its other business activities, Employer D operates a commercial bank and luxury hotel that together constitute a single separate line of business under §1.414(r)–3. No other separate line of business of employer D provides to customers of Employer D property or services in either the banking, insurance, or financial industry category, or the entertainment, sports, or hotel industry category. Under these facts, the separate line of business described in this example satisfies the safe harbor in this paragraph (c).

Example 4. The facts are the same as in *Example 3,* except that Employer D also manufactures computers in the United States and abroad. Employer D apportions its computer operations by designating these operations between two separate lines of business, one consisting of its domestic operations located in the United States and the second consisting of its foreign operations by a foreign subsidiary. Because both lines of business provide property and services in the machinery and electronics industry category to customers of Employer D, neither separate line of business would satisfy the safe harbor in this paragraph (c). However, pursuant to the optional rule in paragraph (c)(2) of his section, Employer D disregards the property and services provided by its foreign computer subsidiary. As a result, no other separate line of business of Employer D provides to customers of Employer D any property or services in the machinery and electronics industry category. Under these facts, Employer D's domestic computer operations separate line of business satisfies the safe harbor in this paragraph (c).

(d) *Safe harbor for separate lines of business that are acquired through certain mergers and acquisitions*—(1) *General rule.* A portion of the employer that is acquired through a transaction described in section 410(b)(6)(C) and §1.410(b)–2(f) (i.e., an asset or stock acquisition, merger, or other similar transaction involving a change in the employer of the employees of a trade or business) (the ''acquired line of business'') satisfies the safe harbor in this paragraph (d) for each testing year in the transition period provided in paragraph (d)(3) of this section if each of the following requirements is satisfied—

(i) For each testing year within the transition period the employer designates the acquired line of business as a line of business within the meaning of §1.414(r)–2;

(ii) On the first testing day in each testing year in the transition period:

(A) The acquired line of business constitutes a separate line of business within the meaning of §1.414(r)–3 (taking into account §1.414(r)–1(d)(4));

(B) No more than 10 percent of the employees who are substantial-service employees with respect to the acquired line of business were substantial-service employees with respect to a different separate line of business for the immediately preceding testing year; and

(C) No more than 10 percent of the employees who were substantial-service employees with respect to the acquired line of business for the immediately preceding testing year are substantial-service employees with respect to a different separate line of business in the respective testing year.

(iii) If the transaction described in paragraph (d)(1) of this section occurs after the first testing day in a testing year, the determinations required by paragraphs (d)(1)(ii) (B) and (C) of this section with respect to that testing year are made as of the date of the transaction.

(2) *Employees taken into account.* For purposes of this paragraph (d), the employees taken into account are the same employees who are taken into account for purposes of applying section 410(b) with respect to the first testing day. For this purpose, employees described in section 410(b)(3) and (b)(4) are excluded. However, section 410(b)(4) is applied with reference to the lowest minimum age requirement, and with reference to the lowest service requirement applicable under any plan of the employer that benefits employees of the separate line of business, as if all the plans were a single plan under §1.410(b)–6(b)(2). The employees of the separate line of business are determined by applying §1.414(r)–7 to the employees taken into account under this paragraph (d)(2). 0

(3) *Transition period.* The transition period for purposes of this safe harbor is the period that begins with the first testing year beginning after the date that the transaction described in paragraph (d)(1) of this section occurs. The employer is permitted, but not required, to extend the transition period to include one, two, or three of the testing years immediately succeeding that first testing year.

(4) *Examples.* The following examples illustrate the application of the safe harbor in this paragraph (d).

Example 1. Employer E is treated as operating three qualified separate lines of business pursuant to §1.414(r)–1(b). In 1996, Employer E acquires a company that employs 4,000 employees who manufacture and sell pharmaceutical supplies, and designates that portion as a line of business under §1.414(r)–2. Under §1.414(r)–1(d)(4), the pharmaceutical supplies line of business is deemed to satisfy the requirements to be a qualified separate line of business (other than the 50-employee and notice requirements) for testing year 1996. In addition, the determination of whether Employer E's remaining three lines of business constitute qualified separate lines of business for testing year 1996 is made without taking into account the acquired employees and by disregarding the property and services provided to customers of Employer E by the pharmaceutical supplies line of business.

Example 2. The facts are the same as in *Example 1* except that, by the first testing day in 1997 (Transition Year 1), there are 300 additional substantial-service employees with respect to the pharmaceutical supplies line of business, increasing the total number to 4,300. Of those 300 employees, 250 were substantial-service employees with respect to a different separate line of business for testing year 1996 and 50 are new hires. Assume that, on the first testing day in Transition Year 1, the pharmaceutical supplies line of business satisfies the requirements of §1.414(r)–3 (taking into account §1.414(r)–1(d)(4)) and therefore constitutes a separate line of business. Because 250 is 6 percent of 4,300, no more than ten percent of the employees who are substantial-service employees with respect to the pharmaceutical supplies line of business were substantial- service employees with respect to a different separate line of business for the immediately preceding testing year. The 50 newly hired employees are disregarded in making this determination. Under these facts, the pharmaceutical supplies separate line of business satisfies the safe harbor in this paragraph (d) for Transition Year 1.

Example 3. The facts are the same as in *Example 2,* except that, before the first day of the next testing year (''Transition Year 2''), Employer E permanently transfers 200 of the 4,300 employees who were substantial-service employees with respect to the pharmaceutical line of business on the first testing day in Transition Year 1 to a different line of business and does not hire any additional employees for the pharmaceutical supplies line of business. Therefore, by the first testing day in Transition Year 2, the number of employees who are substantial-service employees with respect to the pharmaceutical line of business of Employer E has decreased from 4,300 to 4,100. Assume that, on that first testing day in Transition Year 2, the pharmaceutical supplies line of business constitutes a separate line of business within the meaning of §1.414(r)–3. Because 200 is approximately 5 percent of 4,300, no more than 10 percent of the employees who were substantial-service employees of the pharmaceutical line of business for Transition Year 1 are not substantial-service employees of the pharmaceutical line of business in Transition Year 2. Under these facts, the pharmaceutical supplies separate line of business continues to satisfy the safe harbor in this paragraph (d) for Transition Year 2.

(e) *Safe harbor for separate lines of business reported as industry segments*—(1) *In general.* A separate line of business satisfies the safe harbor in this paragraph (e) for the testing year if, for the employer's fiscal year ending latest in the testing year, the separate line of business is reported as one or more industry segments on its annual report required to be filed in conformity with either—

(i) Form 10–K, annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (''Form 10–K''); or

(ii) Form 20–F, Annual Report Pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 with Item 18 financials (''Form 20–F''), and the employer timely files either the Form 10–K or Form 20–F with the Securities and Exchange Commission (''SEC'').

(2) *Reported as an industry segment in conformity with Form 10–K or Form 20–F.* For purposes of this paragraph (e), a separate line of business is reported as one or more industry segments in conformity with either Form 10–K or Form 20–F only if—

(i) The separate line of business consists of one or more industry segments within the meaning of paragraphs 10(a),

11(b), and 12 through 14 of the Statement of Financial Accounting Standards No. 14, Financial Reporting for Segments of a Business Enterprise (''FAS 14''); and

(ii) The property or services provided to customers of the employer by the separate line of business (as designated by the employer for the testing year under §1.414(r)–2) is identical to the property or services provided to customers of the employer by the industry segment or segments (as determined under paragraphs 10(a), 11(b), and 12 through 14 of FAS 14).

(3) *Timely filing of Form 10–K or Form 20–F.* For purposes of this paragraph (e), a Form 10–K of Form 20–F is timely filed with the SEC if it is filed within the required period as provided under 17 CFR 240.12b–25(b)(2)(ii). Therefore, the required period for timely filing of the Form 10–K is the 90-day period after the end of the fiscal year covered by the annual report (including the 15-day extension), and the required period for timely filing of the Form 20–F is the 6-month period after the end of the fiscal year covered by the annual report (including the 15-day extension).

(4) *Examples.* The following examples illustrate the application of the safe harbor in this paragraph (e).

Example 1. Among its other business activities, Employer F operates a bearing manufacturing firm that constitutes a separate line of business under §1.414(r)–3. Employer F is required to file an annual Form 10–K with the SEC. On its timely filed Form 10–K, Employer F reports its bearing manufacturing operations as an industry segment in accordance of FAS 14 (as determined under paragraphs 10(a), 11(b), and 12 through 14 of FAS 14). The group of bearing products provided by the separate line of business (as designated by Employer F under §1.414(r)–2) is identical to the group of bearing products provided by the industry segment (as determined under paragraphs 10(a), 11(b), and 12 through 14 of FAS 14). Under these facts, the separate line of business described in this example satisfies the safe harbor in this paragraph (e).

Example 2. The facts are the same as in *Example 1,* except that Employer F has apportioned its bearing manufacturing operations between two separate lines of business as determined under §1.414(r)–3, one engaged in the manufacture of bearings for use in the automotive industry, and a second engaged in the manufacture of bearings for use in the aerospace industry. Because neither separate line of business provides a group of property or services to customers of Employer F that is identical to the group of bearing products provided by the industry segment reported on Employer F's annual Form 10–K, neither separate line of business described in this example satisfies the safe harbor in this paragraph (e).

(f) *Safe harbor for separate lines of business that provide the same average benefits as other separate lines of business*—(1) *General rule.* A separate line of business satisfies the safe harbor in this paragraph (f) for the testing year only if the level of benefits provided to employees of the separate line of business satisfies paragraph (f)(2) or (f)(3) of this section, whichever is applicable.

(2) *Separate lines of business with a disproportionate number of nonhighly compensated employees*—(i) *Applicability of safe harbor.* This paragraph (f)(2) applies to a separate line of business that for the testing year has a highly compensated employee percentage ratio of less than 50 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement.* A separate line of business satisfies this paragraph (f)(2) only if the actual benefit percentage of the group of nonhighly compensated employees of the separate line of business for the testing period that ends with or within the testing year is at least as great as the actual benefit percentage of the group of all other nonhighly compensated employees of the employer for the same testing period. See §1.410 (b)–5(c) and (d)(3)(ii) for the definitions of actual benefit percentage and testing period, respectively. In determining actual benefit percentages for purposes of this paragraph (f)(2)(ii), the special rule in §1.410(b)–5(e)(3) (permitting an employer to determine employee benefit percentages separately for defined contribution and defined benefit plans) may not be used.

(3) *Separate lines of business with a disproportionate number of highly compensated employees*—(i) *Applicability of safe harbor.* This paragraph (f)(3) applies to a separate line of business that for the testing year has a highly compensated employee percentage ratio of more than 200 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement.* A separate line of business satisfies this paragraph (f)(3) only if the actual benefit percentage of

the group of highly compensated employees of the separate line of business for the testing period that ends with or within the testing year is no greater than the actual benefit percentage of the group of all other highly compensated employees of the employer for the same testing period. See §1.410 (b)–5(c) and (d)(3)(ii) for the definitions of actual benefit percentage and testing period, respectively. In determining actual benefit percentages for purposes of this paragraph (f)(3)(ii), the special rule in §1.410(b)–5(e)(3) (permitting an employer to determine employee benefit percentages separately for defined contribution and defined benefit plans) may not be used.

(4) *Employees taken into account*. An employee of a separate line of business (as determined under §1.414(r)–7 is taken into account for a testing period for purposes of this paragraph (f) only if the employee is an employee of the separate line of business on the first testing day, and would not be an excludable employee for purposes of applying the average benefit percentage test of §1.410(b)–5 to a plan for a plan year included in that testing period. In determining whether an employee is an excludable employee for purposes of the average benefit percentage test, the employer is assumed not to be operating qualified separate lines of business under §1.414(r)–1(b). An employee is treated as a highly compensated employee for purposes of this paragraph (f) if the employee is treated as a highly compensated employee for purposes of applying section 410(b) on the first testing day. See §1.414(r)–11(b)(7) for the definition of ''first testing day''.

(5) *Example*. The rules of this paragraph (f) are illustrated by the following example.

Example. (i) Employer G is treated as operating two separate lines of business, Line 1 and Line 2, in accordance with §1.414(r)–1(b). Employer G maintains three qualified plans. Plan A is a calendar-year profit-sharing plan that benefits all employees of Employer G. Plan B is a defined benefit plan with a plan year ending March 31 that benefits all employees of Line 1. Plan C is a defined benefit plan with a plan year ending November 30 that benefits all employees of Line 2.

(ii) In 1995, Line 1 has a highly compensated employee percentage ratio of 25 percent. Employer G's first testing day is March 31. After applying the rules of §1.414(r)–7, the nonhighly compensated employees of Line 1 and Line 2 on March 31, 1995, are N1–N80 and N81–N100, respectively. N1 is an excludable employee under §1.410(b)–6 for purposes of the average benefit percentage test during the testing period that includes the plan years of Plans A, B, and C that end in 1995 (the ''1995 testing period''), and would therefore not be taken into account in determining whether any of those plans satisfied the average benefit percentage test of §1.410(b)–5 for plan years included in that testing period, because N1 does not satisfy the minimum age and service conditions under any plan of the employer. All other employees of Line 1 and Line 2 on March 31, 1995 are nonexcludable employees for purposes of the average benefit percentage test during the 1995 testing period.

(iii) In order for Line 1 to satisfy the requirements of this paragraph (f) for 1995, the actual benefit percentage of N2–N80 for the 1995 testing period under Plans A, B and C must be at least as great as the actual benefit percentage of N81–N100 for the same testing period under the same plans. N1 is not taken into account because N1 is an excludable employees for purposes of the average benefit percentage test for the 1995 testing period. Any other employees who were taken into account for purposes of the average benefit percentage test for the 1995 testing period are excluded because they are not employees of Line 1 or Line 2 on March 31, 1995.

(g) *Safe harbor for separate lines of business that provide minimum or maximum benefits*—(1) *In general*. A separate line of business satisfied the safe harbor in this paragraph (g) for the testing only if the level of benefits provided to employees of the separate line of business satisfies paragraph (g)(2) or (g)(3) of this section, whichever is applicable. For this purpose, the level of benefits is determined with respect to all qualified plans of the employer that benefit employees of the separate line of business for plan years that begin in the testing year.

(2) *Minimum benefit required*—(i) *Applicability*. This paragraph (g)(2) applies to a separate line of business that for the test year has a highly compensated employee percentage ratio of less than 50 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement*. A separate line of business satisfies this paragraph (g)(2) only if one of the following requirements is satisfied—

(A) At least 80 percent of all nonhighly compensated employees of the

separate line of business either accrue a benefit for the plan year that equals or exceeds the defined benefit minimum in paragraph (g)(2)(iii) of this section, receive all allocation for the plan year that equal or exceeds the defined contribution minimum in paragraph (g)(2)(iv) of this section, or accrue a benefit and receive an allocation that together equal or exceed the combined plan minimum in paragraph (g)(4) of this section. The defined benefit minimum must be provided in a defined plan, and the defined contribution minimum must be provided in a defined contribution plan.

(B) The separate line of business would satisfy the requirements of paragraph (g)(2)(ii)(A) of this section if the 80 percent threshold were reduced to 60 percent, and the average of the accrual rates or allocation rates of all nonhighly compensated employees in the separate line of business equals or exceeds the minimum amount described for each individual employee in paragraph (g)(2)(ii)(A) of this section.

(iii) *Defined benefit minimum*—(A) *In general*. The defined benefit minimum for a plan year is the employer-derived accrual that would result in a normal accrual rate for the plan year equal to 0.75 percent of compensation. For purposes of this paragraph (g)(2)(iii), the normal accrual rate is the percentage (not less than 0) determined by subtracting the employee's normalized accrued benefit as of the end of the prior plan year (expressed as a percentage of average annual compensation as of the end of the prior plan year) from the employee's normalized accrued benefit as of the end of the plan year (expressed as a percentage of average annual compensation as of the end of the plan year).

(B) *Normal form and equivalent benefits*. The benefit that is tested for purposes of this paragraph (g)(2)(iii) is the accrued retirement benefit commencing at normal retirement age. If the normal form of benefit for a plan being tested is other than a straight life annuity beginning at a normal retirement age of 65, the benefit must be normalized (within the meaning of §1.401(a)(4)–12) to a straight life annuity commencing at age 65. No adjustment is permitted for early retirement benefits or for any ancillary benefit, including disability benefits.

(C) *Compensation definition*. The underlying definition of compensation used for purposes of determining accrual rates under this paragraph (g)(2)(iii) must be a definition of compensation that automatically satisfies section 414(s) without a test for nondiscrimination (see §1.414(s)–1(c)).

(D) *Average compensation requirement*. For purposes of determining accrual rates, compensation must be average annual compensation within the meaning of §1.401(a)(4)–3(e)(2) determined using a five-year averaging period. The compensation history to be taken into account are all years beginning with the first year in which the employee benefits under the plan, and ending with the last plan year in which the employee participates in the plan. However, a plan may disregard in a reasonable and consistent manner: years before the effective date of these regulations as set forth in §1.414(r)–1(d)(9)(i), years more than 10 years preceding the current plan year, and years for which the employer does not use this paragraph (g)(2) to satisfy this safe harbor with respect to the separate line of business. If a plan provides a defined benefit minimum that uses three consecutive years (in lieu of five) for calculating average annual compensation, the 0.75 percent annual accrual in paragraph (g)(2)(iii)(A) of this section is multiplied by 93.3 percent, resulting in a normal accrual rate equal to 0.70 percent. If a plan provides a defined benefit minimum that uses more than five consecutive years for calculating average annual compensation or the plan is an accumulation plan as defined in §1.401(a)(4)–12, the 0.75 percent annual accrual rate in paragraph (g)(2)(iii)(A) of this section is multiplied by 133.3 percent, resulting in a normal accrual rate equal to 1.0 percent.

(E) *Special rules*. The special rules of §1.401(a)(4)–3(f) apply for purposes of determining whether a benefit accrual satisfies the minimum benefit requirement. For example, benefits may be determined on other than a plan year basis as permitted by §1.401(a)(4)–3(f)(6). A plan described in section 412(i)

may be used to provide the defined benefit minimum described in this paragraph (g)(2). In such case, the rules in §1.416–1, M–17, apply to such a plan. For purposes of this paragraph (g)(2)(iii) an employee is treated as accruing a benefit equal to the minimum benefit in paragraph (g)(2)(iii)(A) of this section if the reason that the employee does not accrue such a benefit is either—

(*1*) The application of a plan provision that applies uniformly to all employees in the plan and limits the service used for purposes of benefit accrual to a specified maximum no less than 25 years, or

(*2*) The employee has attained normal retirement age and fails to accrue a benefit solely because of the provisions of section 411(b)(1)(H)(iii) regarding adjustments for delayed retirement.

(iv) *Defined contribution minimum*—(A) *In general*. The defined contribution minimum for a plan year is an allocation that results in an allocation rate for the plan year (within the meaning of §1.401(a)(4)–2(c)) equal to three percent of an employee's plan year compensation. Plan year compensation must be based on a definition of compensation that automatically satisfies section 414(s) without a test for nondiscrimination (see §1.414(s)–1(c)). For this purpose, allocations that are taken into account to do not include matching contributions described in §1.401(m)–1(a)(2), elective contributions described in §1.401(k)–6, any adjustment in allocation rates permitted under section 401(*l*) or imputed disparity under §1.401(a)(4)–7.

(B) *Modified allocation definition for averaging*. For purposes of determining whether the average allocation rates for all nonhighly compensated employees of the separate line of business satisfy the minimum benefit requirement in paragraph (g)(2)(ii)(B) of this section, matching contributions described in §1.401(m)–1(a)(2) are treated as employer allocations.

(3) *Maximum benefit permitted—(*i*) Applicability*. This paragraph (g)(3) applies to a separate line of business that for the testing year has a highly compensated employee percentage ratio that exceeds 200 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement*. A separate line of business satisfies this paragraph (g)(3) only if one of the following requirements is satisfied—

(A) No highly compensated employee of the separate line of business accrues a benefit for the plan year that results in an accrual rate that exceeds the defined benefit maximum in paragraph (g)(3)(iii) of this section, receives an allocation that exceeds the defined contribution maximum in paragraph (g)(3)(iv) of this section, or accrues a benefit and receives an allocation that together exceed the combined plan maximum in paragraph (g)(4) of this section. All benefits provided by qualified defined benefit plans are subject to the defined benefit maximum, and all benefits provided by qualified defined contribution plans are subject to the defined contribution maximum.

(B) The average of the accrual rates or allocation rates of all highly compensated employees of the separate line of business is no more than 80 percent of the maximum amount described for any individual employee in paragraph (g)(3)(ii)(A) of this section.

(iii) *Defined benefit maximum*—(A) *In general*. The defined benefit maximum is the employer-derived accrued benefit that would result from calculating a normal accrual rate equal to 2.5 percent of compensation.

(B) *Determination of defined benefit maximum*. The accrual rate used for the defined benefit maximum is determined in the same manner as the normal accrual rate used for the defined benefit minimum is determined under paragraph (g)(2)(iii) of this section, except as provided below. Thus, a defined benefit plan may provide, in addition to the defined benefit maximum, any benefit the value of which is not taken into account under paragraph (g)(2)(iii) of this section. For example, a plan may provide qualified disability benefits described in section 411(a)(9) or ancillary benefits described in §1.401(a)(4)–4(e)(2).

(C) *Adjustment for different compensation definitions*. If a plan subject to the defined benefit maximum determines accrual rates by using three consecutive years (in lieu of five) for purposes

of determining average annual compensation, the 2.5 percent annual accrual rate in paragraph (g)(3)(iii)(B) of this section is multiplied by 93.3 percent, resulting in a maximum accrual rate equal to 2.33 percent. Compensation may be less inclusive than the compensation described in paragraph (g)(2)(iii)(C) of this section. However, no adjustment is made to the maximum normal accrual rate because of the use of a definition of compensation that is less inclusive than the compensation described in paragraph (g)(2)(iii)(C) of this section. In addition, no adjustment is made to the maximum normal accrual rate because the plan uses more than five consecutive years for calculating average annual compensation or the plan is an accumulation plan as defined in §1.401(a)(4)–12.

(D) *Adjustment for certain subsidies.* If the plan provides subsidized optional forms of benefit, the accrual rate for purposes of this paragraph (g)(3) must be determined by taking those subsidies into account. An optional form of benefit is considered subsidized if the normalized optional form of benefit is larger than the normalized normal retirement benefit under the plan. In the case of a plan with subsidized optional forms, the determination of accrual rate for the plan year under paragraph (g)(2)(iii)(A) of this section is the percentage (not less than 0) determined by subtracting the largest of the sums of the employee's normalized QJSAs and QSUPPs determined for each age under §1.401(a)(4)–3(d)(1)(ii) as of the end of the prior plan year (expressed as a percentage of average annual compensation as of the end of the prior plan year) from the largest of the sums of the employee's normalized QJSAs and QSUPPs determined for each age under §1.401(a)(4)–3(d)(1)(ii) as of the end of the plan year (expressed as a percentage of average annual compensation as of the end of the plan year).

(iv) *Defined contribution maximum.* The defined contribution maximum is an allocation that results in an allocation rate for the plan year (within the meaning of §1.401(a)(4)–2(c)) equal to 10 percent of an employee's plan year compensation. Compensation may be less inclusive than the compensation described in paragraph (g)(2)(iv)(A) of this section. However, no adjustment is made to the defined contribution maximum because of the use of a definition of compensation that is less inclusive than the compensation described in paragraph (g)(2)(iv)(A) of this section. For this purpose, allocations that are taken into account do not include elective contributions described in §1.401(k)–6, any adjustment in allocation rates permitted under section 401(*l*) or imputed disparity under §1.401(a)(4)–7 but do include employer matching contributions under §1.401(m)–1(f)(12).

(4) *Duplication of benefits or contributions*—(i) *Plans of the same type.* In the case of an employee who benefits under more than one defined benefit plan, the defined benefit minimum required or the defined benefit maximum permitted under this paragraph (g) is determined by reference to the employee's aggregate employer-provided benefit under all qualified defined benefit plans of the employer. In the case of an employee who benefits under more than one defined contribution plan, the defined contribution minimum required or the defined contribution maximum permitted under this paragraph (g) is determined by reference to the employee's aggregate employer-provided allocations under all qualified defined contribution plans of the employer.

(ii) *Plans of different types.* In the case of an employee who benefits under both a defined benefit plan and a defined contribution plan, a percentage of the minimum benefit required or the maximum benefit permitted under this paragraph (g) may be provided in each type of plan as long as the combined percentage equals at least 100 percent in the case of the minimum benefit required and does not exceed 100 percent in the case of the maximum benefit permitted. Thus, for example, if a highly compensated employee benefits under both types of plans and accrues an aggregate adjusted normal accrual rate equal to 1.25 percent of average annual compensation under all defined benefit plans of the employer (i.e, 50 percent of the defined benefit maximum described in paragraph (g)(3)(iii)

of this section), in order to comply with the maximum benefit safe harbor, the employee may not receive an aggregate allocation under all defined contribution plans of the employer in excess of five percent of plan year compensation (i.e., 50 percent of the defined contribution maximum described in paragraph (g)(3)(iv) of this section).

(iii) *Special rule for floor-offset arrangements.* In the case of a floor-offset arrangement (as described in §1.401(a)(4)–8(d)), the minimum or maximum benefit rules are applied to each plan as if the other plan did not exist. Thus, the defined benefit plan must provide at least 100 percent of the defined benefit minimum (or no more than 100 percent of the defined benefit maximum) based on the gross benefit prior to offset, and the defined contribution plan must provide at least 100 percent of the defined contribution minimum (or no more than 100 percent of the defined contribution maximum).

(5) *Certain contingency provisions ignored.* For purposes of this paragraph (g), an employee's accrual or allocation rate is determined without regard to any minimum benefit or any maximum benefit limitation that is applicable to the employee only if the separate line of business fails otherwise to satisfy the requirement of administrative scrutiny.

(6) *Employees taken into account.* For purposes of this paragraph (g), an employee is taken into account if the employee is taken into account for purposes of applying section 410(b) with respect to any testing day for the testing year. For this purpose, employees described in section 410 (b)(3) and (b)(4) are excluded. However, section 410(b)(4) is applied with reference to the lowest minimum age requirement applicable, and with reference to the lowest service requirement applicable under any plan of the employer that benefits employees of the separate line of business, as if all the plans were a single plan under §1.410(b)–6(b)(2). For purposes of the minimum benefit requirement of paragraph (g)(2) of this section, section 410(b)(4) may be applied with reference to the lowest minimum age requirement, and with reference to the lowest minimum service requirement, applicable under any plan of the employer that benefits highly compensated employees of the separate line of business, as if all the plans were a single plan under §1.410(b)–6(b)(2), or, if no plan of the employer benefits highly compensated employees of the separate line of business, with reference to the greatest age and service requirements permitted under section 410(a)(1)(A). The employees of the separate line of business are determined by applying §1.414(r)–7 to the employees taken into account under this paragraph (g)(6). An employee is treated as a highly compensated employee for purposes of this paragraph (g) if the employee is treated as a highly compensated employee for purposes of applying section 410(b) on any testing day for the testing year. For the definition of ''testing day,'' see §1.414(r)–11(b)(6).

[T.D. 8376, 56 FR 63446, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32919, June 27, 1994; T.D. 9169, 69 FR 78153, Dec. 29, 2004]

§1.414(r)–6 Qualified separate line of business—administrative scrutiny requirement—individual determinations.

(a) *In general.* A separate line of business (as determined under §1.414(r)–3) that does not satisfy any of the safe harbors in §1.414(r)–5 for a testing year nonetheless satisfies the administrative scrutiny requirement of §1.414(r)–1(b)(2)(iv)(D) if the employer requests and receives from the Commissioner an individual determination under this section that the separate line of business satisfies the requirement of administrative scrutiny for the testing year. This section implements the individual determinations provided for under section 414(r)(2)(C). The Commissioner shall issue such an individual determination only when it is consistent with the purpose of section 414(r), taking into account the nondiscrimination requirements of sections 401(a)(4) and 410(b). Paragraph (b) of this section authorizes the Commissioner to establish procedures for requesting and granting individual determinations.

(b) *Authority to establish procedures.* The Commissioner may, in revenue rulings and procedures, notices, and other guidance, published in the Internal Revenue Bulletin (see

§ 601.601(d)(2)(ii)(b) of this chapter), provide any additional guidance that may be necessary or appropriate for requesting and granting individual determinations under this section. For example, such guidance may specify the circumstances in which an employer may request an individual determination and factors to be taken into account in deciding whether to grant a favorable individual determination. In addition, such guidance may describe situations that automatically fail the administrative scrutiny requirement.

[T.D. 8376, 56 FR 63452, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32920, June 27, 1994]

§ 1.414(r)–7 Determination of the employees of an employer's qualified separate lines of business.

(a) *Introduction*—(1) *In general.* This section provides the rules for determining the employees of each qualified separate line of business operated by an employer. Paragraph (a)(2) of this section lists the specific provisions of the regulations for which these rules apply. Paragraph (b) of this section provides the procedure for assigning the employees of the employer among the qualified separate lines of business of the employer and for determining the day or days on which such assignments must be made. Under this procedure, each employee (i.e., a substantial-service employee or a residual shared employee as defined in § 1.414(r)–11(b)(2) and (4)) is assigned to a single qualified separate line of business in a consistent manner for all purposes listed in paragraph (a)(2) of this section with respect to the testing year and plan years beginning within the testing year. Paragraph (c) of this section provides methods for allocating residual shared employees among qualified separate lines of business.

(2) *Purposes for which this section applies.* This section applies solely for purposes of determining whether—

(i) A separate line of business satisfies the statutory safe harbor of § 1.414(r)–5(b) for a testing year (see § 1.414(r)–5(b)(3) for the employees taken into account for this purpose);

(ii) A separate line of business satisfies the merger and acquisition safe harbor of § 1.414(r)–5(d) for a testing year (see § 1.414(r)–5(d)(2) for the employees taken into account for this purpose);

(iii) A separate line of business satisfies the average benefits safe harbor of § 414(r)–5(f) for a testing year (see § 414(r)–5(f)(4) for the employees taken into account for this purpose);

(iv) A separate line of business satisfies the minimum or maximum benefits safe harbor of § 414(r)–5(g) for a testing year (see § 1.414(r)–5(g)(6) for the employees taken into account for this purpose);

(v) A plan of the employer satisfies sections 410(b) and 401(a)(4) for a plan year (see § 414(r)–8(d)(3) for the employees taken into account for this purpose); or

(vi) A plan of the employer satisfies section 401(a)(26) for a plan year (see § 414(r)–9(c)(3) for the employees taken into account for this purpose).

(b) *Assignment procedure*—(1) *In general.* To apply the provisions listed in paragraph (a)(2) of this section with respect to a testing year or plan year, as the case may be, each of the employees taken into account under that provision must be assigned to a qualified separate line of business of the employer on one or more testing days (or section 401(a)(26) testing days) during the year. The first day for which this assignment procedure is required for a testing year is the first testing day. See § 414(r)–11(b)(6), (7) and (8) (definitions of ''testing day'', ''first testing day'' and ''section 401(a)(26) testing day''). Section § 414(r)–8 may require that the assignment procedure be repeated for testing days that fall after the first testing day (including testing days that fall after the close of the testing year in a plan year that begins in the testing year). Accordingly, new employees may be taken into account for the first time on these later testing days who were not taken into account on the first testing day. Section § 414(r)–9 may have the same effect with respect to section 401(a)(26) testing days that fall after the first testing day.

(2) *Assignment for the first testing day.* The employees taken into account under a provision described in paragraph (a)(2) of this section with respect to the first testing day for a testing

year are assigned among the employer's qualified separate lines of business by applying the following procedure to each of those employees—

(i) An employee who is a substantial-service employee with respect to a qualified separate line of business within the meaning of § 414(r)–11(b)(2) must be assigned to that qualified separate line of business;

(ii) An employee who is a residual shared employee within the meaning of § 414(r)–11(b)(4) must be assigned to a qualified separate line of business under paragraph (c) of this section.

Each employee assigned to a qualified separate line of business under paragraph (b)(2)(i) of this section or this paragraph (b)(2)(ii) remains assigned to the same qualified separate line of business for all purposes with respect to the testing year listed in paragraph (a)(2) of this section and for all plan years beginning in that testing year. Once an employee is assigned to a qualified separate line of business with respect to a particular testing day or section 401(a)(26) testing day, that employee remains assigned to that qualified separate line of business after the employee terminates employment. However, after the employee terminates employment, that employee will in most cases not be taken into account with respect to a subsequent testing day or section 401(a)(26) testing day for purposes of applying one or more of the provisions in paragraph (a)(2) of this section.

(3) *Assignment of new employees for subsequent testing days.* After the first testing day for the testing year, the employees taken into account under a provision described in paragraph (a)(2) of this section with respect to a subsequent testing day (or a section 401(a)(26) testing day) for the testing year may include one or more employees who previously have not been assigned to a qualified separate line of business for any purpose listed in paragraph (a)(2) of this section with respect to the testing year. An employee may not previously have been assigned to a qualified separate line of business for any purpose with respect to the testing year if, for example, the employee has just been hired or has just become a nonexcludable employee. Previously unassigned employees are assigned among the employer's qualified separate lines of business by applying the procedure in paragraph (b)(2) of this section to those employees. In determining whether an employee who is not employed by the employer during the testing year is a substantial-service or a residual shared employee with respect to a qualified separate line of business, § 414(r)–3(c)(5) is applied with reference to services performed by the employee during a period in the immediately succeeding testing year that are reasonably representative of the employee's services for the employer.

(4) *Special rule for employers using annual option under section 410(b).* Notwithstanding the fact that paragraphs (b)(1) through (b)(3) of this section generally only require employees to be assigned on testing days beginning with the first testing day, if a plan is tested under section 410(b) using the annual option of § 410(b)–8(a)(4) (including for purposes of the average benefit percentage test), employees must be assigned on every day of the plan year of that plan for purposes of this paragraph (b). Thus, all employees who provide services at any time during the plan year of a plan that is tested using the annual option of § 1.410(b)–8(a)(4) must be assigned to a line of business even if they terminate employment before the first testing day within the meaning of § 414(r)–11(b)(7) of the testing year in which the plan year begins.

(c) *Assignment and allocation of residual shared employees*—(1) *In general.* All residual shared employees must be allocated among an employer's qualified separate lines of business under one of the allocation methods provided in paragraphs (c)(2) through (5) of this section. An employer is permitted to select which method of allocation to apply for the testing year to residual shared employees. However, the same allocation method must be used for all of the employer's residual shared employees and for all purposes listed in paragraph (a)(2) of this section with respect to the testing year.

(2) *Dominant line of business method of allocation*—(i) *In general.* Under the method of allocation in this paragraph (c)(2), all residual shared employees are allocated to the employer's dominant

line of business. This method does not apply unless the employer has a dominant line of business within the meaning of paragraph (c)(2)(ii) or (c)(2)(iv) of this section. If an employer has more than one dominant line of business under this paragraph (c), the employer must select which qualified separate lines of business is its dominant line of business.

(ii) *Dominant line of business.* An employer's dominant line of business is that qualified separate line of business that has an employee assignment percentage of at least 50 percent.

(iii) *Employee assignment percentage*—(A) *Determination of percentage.* The employee assignment percentage of a qualified separate line of business is the fraction (expressed as a percentage)—

(*1*) The numerator of which is the number of substantial-service employees with respect to the qualified separate line of business who are assigned to that line of business under paragraph (b) of this section; and

(*2*) The denominator of which is the total number of substantial-service employees who are assigned to all qualified separate lines of business of the employer under paragraph (b) of this section.

(B) *Employees taken into account.* The employee assignment percentage is calculated solely with respect to employees who are taken into account for purposes of satisfying section 410(b) with respect to the first testing day. Therefore, this percentage is calculated only once for all purposes with respect to a testing year. The employees described in section 410(b)(3) and (4) are excluded. However, section 410(b)(4) is applied with reference to the lowest minimum age requirement applicable under any plan of the employer, and with reference to the lowest service requirement applicable under any plan of the employer, as if all the plans were a single plan under §1.410(b)–6(b)(2).

(iv) *Option to apply reduced percentage.* An employer is permitted to determine whether it has a dominant line of business by substituting 25 percent for 50 percent in paragraph (c)(2)(ii) of this section. This option is available for a testing year only if the qualified separate line of business satisfies one of the following requirements:

(A) The qualified separate line of business accounts for at least 60 percent of the employer's gross revenues for the employer's latest fiscal year ending in the testing year.

(B) The employee assignment percentage of the qualified separate line of business would be at least 60 percent if collectively bargained employees were taken into account.

(C) Each qualified separate line of business of the employer satisfies the statutory safe harbor of §1.414(r)–5(b), the average benefits safe harbor of §1.414(r)–5(f), or the minimum or maximum benefits safe harbor of §1.414(r)–5(g). Whether a qualified separate line of business satisfies one of these safe harbors is determined after the application of this section, including the assignment of all residual shared employees under this paragraph (c)(2).

(D) The employee assignment percentage of the qualified separate line of business is at least twice the employee assignment percentages of each of the employer's other qualified separate lines of business.

(v) *Examples.* The following examples illustrate the application of the method of allocation in this paragraph (c)(2).

Example 1. (i) Employer A operates four qualified separate lines of business as determined under §1.414(r)–1(b) for the testing year, consisting of a software developer, a health food products supplier, a real estate developer, and a ski equipment manufacturer. In applying this section for the first testing day with respect to the testing year, Employer A determines that it has a total of 21,000 employees, of whom 10,000 are substantial-service employees not excludable under section 410(b)(3) or (b)(4). Pursuant to paragraph (b) of this section, these 10,000 employees are assigned among Employer A's qualified separate lines of business as follows:

	Software developer	Health food	Real estate	Ski equipment
Substantial-Service Employees	2,500	1,000	2,500	4,000
Percentage Assigned to QSLOB	25%	10%	25%	40%

(ii) Under these facts, Employer A is not permitted to apply the method of allocation in paragraph (c)(2)(ii) of this section, because none of its qualified separate lines of business satisfies the 50 percent requirement in paragraph (c)(3)(ii) of this section.

Example 2. The facts are the same as in *Example 1*, except that, after allocating all residual shared employees to the ski equipment line of business, the software, ski equipment and health food supplier lines of business each would satisfy the statutory safe harbor of §1.414(r)–5(b), and that the real estate development line of business would satisfy the minimum or maximum benefits safe harbor of §1.414(r)–5(g). Under these facts, Employer A is permitted to apply the method of allocation in this paragraph (c)(2) to allocate all its residual shared employees to the ski equipment line of business, because the employee assignment percentage of the ski equipment line of business exceeds 25 percent and each qualified separate line of business satisfies either the statutory safe harbor of §1.414(r)–5(b) or the minimum or maximum benefits safe harbor of §1.414(r)–5(g).

Example 3. (i) The facts are the same as in *Example 1*, except that, Employer A chooses not to satisfy the minimum or maximum benefits safe harbor of §1.414(r)–5(g). Instead, Employer A combines the real estate developer and ski equipment manufacturer into a single line of business. As a result, Employer A has three qualified separate lines of business as determined under §1.414(r)–1(b). Assume that no residual shared employee becomes a substantial-service employee as a result of the new combination. Employer A's substantial-service employees are assigned among Employer A's qualified separate lines of business as follows:

	Software developer	Health food	Real estate/ ski equipment
Substantial-Service Employees	2,500	1,000	6,500
Percentage Assigned to QSLOB	25%	10%	65%

(ii) Under these facts, Employer A is permitted to apply the method of allocation in this paragraph (c)(2) to allocate all its residual shared employees to the combined real estate development and ski equipment manufacturing line of business, because more than 50 percent of Employer A's substantial-service employees that are taken into account for the first testing day are assigned to that qualified separate line of business.

Example 4. (i) The facts are the same as in *Example 1*, except that, of the remaining 11,000 employees of Employer A, 10,000 employees are substantial-service employees who are collectively bargained employees. Pursuant to paragraph (b) of this section, the 10,000 substantial-service employees and the 10,000 substantial-service employees who are collectively bargained employees are assigned among Employer A's qualified separate lines of business as follows:

	Software developer	Health food	Real estate	Ski equipment
Substantial-Service Employees	2,500	1,000	2,500	4,000
Percentage of total substantial-service employees assigned to QSLOB	25%	10%	25%	40%
Substantial-Service Employees (including collectively bargained employees)	2,500	1,000	2,500	14,000
Percentage of total employees (including collectively bargained employees) assigned to QSLOB	12.5%	5%	12.5%	70%

(ii) Thus, the ski equipment line of business satisfies the 25-percent threshold in paragraph (c)(2)(iv) of this section. In addition, the ski equipment's percentage of substantial-service employees is at least 60 percent when taking into account substantial-service employees who are collectively bargained employees and therefore satisfies the requirement under paragraph (c)(2)(iv)(B) of this section. Under these facts, Employer A is permitted to apply the method of allocation in this paragraph (c)(2) to allocate all its residual shared employees to the ski equipment line of business.

(3) *Pro-rata method of allocation*—(i) *In general*. Under the method of allocation in this paragraph (c)(3), all residual shared employees are allocated among an employer's qualified separate lines of business in proportion to the employee assignment percentage of each qualified separate line of business, as determined under paragraph (c)(2)(iii) of this section.

(ii) *Allocation procedure.* The procedure for allocating residual shared employees under the method in this paragraph (c)(3) is as follows—

(A) The number of highly compensated residual shared employees who are allocated to each qualified separate line of business is equal to the product determined by multiplying the total number of highly compensated residual shared employees of the employer by the employee assignment percentage determined with respect to the qualified separate line of business under paragraph (c)(3)(i) of this section;

(B) The number of nonhighly compensated residual shared employees who are allocated to each qualified separate line of business is equal to the product determined by multiplying the total number of nonhighly compensated residual shared employees of the employer by the employee assignment percentage determined with respect to the qualified separate line of business under paragraph (c)(3)(i) of this section;

(C) For purposes of this procedure, the employer is permitted to determine which highly compensated residual shares employees and which nonhighly compensated residual shared employees are allocated to each qualified separate line of business, provided that the required number of highly and nonhighly compensated residual shared employees are allocated to each qualified separate line of business.

(iii) *Examples.* The following example illustrates the application of the method of allocation in this paragraph (c)(4).

Example 1. The facts that are the same as in *Example 1* under paragraph (c)(2)(v) of this section except that there are no additional residual shared employees after the first testing day. Of Employer A's 1,000 residual shared employees, 800 are highly compensated employees and 200 are nonhighly compensated employees. Employer A applies the pro-rata method of allocation in this paragraph (c)(3). Under these facts, the 1,000 residual shared employees are allocated among Employer A's qualified separate lines of business as follows:

	Software developer	Health food	Real estate	Ski equipment
Substantial-Service Employees	2,500	1,000	2,500	4,000
Percentage Assigned to QSLOB ("employee assignment percentage")	25%	10%	25%	40%
Residual Shared HCEs	200	80	200	320
Allocated to QSLOB	(25%X800)	(10%X800)	(25%X800)	(40%X200)
Residual Shared NHCEs	50	20	50	80
Allocated to QSLOB	(25%X200)	(10%X200)	(25%X200)	(40%X200)

(4) *HCE percentage ratio method of allocation*—(i) *In general.* Under the method of allocation in this paragraph (c)(4), all residual shared employees are allocated among an employer's qualified separate lines of business according to the highly compensated employee percentage assignment ratio of each qualified separate line of business.

(ii) *Highly compensated employee percentage assignment ratio.* For purposes of this paragraph (c)(4), the highly compensated employee percentage assignment ratio of a qualified separate line of business is the fraction expressed as a percentage)—

(A) The numerator of which is the percentage of all employees who have previously been assigned to the qualified separate line of business under this section with respect to the testing year who are highly compensated employees; and

(B) The denominator of which is the percentage of all employees who have previously been assigned to any qualified separate line of business under this section with respect to the testing year who are highly compensated employees.

Thus, the highly compensated employee percentage assignment ratio of each of the employer's qualified separate lines of business is recalculated each time a residual shared employee is allocated to a qualified separate line of business under this paragraph (c)(5).

(iii) *Allocation procedure.* The procedure for allocating all residual shared

employees under the method in this paragraph (c)(4) is as follows—

(A) If there are any qualified separate lines of business with a highly compensated employee percentage assignment ratio of less than 50 percent (as determined immediately before the employee is allocated to a qualified separate line of business), the highly compensated residual shared employee must be allocated to one of these qualified separate lines of business;

(B) If there are any qualified separate lines of business with a highly compensated employee percentage assignment ratio of greater than 200 percent (as determined immediately before the employee is allocated to a qualified separate line of business), the nonhighly compensated residual shared employee must be allocated to one of these qualified separate lines of business;

(C) If there are no qualified separate lines of business with a highly compensated employee percentage assignment ratio less than 50 percent, a highly compensated residual shared employee may be allocated to any qualified separate line of business with a highly compensated employee percentage assignment ratio of no more than 200 percent, provided that the employee's allocation to the qualified separate line of business does not cause its highly compensated employee percentage assignment ratio to exceed 200 percent (as determined immediately after the employee is allocated to the qualified separate line of business);

(D) If there are no qualified separate lines of business with a highly compensated employee percentage assignment ratio greater than 200 percent, a nonhighly compensated residual shared employee may be allocated to any qualified separate line of business with a highly compensated employee percentage assignment ratio of no less than 50 percent, provided that the employee's allocation to the qualified separate line of business does not cause its highly compensated employee percentage assignment ratio to fall below 50 percent (as determined immediately after the employee is allocated to the qualified separate line of business);

(E) For purposes of this procedure, the employer is permitted to determine which highly compensated residual shared employees and which nonhighly compensated residual shared employees are allocated to each qualified separate line of business, provided that the requirements of this paragraph (c)(4)(iii) are satisfied.

(5) *Small group method*—(i) *In general*. Under the method of allocation provided for in this paragraph (c)(5), each residual shared employee is allocated to a qualified separate line of business chosen by the employer. This method does not apply unless all of the requirements of paragraphs (c)(5)(ii), (iii), and (iv) of this section are satisfied.

(ii) *Size of group*. The total number of the employer's residual shared employees allocated under this paragraph (c) must not exceed three percent of all of the employer's employees. For this purpose, the employer's employees include only those employees taken into account under paragraph (c)(2)(iii)(B) of this section.

(iii) *Composition of qualified separate line of business*. The qualified separate line of business to which the residual shared employee is allocated must have an employee assignment percentage under paragraph (c)(2)(iii) of this section of at least ten percent. In addition, the qualified separate line of business to which the residual shared employee is allocated must satisfy the statutory safe harbor under §1.414(r)–5(b) after the employee is so allocated.

(iv) *Reasonable allocation*. The allocation of residual shared employees under the small group method provided for in this paragraph (c)(5) must be reasonable. Reasonable allocations generally include allocations that are based on the level of services that the residual shared employees provide to the employer's qualified separate lines of business, the similar treatment of similarly situated residual shared employees, and other bona fide business criteria; in contrast, an allocation that is designed to maximize benefits for select employees is not considered a reasonable allocation. For example, allocation of all residual shared employees who work in the same department, or at the same location, to the same qualified separate line of business would be an indication of reasonableness. However, allocation of a group of

similarly situated residual shared employees to a qualified separate line of business for which they provide minimal services might not be considered reasonable. In addition, the allocation of the professional employees of a department to one qualified separate line of business and the allocation of the support staff of the same department to a different qualified separate line of business would not be reasonable.

[T.D. 8376, 56 FR 63453, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32920, June 27, 1994]

§ 1.414(r)–8 Separate application of section 410(b).

(a) *General rule*. If an employer is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with § 1.414(r)–1(b) for a testing year, the requirements of section 410(b) must be applied in accordance with this section separately with respect to the employees of each qualified separate line of business for purposes of testing all plans of the employer for plan years that begin in the testing year (other than a plan tested under the special rule for employer-wide plans in § 1.414(r)–(c)(2)(ii) for such a plan year). Conversely, if an employer is not treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with § 1.414(r)–1(b) for a testing year, the requirements of section 410(b) must be applied on an employer-wide basis for purposes of testing all plans of the employer for plan years that begin in the testing year. See § 1.414(r)–1(c)(2) and (d)(6). Paragraph (b) of this section explains how the requirements of section 410(b) are applied separately with respect to the employees of a qualified separate line of business for purposes of testing a plan. Paragraph (c) of this section explains the coordination between sections 410(b) and 401(a)(4). Paragraph (d) of this section provides certain supplementary rules necessary for the application of this section.

(b) *Rules of separate application*—(1) *In general*. If the requirements of section 410(b) are applied separately with respect to the employees of each qualified separate line of business operated by the employer for a testing year, a plan (other than a plan that is tested under the special rule for employer-wide plans in § 1.414(r)–1(c)(2)(ii) for a plan year) satisfies the requirements of section 410(b) only if—

(i) The plan satisfies section 410(b)(5)(B) of an employer-wide basis; and

(ii) The plan satisfies section 410(b) on a qualified-separate-line-of-business basis.

(2) *Satisfaction of section 410(b)(5)(B) on an employer-wide basis*—(i) *General rule*. Section 410(b)(5)(B) provides that a plan is not permitted to be tested separately with respect to the employees of a qualified separate line of business unless the plan benefits a classification of employees found by the Secretary to be nondiscriminatory. A plan satisfies this requirement only if the plan satisfies either the ratio percentage test of § 1.410(b)–2(b)(2) or the nondiscriminatory classification test of § 1.410(b)–4 (without regard to the average benefit percentage test of § 1.410(b)–5), taking into account the other applicable provisions of §§ 1.410(b)–1 through 1.410(b)–10. For this purpose, the nonexcludable employees of the employer taken into account in testing the plan under section 410(b) are determined under § 1.410(b)–6, without regard to the exclusion in § 1.410(b)–6(e) for employees of other qualified separate lines of business of the employer. Thus, in testing a plan separately with respect to the employees of one qualified separate line of business under this paragraph (b)(2), the otherwise nonexcludable employees of the employer's other qualified separate lines of business are not treated as excludable employees. However, under the definition of ''plan'' in paragraph (d)(2) of this section, these employees are not treated as benefiting under the plan for purposes of applying this paragraph (b)(2).

(ii) *Application of facts and circumstances requirements under nondiscriminatory classification test*. The fact that an employer has satisfied the qualified-separate-line-of-business requirements in §§ 1.414(r)–1 through 1.414(r)–7 is taken into account in determining whether a classification of employees benefiting under a plan that falls between the safe and unsafe harbors satisfies § 1.410(b)–4(c)(3) (facts and circumstances requirements). Except

in unusual circumstances, this fact will be determinative.

(iii) *Modification of unsafe harbor percentage for plans satisfying ratio percentage test at 90 percent level*—(A) *General rule*. If a plan benefits a group of employees for a plan year that would satisfy the ratio percentage test of §1.410(b)–2(b)(2) on a qualified-separate-line-of-business basis under paragraph (b)(3) of this section if the percentage in §1.410(b)–2(b)(2) were increased to 90 percent, the unsafe harbor percentage in §1.410(b)–4(c)(4)(ii) for the plan is reduced by five percentage points (not five percent) for the plan year and is applied without regard to the requirement that the unsafe harbor percentage not be less than 20 percent. Thus, if the requirements of this paragraph (b)(2)(iii)(A) are satisfied, the unsafe harbor percentage in §1.410(b)–4(c)(4)(ii) is treated as 35 percent, reduced by ¾ of a percentage point for each whole percentage point by which the nonhighly compensated employee concentration percentage exceeds 60 percent.

(B) *Facts and circumstances alternative*. If a plan satisfies the requirements of paragraph (b)(2)(iii)(A) of this section, but has a ratio percentage on an employer-wide basis that falls below the unsafe harbor percentage determined under paragraph (b)(2)(iii)(A) of this section, the plan nonetheless is deemed to satisfy section 410(b)(5)(B) on an employer-wide basis if the Commissioner determines that, on the basis of all of the relevant facts and circumstances, the plan benefits such employees as qualify under a classification of employees that does not discriminate in favor of highly compensated employees.

(3) *Satisfaction of section 410(b) on a qualified-separate-line-of-business basis*. A plan satisfies section 410(b) on a qualified-separate-line-of-business basis only if the plan satisfies either the ratio percentage test of §1.410(b)–2(b)(2) or the average benefit test of §1.410(b)–2(b)(3) (including the nondiscriminatory classification test of §1.410(b)–4 and the average benefit percentage test of §1.410(b)–5), taking into account the other applicable provisions of §§1.410(b)–1 through 1.410(b)–10. For this purpose, the non-excludable employees of the employer taken into account in testing the plan under section 40(b) are determined under §1.410(b)–6, taking into account the exclusion in §1.410(b)–6(e) for employees of other qualified separate lines of business of the employer. Thus, in testing a plan separately with respect to the employees of one qualified separate line of business under this paragraph (b)(3), all employees of the employer's other qualified separate lines of business are treated as excludable employees.

(4) *Examples*. The following examples illustrate the application of this paragraph (b).

Example 1. (i) Employer A is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with §1.414(r)–1(b) for the 1994 testing year with respect to all of its plans. Employer A operates two qualified separate lines of business as determined under §1.414(r)–1(b)(2), Line 1 and Line 2. Employer A maintains only two plans, Plan X which benefits solely employees of Line 1, and Plan Y which benefits solely employees of Line 2. In testing Plan X under section 410(b) with respect to the first testing day for the plan year of Plan X beginning in the 1994 testing year, it is determined that Employer A has 2,100 nonexcludable employees, of whom 100 are highly compensated employees and 2,000 are nonhighly compensated employees. After applying §1.414(r)–7 to these employees, 50 of the highly compensated employees and 100 of the nonhighly compensated employees are treated as employees of Line 2, and the remaining 50 highly compensated employees and the remaining 1,900 nonhighly compensated employees are treated as employees of Line 1.

(ii) All of the highly compensated employees and 1,300 of the nonhighly compensated employees who are treated as employees of Line 1 benefit under Plan X. Thus, on an employer-wide basis, Plan X benefits 50 percent of all Employer A's highly compensated employees (50 out of 100) and 65 percent of all Employer A's nonhighly compensated employees (1,300 out of 2,000). Plan X consequently has a ratio percentage determined on an employer-wide basis of 130 percent (65% ÷ 50%), see §1.410(b)–9, and could satisfy section 410(b) under the ratio percentage test of §1.410(b)–2(b)(2) if that section were applied on an employer-wide basis without regard to the provisions of this paragraph (b). Under paragraph (a) of this section, however, the requirements of section 410(b) must be applied separately with respect to the employees of each qualified separate line of business operated by Employer A for all plans of Employer A for plan years that begin in the 1994 testing year. This rule does

not apply to plans tested under the special rule for employer-wide plans in §1.414(r)–1(c)(2)(ii). Plan X benefits only 65 percent of the nonhighly compensated employees of Employer A, however, and therefore cannot satisfy the 70 percent requirement necessary to be tested under that rule. As a result, for the plan year of Plan X beginning in the 1994 testing year, Plan X is not permitted to satisfy section 410(b) on an employer-wide basis and, instead, is only permitted to satisfy section 410(b) separately with respect to the employees of each qualified separate line of business operated by Employer A, in accordance with paragraphs (b)(2) and (b)(3) of this section.

Example 2. The facts are the same as in *Example 1.* All of the 50 highly compensated employees treated as employees of Line 2 benefit under Plan Y, and 80 of the 100 nonhighly compensated employees treated as employees of Line 2 benefit under Plan Y. Thus, Plan Y benefits 50 percent of all Employer A's highly compensated employees (50 out of 100) and only 4 percent of all Employer A's nonhighly compensated employees (80 out of 2,000). Thus, while Plan Y has a ratio percentage of 80 percent (80% ÷ 100%) on a qualified-separate-line-of-business basis, it has a ratio percentage of only 8 percent (4% ÷ 50%) on an employer-wide basis. See §1.410(b)–9. Under §1.410(b)–4(c)(4)(iii), the nonhighly compensated employee concentration percentage is 2,000/2,100 or 95 percent. Because 8 percent is less than 20 percent (the unsafe harbor percentage applicable to Employer A under §1.410(b)–4(c)(4)(ii)), Plan Y does not satisfy the nondiscriminatory classification test of §1.410(b)–4 on an employer-wide basis. Nor does Plan Y satisfy the ratio percentage test of §1.410(b)–2(b)(2) on an employer-wide basis, since 8 percent is less than 70 percent. Under these facts, Plan Y does not satisfy section 410(b)(5)(B) on an employer-wide basis in accordance with paragraph (b)(2) of this section for the plan year of Plan Y beginning in the 1994 testing year, and therefore fails to satisfy section 410(b) for that year. This is true even though Plan Y satisfies section 410(b) on a qualified-separate-line-of-business basis in accordance with paragraph (b)(3) of this section.

Example 3. The facts are the same as in *Example 2,* except that all of the employees treated as employees of Line 2 benefit under Plan Y. Thus, Plan Y benefits 50 percent of all of Employer A's highly compensated employees (50 out of 100) and 5 percent of all of Employer A's nonhighly compensated employees (100 out of 2,000). Plan Y therefore has a ratio percentage of 100 percent (100% ÷ 100%) on a qualified-separate-line-of-business basis and a ratio percentage of 10 percent (5% ÷ 50%) on an employer-wide basis. Because Plan Y has a ratio percentage of at least 90 percent on a qualified-separate-line-of-business basis, a reduced unsafe harbor percentage applies to Plan Y under paragraph (b)(2)(iii)(A) of this section. The reduced unsafe harbor percentage applicable to Plan Y is 8.75 percent because Employer A's nonhighly compensated employee concentration percentage is 95 percent. Plan Y's employer-wide ratio percentage of 10 percent therefore exceeds the unsafe harbor percentage. Plan Y thus satisfies section 410(b)(5)(B) on an employer-wide basis in accordance with paragraph (b)(2) of this section for the plan year of Plan Y beginning in the 1994 testing year. Plan Y also satisfies section 410(b) on a qualified-separate-line-of-business basis in accordance with paragraph (b)(3) of this section.

Example 4. The facts are the same as in *Example 3,* except that Employer A's total nonexcludable nonhighly compensated employees are 2,500 (rather than 2,000), of whom 100 are treated as employees of Line 2 and of whom 90 benefit under Plan Y. Plan Y has a ratio percentage of 90 percent (90% ÷ 100%) on a qualified-separate-line-of-business basis, and Employer A's nonhighly compensated employee concentration percentage is 2,500/2,600 or 96 percent. Thus, the reduced unsafe harbor percentage applicable to Plan Y under paragraph (b)(2)(iii)(A) of this section is 8 percent. Plan Y benefits 50 percent of all of Employer A's highly compensated employees (50 out of 100) and 3.6 percent of all of Employer A's nonhighly compensated employees (90 out of 2,500). Plan Y therefore has a ratio percentage of only 7.2 percent (3.6% ÷ 50%) on an employer-wide basis, which falls below the reduced unsafe harbor percentage of 8 percent. Nonetheless, under paragraph (b)(2)(iii)(B) of this section, Plan Y will be deemed to satisfy section 410(b)(5)(B) on an employer-wide basis if the Commissioner determines that, on the basis of all of the relevant facts and circumstances, the plan benefits such employees as qualify under a classification of employees that does not discriminate in favor of highly compensated employees.

Example 5. (i) The facts are the same as in *Example 1,* except that Plan X benefits only 950 of the employees of Line 1. Assume Plan X satisfies the reasonable classification requirement of §1.410(b)–4(b) on an employer-wide basis. Plan X benefits 50 percent of all Employer A's highly compensated employees (50 out 100) and 47.5 percent of all Employer A's nonhighly compensated employees (950 out of 2,000). Plan X consequently has a ratio percentage determined on an employer-wide basis of 95 percent (47.5% ÷ 50%), see §1.410(b)–9, and thus satisfies section 410(b)(5)(B) on an employer-wide basis.

(ii) Plan X has a ratio percentage determined on a qualified-separate-line-of-business basis of 50 percent (50% ÷ 100%). Because 50 percent is less than 70 percent, Plan X must satisfy the nondiscriminatory classification test of §1.410(b)–4 and the average

benefit percentage test of §1.410(b)–5 on a qualified-separate-line-of-business basis in order to satisfy the other requirements of section 410(b). Plan X satisfies the nondiscriminatory classification requirement of §1.410(b)–4(c) on a qualified-separate-line-of-business because its ratio percentage determined on a qualified-separate-line-of-business basis is more than 22.25 percent, the safe harbor percentage applicable to Line 1 under §1.410(b)–4(c)(4)(i). Because Plan X satisfies the reasonable classification requirement of §1.410(b)–4(b) on an employer-wide basis, it is also deemed to satisfy this requirement on a qualified-separate-line-of-business basis. See §1.410(b)–7(c)(5). In determining whether Plan X satisfies the average benefit percentage test of §1.410(b)–5, only Plan X and only employees of Line 1 are taken into account. See §§1.410(b)–6(e) and 1.410(b)–7(e).

Example 6. The facts are the same as in *Example 2*, except that, prior to the 1994 testing year, Employer A merges Plan X and Plan Y so that they form a single plan within the meaning of section 414(*l*). Under the definition of ''plan'' in paragraph (d)(2) of this section, however, the portion of the newly merged plan that benefits employees of Line 2 (former Plan Y) is still treated as a separate plan from the portion of the newly merged plan that benefits employees of Line 1 (former Plan X). The portion of the newly merged plan that benefits employees of Line 2 (former Plan Y) fails to satisfy section 410(b) for the reasons stated in *Example 2*. Under these facts, because the portion of the newly merged plan that benefits employees of Line 2 fails to satisfy section 410(b), the entire newly merged plan fails to satisfy section 410(b) for the plan year of the newly merged plan that begins in the 1994 testing year. See paragraph (d)(5) of this section.

(c) *Coordination of section 401(a)(4) with section 410(b)*—(1) *General rule*. For purposes of these regulations, the requirements of section 410(b) encompass the requirements of section 401(a)(4) (including, but not limited to, the permitted disparity rules of section 401(*l*), the actual deferral percentage test of section 401(k)(3), and the actual contribution percentage test of section 401(m)(2)). Therefore, if the requirements of section 410(b) are applied separately with respect to the employees of each qualified separate line of business of an employer for purposes of testing one or more plans of the employer for plan years that begin in a testing year, the requirements of section 401(a)(4) must also be applied separately with respect to the employees of the same qualified separate lines of business for purposes of testing the same plans for the same plan years. Furthermore, if section 401(a)(4) requires that a group of employees under the plan satisfy section 410(b) for purposes of satisfying section 401(a)(4), section 410(b) must be applied for this purpose in the same manner provided in paragraph (b) of this section. See, for example, §§1.401(a)(4)–2(c)(1) and 1.401(a)(4)–3(c)(1) (requiring each rate group of employees under a plan to satisfy section 410(b)), §1.401(a)(4)–4(b) (requiring the group of employees to whom each benefit, right, or feature is currently available under a plan to satisfy section 410(b)), and §1.401(a)(4)–9(c)(1) (requiring the group of employees included in each component plan into which a plan is restructured to satisfy section 410(b)). Thus, the group of employees must satisfy section 410(b)(5)(B) on an employer-wide basis in accordance with paragraph (b)(2) of this section and also must satisfy section 410(b) on a qualified-separate-line-of-business basis in accordance with paragraph (b)(3) of this section, in both cases as if the group of employees were the only employees benefiting under the plan.

(2) *Examples*. The following examples illustrate the application of the rule in this paragraph (c).

Example 1. Employer B is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with §1.414(r)–1(b) for the 1993 testing year. Employer B operates two qualified separate lines of business as determined under §1.414(r)–1(b)(2), Line 1 and Line 2. Employer B maintains Plan Z, which benefits employees in both Line 1 and Line 2. Under the definition of ''plan'' in paragraph (d)(2) of this section, the portion of Plan Z that benefits employees of Line 1 is treated as a separate plan from the portion of Plan Z that benefits employees of Line 2. Under this paragraph (c), this result applies for purposes of both section 410(b) and section 401(a)(4).

Example 2. The facts are the same as in *Example 1*, except that Plan Z benefits solely employees of Line 1. In testing Plan Z under section 401(a)(4) for the plan year of Plan Z beginning in the 1993 testing year, Employer B restructures Plan Z into several component plans (within the meaning of §1.401(a)(4)–9(c)). Under §1.401(a)(4)–9(c)(1), each of these component plans is required to satisfy section 410(b). This paragraph (c) requires that each of the component plans be

tested separately with respect to the employees of each qualified separate line of business operated by Employer B. This testing must be done in accordance with paragraph (b) of this section. Consequently, each component plan must satisfy section 410(b)(5)(B) on an employer-wide basis in accordance with paragraph (b)(2) of this section and must also satisfy section 410(b) on a qualified-separate-line-of-business basis in accordance with paragraph (b)(3) of this section.

Example 3. The facts are the same as in *Example 1*, except that Plan Z is a profit-sharing plan, and contributions to Plan Z are made pursuant to cash or deferred arrangement in which all employees of Employer B are eligible to participate. Assume that, as a result, Plan Z satisfies the requirements to be tested under the special rule for employer-wide plans in §1.414(r)–1(c)(2)(ii). Under these facts, the requirements of sections 410(b), 401(a)(4) and 401(k), including the actual deferral percentage test of section 401(k)(3) and §1.401(k)–1(b), would generally be required to be applied separately to the portions of Plan Z that benefit the employees of Line 1 and Line 2, respectively. However, if Plan Z is tested under the special rule in §1.414(r)–1(c)(2)(ii), these requirements must be applied on an employer-wide basis.

(d) *Supplementary rules*—(1) *In general.* This paragraph (d) provides certain supplementary rules necessary for the application of this section.

(2) *Definition of plan.* For purposes of this section, the term *plan* means a plan within the meaning of §1.410(b)–7(a) and (b), after application of the mandatory disaggregation rules of §1.410(b)–7(c) (including the mandatory disaggregation rule for portions of a plan that benefit employees of different qualified separate lines of business) and the permissive aggregation rules of §1.410(b)–7(d). Thus, for purposes of this section, the portion of a plan that benefits employees of one qualified separate line of business is treated as a separate plan from the other portions of the same plan that benefit employees of other qualified separate lines of business of the employer, unless the plan is tested under the special rule for employer-wide plans in §1.414(r)–1(c)(2)(ii) for the plan year.

(3) *Employees of a qualified separate line of business.* For purposes of applying paragraph (b) of this section with respect to a testing day, the employees of each qualified separate line of business of the employer are determined by applying §1.414(r)–7 to the employees of the employer otherwise taken into account under section 410(b) for the testing day. For purposes of applying paragraph (c) of this section with respect to a testing day, the employees of each qualified separate line of business of the employer are determined by applying §1.414(r)–7 to the employees of the employer otherwise taken into account under section 410(a)(4) for the testing day. For the definition of *testing day*, see §1.414(r)–11(b)(6).

(4) *Consequences of failure.* If a plan fails to satisfy either paragraph (b)(2), (b)(3), or (c)(1) of this section, the plan (and any plan of which it constitutes a portion) fails to satisfy section 401(a). However, this failure alone does not cause the employer to fail to be treated as operating qualified separate lines of business in accordance with §1.414(r)–1(b), unless the employer is relying on benefits provided under the plan to satisfy the minimum benefit portion of the safe harbor in §1.414(r)–5(g)(2) with respect to at least one of its qualified separate lines of business.

[T.D. 8376, 56 FR 63457, Dec. 4, 1991, as amended by T.D. 8376, 57 FR 52591, Nov. 4, 1992; T.D. 8548, 59 FR 32921, June 27, 1994]

§1.414(r)–9 Separate application of section 401(a)(26).

(a) *General rule.* If an employer is treated as operating qualified separate lines of business for purposes of section 401(a)(26) in accordance with §1.414(r)–1(b) for a testing year, the requirements of section 401(a)(26) must be applied separately with respect to the employees of each qualified separate line of business for purposes of testing all plans of the employer for plan years that begin in the testing year (other than a plan tested under the special rule for employer-wide plans in §1.414(r)–1(c)(3)(ii) for such a plan year). Conversely, if an employer is not treated as operating qualified separate lines of business for purposes of section 401(a)(26) in accordance with §1.414(r)–1(b) for a testing year, the requirements of section 401(a)(26) must be applied on an employer-wide basis for purposes of testing all plans of the employer for plan years that begin in the

testing years. See §1414(r)–1(c)(3) and (d)(6). Paragraph (b) of this section explains how the requirements of section 401(a)(26) are applied separately with respect to the employees of a qualified separate line of business for purposes of testing a plan. Paragraph (c) of this section provides certain supplementary rules necessary for the application of this section.

(b) *Requirements applicable to a plan.* If the requirements of section 401(a)(26) are applied separately with respect to the employees of a qualified separate line of business for a testing year, a plan (other than a plan that is tested under the special rule for employer-wide plans in §1.414(r)–1(c)(3)(ii) for a plan year) satisfies section 401(a)(26) only if it satisfies the requirements of §§1.401(a)(26)–1 through 1.401(a)(26)–9 on a qualified-separate-line-of-business basis. For this purpose, the nonexcludable employees of the employer taken into account in testing the plan under section 401(a)(26) are determined under §1.401(a)(26)–6(b), taking into account the exclusion in §1.401(a)(26)–6(b)(8) for employees of other qualified separate lines of business of the employer. Thus, in testing a plan separately with respect to the employees of one qualified separate line of business under this paragraph (b), all employees of the employer's other qualified separate lines of business are treated as excludable employees.

(c) *Supplementary rules*—(1) *In general.* This paragraph (c) provides certain supplementary rules necessary for the application of this section.

(2) *Definition of plan.* For purposes of this section, the term *plan* mean a plan within the meaning of §1.401(a)(26)–2(c) and (d), including the mandatory disaggregation rule of §1.401(a)(26)–2(d)(6) for portions of a plan that benefit employees of different qualified separate lines of business. Thus, for purposes of this section, the portion of a plan that benefits employees of one qualified separate line of business is treated as a separate plan from the other portions of the same plan that benefit employees of other qualified separate lines of business of the employer, unless the plan is tested under the special rule for employer-wide plans in §1.414(r)–1(c)(3)(ii) for the plan year.

(3) *Employees of a qualified separate line of business.* For purposes of applying paragraph (b)(2) of this section with respect to a section 401(a)(26) testing day, the employees of each qualified separate line of business of the employer are determined by applying §1.414(r)–7 to the employees of the employer otherwise taken into account under section 401(a)(26) for the section 401(a)(26) testing day. For the definition of *section 401(a)(26) testing day*, see §1.414(r)–11(b)(8).

(4) *Consequences of failure.* If a plan fails to satisfy paragraph (b)(2) of this section, the plan (and any plan of which it constitutes a portion) fails to satisfy section 401(a). However, this failure alone would not cause the employer to fail to be treated as operating qualified separate lines of business in accordance with §1.414(r)–1(b), unless the employer is relying on benefits provided under the plan to satisfy the minimum benefit portion of the safe harbor in §1.414(r)–5(g)(2) with respect to at least one of its qualified separate lines of business.

[T.D. 8376, 56 FR 63459, Dec. 4, 1991]

§1.414(r)–10 Separate application of section 129(d)(8). [Reserved]

§1.414(r)–11 Definitions and special rules.

(a) *In general.* This section contains certain definitions and special rules applicable under these regulations. Paragraph (b) of this section provides certain definitions that apply for purposes of these regulations. Paragraph (c) of this section provides averaging rules under which certain provisions of these regulations may be applied on the basis of a two-year or a three-year average.

(b) *Definitions*—(1) *In general.* In applying the provisions of this section and of §§1.414(r)–1 through 1.414(r)–10, unless otherwise provided, the definitions in this paragraph (b) govern in addition to the definitions in §1.410(b)–9.

(2) *Substantial-service employee.* An employee is a substantial-service employee with respect to a line of business for a testing year if at least 75 percent of the employee's services are provided to that line of business for that testing year within the meaning of §1.414(r)–3(c)(5). In addition, if an employee provides at least 50% and less than 75% of the employee's services to a line of business for the testing year within the meaning of §1.414(r)–3(c)(5), the employer may treat that employee as a substantial-service employee with respect to that line of business provided the employee is so treated for all purposes of these regulations. The employer may choose such treatment separately with respect to each employee.

(3) *Top-paid employee.* Generally, an employee is a top-paid employee with respect to a line of business for a testing year if the employee is among the top 10 percent by compensation of those employees who provide services to that line of business for that testing year within the meaning of §1.414(r)–3(c)(5) and who are not substantial-service employees within the meaning of paragraph (b)(2) of this section with respect to any other line of business. In addition, in determining the group of top-paid employees, the employer may choose to disregard all employees who provide less than 25 percent of their services to the line of business. For purposes of this paragraph (b)(3), an employee's compensation is the compensation used to determine the employee's status as a highly or nonhighly compensated employee under section 414(q) for purposes of applying section 410(b) with respect to the first testing day. For this purpose, only compensation received during the determination year (within the meaning of §1.414(q)–1T, Q&A–13) is taken into account. See §1.414(r)–3(c)(7) for examples of the determination of top-paid employee.

(4) *Residual shared employee.* An employee is a residual shared employee for a testing year if the employee is not a substantial-service employee with respect to any line of business for the testing year.

(5) *Testing year.* The term *testing year* means the calendar year.

(6) *Testing day.* The term *testing day* means any day on which §1.410(b)–8(a)(1) requires any plan (within the meaning of §1.414(r)–8(d)(2)) of the employer actually to satisfy section 410(b) with respect to plan year that begins in the testing year. Thus, if a plan is required to satisfy section 410(b) on one day within each quarter of the plan year under the quarterly testing option of §1.410(b)–8(a)(3), each of those four days is a testing day. Similarly, if a plan is required to satisfy section 410(b) on every day of the plan year under the daily testing option of §1.410(b)–8(a)(2), every day of the plan year is a testing day.

(7) *First testing day.* The term *first testing day* means the testing day that occurs earliest in time of all the testing days under all plans of the employer with respect to the testing year. If a plan is tested under the annual testing option of §1.410(b)–8(a)(4) (other than for purposes of the average benefit percentage test of §1.410(b)–5) for a plan year that begins in a testing year, then, solely for purposes of determining the first testing day in a testing year, the employer may treat any day in the plan year as a testing day, provided that the coverage of each plan of the employer on the day selected is reasonably representative of the coverage of the plan over the entire plan year. The first testing day with respect to a testing year must fall within that testing year.

(8) *Section 401(a)(26) testing day.* The term *section 401(a)(26) testing day* means any day on which §1.401(a)(26)–7(a) or (b) requires any plan of the employer actually to satisfy section 401(a)(26) with respect to a plan year that begins in the testing year. In no event may a section 401(a)(26) testing day with respect to a testing year fall before the first testing day for that testing year. For purposes of this paragraph (b)(8), the term *plan* has the same meaning as in §1.414(r–9(c)(2).

(c) *Averaging rules*—(1) *In general.* The provisions specified in this paragraph (c) are permitted to be applied based on the average of the percentages for the current testing year and the consecutive testing years (not to exceed four consecutive testing years) immediately preceding the current testing year.

(2) *Specified provisions*. The provisions specified in this paragraph (c) are—

(i) The 90-percent separate employee workforce requirement of §1.414(r)–3(b)(4);

(ii) The 80-percent separate management requirement of §1.414(r)–3(b)(5);

(iii) The 25-percent provision-to-customers requirement of §1.414(r)–3(d)(2)(iii);

(iv) The minimum and maximum highly compensated employee percentage ratios under the statutory safe harbor of §1.414(r)–5(b)(1)(i) and (ii) (50 percent and 200 percent, respectively), but not the 10-percent exception in §1.414(r)–5(b)(4);

(v) The employee assignment percentage applied for purposes of the dominant line of business method of allocating residual shared employees under §1.414(r)–7(c)(2) and the pro-rata method for allocating residual shared employees under §1.414(r)–7(c)(3).

(3) *Averaging of large fluctuations not permitted*. A provision is not permitted to be applied based on an average determined under this paragraph (c) if the percentage for any testing year taken into account in calculating the average falls below a mimimum percentage, or exceeds a maximum percentage, by more than 10 percent (not 10 percentage points) of the respective minimum or maximum percentage. Thus, for example, the statutory safe harbor of §1.414(r)–5(b) is not permitted to be applied based on an average determined under this paragraph (c) if the percentage for any testing year taken into account in calculating the average falls below 45 percent (which is 10 percent below the 50-percent minimum) or exceeds 220 percent (which is 10 percent above the 200-percent maximum).

(4) *Consistency requirements*. A provision is permitted to be applied on an averaging basis under this paragraph (c) regardless of how any other provision is applied, except in the case of the separate employee workforce and separate management requirements of §1.414(r)–3(b)(4) and (5), which each must be applied on the same basis as the other. A provision is also permitted to be applied on an averaging basis under this paragraph (c) for a testing year, regardless of how the provision is applied for any other testing year. However, once a provision is applied on an averaging basis under this paragraph (c) for a testing year, it must be applied on the same basis to all the employer's lines of business to which the provision is applied for the testing year. The percentage for a preceding testing year may be taken into account under this paragraph (c) only if—

(i) The employer calculates the percentage for the preceding testing year in the same manner as the employer calculates the percentage for the current testing year;

(ii) The employer is treated as operating qualified separate lines of business in accordance with §1.414(r)–1(b) for the preceding testing year; and

(iii) The employer designated the same lines of business in the preceding testing year as in the current testing year.

[T.D. 8376, 56 FR 63460, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32922, June 27, 1994]

§1.414(s)–1 Definition of compensation.

(a) *Introduction*—(1) *In general*. Section 414(s) and this section provide rules for defining compensation for purposes of applying any provision that specifically refers to section 414(s) or this section. For example, section 414(s) is referred to in many of the nondiscrimination provisions applicable to pension, profit-sharing, and stock bonus plans qualified under section 401(a). In accordance with section 414(s)(1), this section defines compensation as compensation within the meaning of section 415(c)(3). It also implements the election provided in section 414(s)(2) to treat certain deferrals as compensation and exercises the authority granted to the Secretary in section 414(s)(3) to prescribe alternative nondiscriminatory definitions of compensation.

(2) *Limitations on scope of section 414(s)*. Section 414(s) and this section do not apply unless a provision specifically refers to section 414(s) or this section. For example, even though a definition of compensation permitted under section 414(s) must be used in determining whether the contributions or

benefits under a pension, profit-sharing, or stock bonus plan satisfy a certain applicable provision (such as section 401(a)(4)), except as otherwise specified, the plan is not required to use a definition of compensation that satisfies section 414(s) in calculating the amount of contributions or benefits actually provided under the plan.

(3) *Overview*. Paragraph (b) of this section provides rules of general application that govern a definition of compensation that satisfies section 414(s). Paragraph (c) of this section contains specific definitions of compensation that satisfy section 414(s) without satisfying any additional nondiscrimination requirement under section 414(s). Paragraph (d) of this section provides rules permitting the use of alternative definitions of compensation that satisfy section 414(s) as long as the nondiscrimination requirement and other requirements described in paragraph (d) of this section are satisfied. Paragraph (e) and (f) of this section provide special rules permitting the use of rate of compensation, or prior-employer compensation or imputed compensation, rather than actual compensation, under a definition of compensation that satisfies section 414(s). Paragraph (g) of this section provides other special rules, including a special rule for determining the compensation of a self-employed individual under an alternate definition of compensation. Paragraph (h) of this section provides definitions for certain terms used in this section.

(b) *Rules of general application*—(1) *Use of a definition*. Any definition of compensation that satisfies section 414(s) may be used when a provision explicitly refers to section 414(s) unless the reference or this section specifically indicates otherwise.

(2) *Consistency rule*—(i) *General rule*. A definition of compensation selected by an employer for use in satisfying an applicable provision must be used consistently to define the compensation of all employees taken into account in satisfying the requirements of the applicable provision for the determination period. For example, although any definition of compensation that satisfies section 414(s) may be used for section 401(a)(4) purposes, the same definition of compensation generally must be used consistently to define the compensation of all employees taken into account in determining whether a plan satisfies section 401(a)(4). Furthermore, a different definition of compensation that satisfies section 414(s) is permitted to be used to determine whether another plan maintained by the same employer separately satisfies the requirements of section 401(a)(4). Although a definition of compensation must be used consistently, an employer may change its definition of compensation for a subsequent determination period with respect to the applicable provision. Rules provided under any applicable provision may modify the consistency requirements of this paragraph (b)(2).

(ii) *Scope of consistency rule*. Compensation will not fail to be defined consistently for a group of employees merely because some employees do not receive one or more of the types of compensation included in the definition. For example, a definition of compensation that includes salary, regular or scheduled pay, overtime, and specified types of bonuses will not fail to define compensation consistently merely because only salaried employees receive salary and these specified types of bonuses and only hourly employees receive regular or scheduled pay and overtime.

(3) *Self-employed individuals*. Notwithstanding paragraph (b)(1) of this section, self-employed individuals' compensation can only be determined under paragraph (c)(2) of this section (with or without the modification permitted by paragraph (c)(4) of this section or a modification permitted by paragraph (c)(5) of this section) or by using an equivalent alternative compensation amount determined in accordance with paragraph (g)(1) of this section. These limitations on self-employed individuals do not affect their common-law employees. Thus, the compensation of common-law employees of a partnership or sole proprietorship may be defined using an alternative definition, provided the definition otherwise satisfies paragraph (c)(3), (d), (e), or (f) of this section. If an alternative definition of compensation under paragraph (c)(3), (d), (e), or

(f) of this section is used for other employees to satisfy an applicable provision, the consistency requirement is only met if paragraph (g) of this section is used for the self-employed individuals.

(c) *Specific definitions of compensation that satisfy section 414(s)*—(1) *General rules*. The definitions of compensation provided in paragraphs (c)(2) and (c)(3) of this section satisfy section 414(s) and need not satisfy any additional requirements under section 414(s). Paragraph (c)(2) of this section describes definitions of compensation within the meaning of section 415(c)(3). Paragraph (c)(3) of this section provides a safe harbor alternative definition that excludes certain additional items of compensation. Paragraph (c)(4) of this section permits any definition provided in paragraph (c)(2) or (c)(3) of this section to include certain types of elective contributions and deferred compensation. Paragraph (c)(5) of this section permits certain modifications to a definition otherwise provided under this paragraph (c).

(2) *Compensation within the meaning of section 415(c)(3)*. A definition of compensation that includes all compensation within the meaning of section 415(c)(3) and excludes all other compensation satisfies section 414(s). Sections 1.415(c)–2(b) and (c) provide rules for determining items of compensation included in and excluded from compensation within the meaning of section 415(c)(3). In addition, section 414(s) is satisfied by the safe harbor definitions provided in §1.415(c)–2(d)(2), (d)(3) and (d)(4) and any additional definitions of compensation prescribed by the Commissioner under the authority provided in §1.415(c)–2(d)(1) that are treated as satisfying section 415(c)(3).

(3) *Safe harbor alternative definition*. Under the safe harbor alternative definition in this paragraph (c)(3), compensation is compensation as defined in paragraph (c)(2) of this section, reduced by all of the following items (even if includible in gross income): reimbursements or other expense allowances, fringe benefits (cash and noncash), moving expenses, deferred compensation, and welfare benefits.

(4) *Inclusion of certain deferrals in compensation*. Any definition of compensation provided in paragraph (c)(2) or (c)(3) of this section satisfies section 414(s) even though it is modified to include all of the following types of elective contributions and all of the following types of deferred compensation—

(i) Elective contributions that are made by the employer on behalf of its employees that are not includible in gross income under section 125, section 402(e)(3), section 402(h), and section 403(b);

(ii) Compensation deferred under an eligible deferred compensation plan within the meaning of section 457(b) (deferred compensation plans of state and local governments and tax-exempt organizations); and

(iii) Employee contributions (under governmental plans) described in section 414(h)(2) that are picked up by the employing unit and thus are treated as employer contributions.

(5) *Exclusions applicable solely to highly compensated employees*. Any definition of compensation that satisfies paragraph (c)(2) or (c)(3) of this section, with or without the modification permitted by paragraph (c)(4) of this section, may be modified to exclude any portion of the compensation of some or all of the employer's highly compensated employees (including, for example, any one or more of the types of elective contributions or deferred compensation described in paragraph (c)(4) of this section).

(d) *Alternative definitions of compensation that satisfy section 414(s)*—(1) *General rule*. In addition to the definitions provided in paragraph (c) of this section, any definition of compensation satisfies section 414(s) with respect to employees (other than self-employed individuals treated as employees under section 401(c)(1)) if the definition of compensation does not by design favor highly compensated employees, is reasonable within the meaning of paragraph (d)(2) of this section, and satisfies the nondiscrimination requirement in paragraph (d)(3) of this section.

(2) *Reasonable definition of compensation*—(i) *General rule*. An alternative definition of compensation under this paragraph (d) is reasonable under section 414(s) if it is a definition of compensation provided in paragraph (c) of

this section, modified to exclude all or any portion of one or more of the types of compensation described in paragraph (d)(2)(ii) of this section. See paragraph (e) of this section, however, for special rules that permit definitions of compensation based on employees' rates of compensation and paragraph (f) of this section for special rules that permit definitions of compensation that include prior-employer compensation or imputed compensation.

(ii) *Items that may be excluded.* A reasonable definition of compensation is permitted to exclude, on a consistent basis, all or any portion of irregular or additional compensation, including (but not limited to) one or more of the following: Any type of additional compensation for employees working outside their regularly scheduled tour of duty (such as overtime pay, premiums for shift differential, and call-in premiums), bonuses, or any one or more of the types of compensation excluded under the safe harbor alternative definition in paragraph (c)(3) of this section. Whether a type of compensation is irregular or additional is determined based on all the relevant facts and circumstances. A reasonable definition is also permitted to include, on a consistent basis, all or any portion of the types of elective contributions or deferred compensation described in paragraph (c)(4) of this section and, thus, need not include all those types of elective contributions or deferred compensation as otherwise required under paragraph (c)(4) of this section.

(iii) *Limits on the amount excluded from compensation.* A definition of compensation is not reasonable if it provides that each employee's compensation is a specified portion of the employee's compensation measured for the otherwise applicable determination period under another definition. For example, a definition of compensation that specifically limits each employee's compensation for a determination period to 95 percent of the employee's compensation using a definition provided in paragraph (c) of this section is not reasonable. Similarly, a definition of compensation that limits each employee's compensation used to satisfy an applicable provision with a 12-month determination period to compensation under a definition provided in paragraph (c) of this section for one month is not a reasonable definition of compensation. However, a definition of compensation is not unreasonable merely because it excludes all compensation in excess of a specified dollar amount.

(3) *Nondiscrimination requirement*—(i) *In general.* An alternative definition of compensation under this paragraph (d) is nondiscriminatory under section 414(s) for a determination period if the average percentage of total compensation included under the alternative definition of compensation for an employer's highly compensated employees, as a group for the determination period does not exceed by more than a de minimis amount the average percentage of total compensation included under the alternative definition for the employer's nonhighly compensated employees as a group.

(ii) *Total compensation*—(A) *General rule.* For purposes of this paragraph (d)(3), total compensation must be determined using a definition of compensation provided in paragraph (c)(2) of this section, either with or without the modification permitted by paragraph (c)(4) of this section. Thus, total compensation does not include prior-employer compensation or imputed compensation described in paragraph (f)(1) of this section (including imputed compensation for a period during which an employee performs services for another employer). Total compensation taken into account for each employee (including, if added, the elective contributions and deferred compensation described in paragraph (c)(4) of this section) may not exceed the annual compensation limit of section 401(a)(17).

(B) *Alternative definitions with exclusions applicable solely to highly compensated employees.* If an alternative definition of compensation contains a provision that excludes amounts from compensation and, as described in paragraph (c)(5) of this section, the provision only applies in defining the compensation of some highly compensated employees, then, for purposes of this paragraph (d)(3), the total compensation of any highly compensated

employee subject to the provision must be reduced by any amount excluded from the employee's compensation as a result of the provision. However, if the provision applies consistently in defining the compensation of all highly compensated employees, this adjustment to total compensation is not required.

(iii) *Employees taken into account*—(A) *General rule*. In applying the requirement of this paragraph (d)(3), the employees taken into account are the same employees taken into account in satisfying the requirements of the applicable provision for the determination period. For example, in determining whether a plan satisfies section 401(a)(4), an alternative definition must satisfy this paragraph (d)(3) taking into account all employees who benefit under the plan for the plan year (within the meaning of §1.410(b)–3(a)). If an employer is using the same alternative definition of compensation to determine whether more than one separate plan satisfies section 401(a)(4), the employer is permitted to take into account all the employees who benefit under all of those plans for the plan year in determining whether the alternative definition of compensation being used satisfies this paragraph (d)(3).

(B) *Exclusion of self-employed individuals*. In applying the requirement of this paragraph (d)(3), self-employed individuals are disregarded.

(C) *Certain employees disregarded*. If an employee's total compensation for the determination period, determined under paragraph (d)(3)(ii) and (d)(3)(vi)(B) of this section, is zero, the employee is disregarded in determining whether the nondiscrimination requirement of paragraph (d)(3) of this section is satisfied for that determination period. For example, an employee who does not receive any actual compensation during a determination period because the employee is on unpaid leave of absence for the entire period, but who is credited with imputed compensation described in paragraph (f)(1) of this section, is disregarded in determining whether the nondiscrimination requirement of this paragraph (d)(3) is satisfied for that determination period.

(iv) *Calculation of average percentages*—(A) *General rule*. To determine the average percentages described in paragraph (d)(3)(i) of this section, an individual compensation percentage must be calculated for each employee in a group, and then the average of the separately calculated compensation percentages for each employee in the group must be determined. The individual compensation percentage for an employee is calculated by dividing the amount of the employee's compensation that is included under the alternative definition by the amount of the employee's total compensation.

(B) *Other reasonable methods*. Notwithstanding paragraph (d)(3)(iv)(A) of this section, any other reasonable method is permitted to be used to determine the average percentages described in paragraph (d)(3)(i) of this section for either or both of the groups (i.e., highly compensated employees and nonhighly compensated employees), provided that the method cannot reasonably be expected to create a significant variance from the average percentage for that group determined using the individual-percentage method provided in paragraph (d)(3)(iv)(A) of this section. The same method is not required to be used for calculating the two average percentages. For example, to determine the average percentage for nonhighly compensated employees as a group, an employer may calculate an aggregate compensation percentage by dividing the aggregate amount of compensation of nonhighly compensated employees that are included under the alternative definition by the aggregate amount of total compensation of nonhighly compensated employees, provided the resulting percentage is not reasonably expected to vary significantly from the average percentage produced using the individual-percentage method provided in paragraph (d)(3)(iv)(A) of this section because of the extra weight given employees with higher compensation.

(v) *Facts and circumstances determination*. The determination of whether the average percentage of total compensation included for the employer's highly compensated employees as a group for a determination period exceeds by more than a de minimis amount the

average percentage of total compensation included for the employer's nonhighly compensated employees as a group is based on all the relevant facts and circumstances. The differences between the percentages for prior determination periods may be considered in determining whether the amount of the difference between the percentages is more than de minimis. In addition, an isolated instance of a more than de minimis difference between the compensation percentages that is due to an extraordinary unforeseeable event (such as overtime payments to employees of a public utility due to a major hurricane) will be disregarded if the amount of the difference in prior determination periods was de minimis.

(vi) *Special rules for definitions of compensation based on rate of compensation or that include prior-employer or imputed compensation*—(A) *Special rule for determining compensation included under an alternative definition.* If an alternative definition uses rate of compensation or includes prior-employer compensation or imputed compensation, the amount of each employee's compensation for a determination period that is treated as included under the alternative definition for purposes of determining the average percentages for the nondiscrimination requirement (i.e. the amount used in the numerator) must not be more than 100 percent of the employee's total compensation for that period, determined under paragraph (d)(3)(ii) and (d)(3)(vi)(B) of this section. This limit on the amount of compensation treated as included under the alternative definition applies even if the amount of compensation actually credited to the employee for the determination period under the definition and, thus, used as compensation within the meaning of section 414(s), exceeds the employee's total compensation for the period.

(B) *Special rule for determining total compensation.* If an alternative definition uses rate of compensation or includes prior-employer compensation or imputed compensation, each employee's total compensation for purposes of determining the average percentages for the nondiscrimination requirement (i.e. the amount used in the denominator) must include all the types of elective contributions and deferred compensation described in paragraph (c)(4) of this section.

(e) *Rate of compensation*—(1) *General rule.* A definition of compensation satisfies section 414(s) as a reasonable definition of compensation even though it defines the amount of each employee's basic or regular compensation using the employee's basic or regular rate of compensation rather than using the employee's actual basic or regular compensation from the employer if the definition satisfies the requirements specified in paragraph (e)(3) of this section and otherwise satisfies the requirements of paragraph (d) of this section, including the nondiscrimination test in paragraph (d)(3) of this section. For this purpose, the employee's rate of compensation must be determined using an hourly pay scale, weekly salary, or similar unit of basic or regular compensation applicable to the employee. A definition will not fail to satisfy the requirements of this paragraph (e) merely because it defines compensation as including each employee's basic or regular compensation, the amount of which is determined using each employee's basic or regular rate of compensation, plus actual amounts of irregular or additional compensation, such as overtime or bonuses. In addition, a definition of compensation will not fail to satisfy section 414(s) merely because it defines compensation for each employee as the greater of the employee's actual compensation, the amount of which is determined using a definition that would otherwise satisfy paragraph (c) or (d)(2) of this section, or the employee's basic or regular compensation, the amount of which is determined using the employee's basic or regular rate of compensation.

(2) *Not applicable to certain contributions.* This paragraph (e) does not apply to a definition of compensation used in determining whether elective deferrals (as defined in section 402(g)(3)), matching contributions (as defined in section 401(m)(4)), or employee contributions subject to section 401(m) satisfy any applicable provision. Thus, for example, a definition of compensation that defines compensation based on each employee's basic or regular rate of compensation may not be used to

measure compensation for purposes of determining if a qualified cash or deferred arrangement satisfies the actual deferral percentage test in section 401(k)(3).

(3) *Requirements for definitions of compensation based on rate of compensation*—(i) *Benefit determination*. The definition of compensation must actually be used to calculate the benefits, contributions, or other amounts, that are subject to the applicable provision. For example, a definition of compensation that defines compensation based on each employee's basic or regular rate of compensation may not be used to determine whether a plan satisfies section 401(a)(4) unless the benefits, contributions, or other amounts for each employee in the plan are determined using that definition of compensation.

(ii) *Period for determining compensation*. The amount of each employee's basic or regular compensation for the determination period must be determined using the employee's basic or regular rate of compensation as of a designated date in the determination period. For example, if the determination period is a calendar year, this requirement would be satisfied if the amount of each employee's basic or regular compensation for the calendar year is determined using the employee's basic or regular rate of compensation as of January 1 of the calendar year. Alternatively, the amount of each employee's basic or regular compensation for a determination period can be the sum of the amounts separately determined for shorter specified periods (e.g., weeks or months) within the determination period provided the amount of each employee's basic or regular compensation for each specified period is determined using the employee's basic or regular rate of compensation as of a designated date within the specified period.

(iii) *Dates for determining rate of compensation*. One or more dates may be used to determine employees' rates of compensation for a determination period or specified period provided that, if the same date is not used for all employees, the dates selected are designed to determine the rates of compensation for that period on a consistent basis for all employees taken into account for the determination period. For example, if annual compensation increases are provided to different groups of employees on different dates during the year, it would be consistent to choose a different date for each group in order to include the annual increase in the employees' rates of compensation for the determination period. In addition, the date or dates selected, by themselves, must not cause the portion of total compensation included to vary significantly among employees.

(iv) *Periods without compensation or with reduced compensation*. An employee's compensation may generally only be determined using the employee's rate of compensation for employment periods during which the employer actually compensates the employee. However, if an employee terminates employment or otherwise stops performing services (such as for a leave of absence, layoff or similar event) either without compensation or with reduced compensation during a determination period, the employer may continue to credit the employee with compensation based on the employee's rate of compensation for a period of up to 31 days after the event, but not beyond the end of the determination period. Paragraph (f) of this section contains special rules for crediting imputed compensation for periods extending beyond 31 days during which an employee is not compensated or an employee's compensation is reduced. See also the definition of *Section 414(s) compensation* in §1.401(a)(4)–12 that, for purposes of satisfying section 401(a)(4), permits adjustments to compensation to reflect the equivalent of full-time compensation to the extent necessary to satisfy the requirements of 29 CFR 2530.204–2(d) (regarding double proration of service and compensation).

(f) *Prior-employer compensation and imputed compensation*—(1) *General rule*. Solely for purposes of determining whether a defined benefit plan, as defined in §1.410(b)–9, satisfies section 401(a)(4) or 410(b), an alternative definition that includes prior-employer compensation or imputed compensation satisfies section 414(s) as a reasonable alternative definition if the definition satisfies the requirements specified in

paragraphs (f) (2) and (3) of this section. For this purpose, prior-employer compensation is compensation from an employer other than the employer (determined at the time that the compensation is paid) maintaining the plan that is credited for periods prior to the employee's employment with the employer maintaining the plan and during which the employee performed services for the other employer. For this purpose, imputed compensation is compensation credited for periods after an employee has commenced or recommenced participation in a plan while the employee is not compensated by the employer maintaining the plan or is compensated at a reduced rate by that employer because the employee is not performing services as an employee for the employer (including a period in which the employee performs services for another employer, e.g., a joint venture) or because the employee has a reduced work schedule.

(2) *Requirements for definitions of compensation crediting prior-employer compensation or imputed compensation*—(i) *General requirement.* The definition must otherwise be described in paragraph (c) of this section or must otherwise satisfy the requirements of paragraph (d) or (e) of this section for alternative definitions of compensation, including the nondiscrimination requirement in paragraph (d)(3) of this section.

(ii) *Benefit determination.* A definition of compensation that credits prior-employer compensation or imputed compensation must actually be used to calculate the benefits under the plan. For example, the definition may not be used to determine whether a defined benefit plan satisfies section 401(a)(4) unless the benefits for each employee in the plan are determined using that definition of compensation.

(iii) *Provision applied to all similarly-situated employees.* A provision in a plan's definition of compensation crediting prior-employer compensation or imputed compensation must apply on the same terms to all similarly-situated employees in the plan. The criteria for determining whether employees are similarly situated for this purpose are the same as the criteria for determining whether a plan provision crediting pre-participation or imputed service satisfies the requirements of §1.401(a)(4)–11(d)(3)(iii)(A).

(iv) *Legitimate business purpose.* There must be a legitimate business purpose, based on all of the relevant facts and circumstances, for crediting prior-employer compensation or imputed compensation to an employee for the period being credited. The standard for determining whether crediting prior-employer compensation or imputed compensation satisfies this requirement is the same as the standard for determining whether crediting pre-participation or imputed service under a plan satisfies the requirements of §1.401(a)(4)–11(d)(3)(iii)(B) and whether crediting imputed service satisfies the additional requirements of §1.401(a)(4)–11(d)(3)(iv)(A). However, if the legitimate business reason for crediting imputed compensation relates to the services the employee is performing for another employer and the reason satisfies the standard in §1.401(a)(4)–11(d)(3)(iii)(B), the additional requirements of §1.401(a)(4)–11(d)(3)(iv)(A) are deemed to be satisfied. For example, if an employee becomes employed by another employer as a result of a merger, acquisition or similar transaction with the other employer and imputed compensation is credited to the employee while the employee is performing services for the other employer, the crediting of imputed compensation to the employee satisfies the standard in §1.401(a)(4)–11(d)(3)(iii)(B). Thus, under that example, crediting the imputed compensation to the employee is deemed to satisfy the additional requirements of §1.401(a)(4)–11(d)(3)(iv)(A), even if the employee is not performing those services under an arrangement that provides an ongoing business benefit to the employer maintaining the plan.

(v) *No significant discrimination.* Based on all of the relevant facts and circumstances, crediting prior-employer compensation or imputed compensation must not by design or in operation discriminate significantly in favor of highly compensated employees. The standard for determining whether crediting prior-employer compensation or imputed compensation satisfies this requirement is the same as the standard

for determining whether crediting preparticipation or imputed service satisfies the requirement in §1.401(a)(4)–11(d)(3)(iii)(C) and whether crediting imputed service satisfies the additional requirement of §1.401(a)(4)–11(d)(3)(iv)(B).

(3) *Reasonable method*—(i) *General rule*. Any reasonable method may be used to determine the amount of prior-employer compensation or imputed compensation provided that the requirements of paragraph (f)(3) (ii) or (iii) of this section are satisfied, whichever is applicable.

(ii) *Requirements for prior-employer compensation*. Prior-employer compensation credited to an employee for a period that an employee is performing services for another employer must be compensation for the employee from the other employer (or be based on the employee's basic or regular rate of compensation from the other employer) for that period. In addition, prior employer compensation credited to an employee must not exceed the amount of compensation from the other employer that would have been included under the definition of compensation in effect for that period for compensation from the employer maintaining the plan. Reasonable assumptions may be made in determining the amount of compensation received from another employer for a period that would have been included under the definition of compensation in effect for that period for compensation from the employer maintaining the plan.

(iii) *Requirements for imputed compensation*—(A) *General rule*. The amount of imputed compensation credited to an employee during any period, when combined with the amount of any actual compensation being included, must not exceed an amount that, based on all of the relevant facts and circumstances, is reasonably representative of the amount of compensation that the employee would have received and that would have been included under the definition of compensation in effect for the period if the employee had continued to perform services for the employer during that period at the same level as the employee was performing before the employee stopped performing services or changed to a reduced work schedule. The relevant facts and circumstances include the compensation that the employee was receiving immediately before the employee stopped performing services or changed to a reduced work schedule, and, if applicable, the rate of compensation in effect while the employee is not performing services or has a reduced work schedule that is applicable to the employee's specific job grade immediately before the change occurred.

(B) *Imputed compensation from another employer*. Imputed compensation credited for a period that an employee is performing services for another employer is deemed to satisfy paragraph (f)(3)(iii)(A) of this section if the amount of compensation credited satisfies the requirements of paragraph (f)(3)(ii) of this section for prior-employer compensation. Thus, for example, the amount of imputed compensation credited to an employee for a period that the employee is performing services for another employer is deemed to satisfy paragraph (f)(3)(iii)(A) of this section if the amount credited is compensation for the employee from the other employer (or is based on the employee's basic or regular rate of compensation from the other employer) for that period, and the amount credited does not exceed the compensation from the other employer that would be included for the employee under the definition of compensation in effect for that period for compensation from the employer maintaining the plan.

(4) *Special nondiscrimination rule for safe harbor definitions*. If a definition of compensation crediting prior-employer or imputed compensation is otherwise described in paragraph (c) of this section, and the prior-employer compensation or imputed compensation credited satisfies the requirements of paragraphs (f) (1), (2), and (3) of this section, then the definition is deemed to satisfy paragraph (d) of this section (i.e., it is deemed to be nondiscriminatory).

(g) *Special rules*—(1) *Self-employed individuals*—(i) *General rule*. If an alternative definition of compensation under paragraph (c)(3), (d), (e), or (f) of this section is used to satisfy an applicable provision, an equivalent alternative compensation amount must be

determined for any self-employed individual who is in the group of employees for whom paragraph (b) of this section requires a single definition of compensation to be used. This equivalent alternative compensation amount is determined by multiplying the self-employed individual's total earned income (as defined in section 401 (c)(2)) for the determination period by the percentage of total compensation (as defined in paragraph (d)(3)(ii) of this section) included under the alternative definition for the employer's nonhighly compensated common-law employees as a group (determined in a manner consistent with the rules in paragraph (d)(3)(iii) of this section and, if applicable, paragraph (d)(3)(vi) of this section). Thus, for purposes of this determination, highly compensated common-law employees must be disregarded. This equivalent alternative compensation amount will be treated as the self-employed individual's compensation under the alternative definition of compensation for the determination period.

(ii) *Inclusion of elective contributions.* If the alternative definition of compensation includes any types of elective contributions described in paragraph (c)(4) of this section, the self-employed individual's earned income for this determination must be increased by the amount of elective contributions made by the employer on behalf of the self-employed individual, and the definition of total compensation for this determination must include all the types of elective contributions described in paragraph (c)(4) of this section made by the employees (other than highly compensated employees.

(iii) *Reductions in equivalent alternative compensation amount applicable only to highly compensated employees.* An alternative definition of compensation may provide that compensation under the alternative definition for some or all self-employed individuals who are highly compensated employees is a specified portion of, rather than equal to, the equivalent compensation amount determined under paragraph (g)(1)(i).

(2) *Leased employees.* [Reserved]

(h) *Definitions.* The following definitions apply for purposes of this section:

(1) *Applicable provision.* Applicable provision means a provision that specifically refers to section 414(s) or this section.

(2) *Determination period.* Determination period means a period during which the amount of compensation is measured for use in determining whether the requirements of an applicable provision are satisfied. If no period is provided under the applicable provision for measuring compensation, the determination period is the period for which the applicable provision must be satisfied. The applicable provision may provide additional rules concerning the determination period to be used for satisfying the nondiscrimination requirement in paragraph (d) of this section.

(3) *Employee.* Employee means employee within the meaning of §1.410(b)–9.

(4) *Highly compensated employee.* Highly compensated employee means highly compensated employee within the meaning of §1.410(b)–9.

(5) *Nonhighly compensated employee.* Nonhighly compensated employee means nonhighly compensated employee within the meaning of §1.410(b)–9.

(6) *Self-employed individual.* Self-employed individual means self-employed individual within the meaning of section 401(c)(1).

(i) *Additional rules.* The Commissioner may in revenue rulings, notices, and other guidance of general applicability provide additional rules for defining compensation within the meaning of section 414(s), including additional definitions of compensation that satisfy section 414(s).

(j) *Effective date and transition rules*—(1) *Statutory effective date.* Section 414(s) applies to years beginning on or after January 1, 1987.

(2) *Regulatory effective date*—(i) *In general.* Except as otherwise provided in paragraph (j)(2)(ii) of this section, §1.414(s)–1 (a) through (i) apply to years beginning on or after January 1, 1994.

(ii) *Plans of tax-exempt organizations.* In the case of a plan maintained by an organization that is exempt from income taxation pursuant to section 501(a), including plans subject to section 403(b)(12)(A)(i) (nonelective plans),

§ 1.414(s)–1 (a) through (i) apply to plan years beginning on or after January 1, 1996.

(3) *Compliance during transition period.* For plan years beginning before the effective date of these regulations, as set forth in paragraph (j)(2) of this section, and on or after the statutory effective date as set forth in paragraph (j)(1) of this section, a plan must be operated in accordance with a reasonable, good faith interpretation of section 414(s). Whether a plan is operated in accordance with a reasonable, good faith interpretation of section 414(s) will generally be determined based on all relevant facts and circumstances, including the extent to which an employer has resolved unclear issues in its favor. A plan will be deemed to be operated in accordance with a reasonable, good faith interpretation of section 414(s)(1) and (2) if it is operated in accordance with the terms of § 1.414(s)–1 (a) through (i). For years beginning on or after the statutory effective date and before the effective date of these regulations, a definition of compensation is also deemed to satisfy section 414(s) as an alternative method of determining compensation under section 414(s)(3) if the definition satisfies the requirements of § 1.414(s)–1 (a) through (i) or if the definition satisfies the prior regulation provisions of § 1.414(s)–1T. (See § 1.414(s)–1T as contained in the CFR edition revised as of April 1, 1991.) In addition, for those transition years, a definition of compensation is deemed to satisfy section 414(s) as an alternative method of determining compensation under section 414(s)(3) if, based on all the relevant facts and circumstances in effect for the year, use of the definition does not cause discrimination in favor of highly compensated employees.

[T.D. 8361, 56 FR 47662, Sept. 19, 1991; 57 FR 10815, 10953, Mar. 31, 1992, as amended by T.D. 8488, 58 FR 47063, Sept. 7, 1993; T.D. 9319, 72 FR 16894, Apr. 5, 2007]

§ 1.414(v)–1 Catch-up contributions.

(a) *Catch-up contributions*—(1) *General rule.* An applicable employer plan shall not be treated as failing to meet any requirement of the Internal Revenue Code solely because the plan permits a catch-up eligible participant to make catch-up contributions in accordance with section 414(v) and this section. With respect to an applicable employer plan, catch-up contributions are elective deferrals made by a catch-up eligible participant that exceed any of the applicable limits set forth in paragraph (b) of this section and that are treated under the applicable employer plan as catch-up contributions, but only to the extent they do not exceed the catch-up contribution limit described in paragraph (c) of this section (determined in accordance with the special rules for employers that maintain multiple applicable employer plans in paragraph (f) of this section, if applicable). To the extent provided under paragraph (d) of this section, catch-up contributions are disregarded for purposes of various statutory limits. In addition, unless otherwise provided in paragraph (e) of this section, all catch-up eligible participants of the employer must be provided the opportunity to make catch-up contributions in order for an applicable employer plan to comply with the universal availability requirement of section 414(v)(4). The definitions in paragraph (g) of this section apply for purposes of this section and § 1.402(g)–2.

(2) *Treatment as elective deferrals.* Except as specifically provided in this section, elective deferrals treated as catch-up contributions remain subject to statutory and regulatory rules otherwise applicable to elective deferrals. For example, catch-up contributions under an applicable employer plan that is a section 401(k) plan are subject to the distribution and vesting restrictions of section 401(k)(2)(B) and (C). In addition, the plan is permitted to provide a single election for catch-up eligible participants, with the determination of whether elective deferrals are catch-up contributions being made under the terms of the plan.

(3) *Coordination with section 457(b)(3).* In the case of an applicable employer plan that is a section 457 eligible governmental plan, the catch-up contributions permitted under this section shall not apply to a catch-up eligible participant for any taxable year for which a higher limitation applies to such participant under section 457(b)(3). For additional guidance, see regulations under section 457.

(b) *Elective deferrals that exceed an applicable limit*—(1) *Applicable limits.* An applicable limit for purposes of determining catch-up contributions for a catch-up eligible participant is any of the following:

(i) *Statutory limit.* A statutory limit is a limit on elective deferrals or annual additions permitted to be made (without regard to section 414(v) and this section) with respect to an employee for a year provided in section 401(a)(30), 402(h), 403(b), 408, 415(c), or 457(b)(2) (without regard to section 457(b)(3)), as applicable.

(ii) *Employer-provided limit.* An employer-provided limit is any limit on the elective deferrals an employee is permitted to make (without regard to section 414(v) and this section) that is contained in the terms of the plan, but which is not required under the Internal Revenue Code. Thus, for example, if, in accordance with the terms of the plan, highly compensated employees are limited to a deferral percentage of 10% of compensation, this limit is an employer-provided limit that is an applicable limit with respect to the highly compensated employees.

(iii) *Actual deferral percentage (ADP) limit.* In the case of a section 401(k) plan that would fail the ADP test of section 401(k)(3) if it did not correct under section 401(k)(8), the ADP limit is the highest amount of elective deferrals that can be retained in the plan by any highly compensated employee under the rules of section 401(k)(8)(C) (without regard to paragraph (d)(2)(iii) of this section). In the case of a simplified employee pension (SEP) with a salary reduction arrangement (within the meaning of section 408(k)(6)) that would fail the requirements of section 408(k)(6)(A)(iii) if it did not correct in accordance with section 408(k)(6)(C), the ADP limit is the highest amount of elective deferrals that can be made by any highly compensated employee under the rules of section 408(k)(6) (without regard to paragraph (d)(2)(iii) of this section).

(2) *Contributions in excess of applicable limit*—(i) *Plan year limits*—(A) *General rule.* Except as provided in paragraph (b)(2)(ii) of this section, the amount of elective deferrals in excess of an applicable limit is determined as of the end of the plan year by comparing the total elective deferrals for the plan year with the applicable limit for the plan year. In addition, except as provided in paragraph (b)(2)(i)(B) of this section, in the case of a plan that provides for separate employer-provided limits on elective deferrals for separate portions of plan compensation within the plan year, the applicable limit for the plan year is the sum of the dollar amounts of the limits for the separate portions. For example, if a plan sets a deferral percentage limit for each payroll period, the applicable limit for the plan year is the sum of the dollar amounts of the limits for the payroll periods.

(B) *Alternative method for determining employer-provided limit*—(*1*) *General rule.* If the plan limits elective deferrals for separate portions of the plan year, then, solely for purposes of determining the amount that is in excess of an employer-provided limit, the plan is permitted to provide that the applicable limit for the plan year is the product of the employee's plan year compensation and the time-weighted average of the deferral percentage limits, rather than determining the employer-provided limit as the sum of the limits for the separate portions of the year. Thus, for example, if, in accordance with the terms of the plan, highly compensated employees are limited to 8% of compensation during the first half of the plan year and 10% of compensation for the second half of the plan year, the plan is permitted to provide that the applicable limit for a highly compensated employee is 9% of the employee's plan year compensation.

(*2*) *Alternative definition of compensation permitted.* A plan using the alternative method in this paragraph (b)(2)(i)(B) is permitted to provide that the applicable limit for the plan year is determined as the product of the catch-up eligible participant's compensation used for purposes of the ADP test and the time-weighted average of the deferral percentage limits. The alternative calculation in this paragraph (b)(2)(i)(B)(*2*) is available regardless of whether the deferral percentage limits change during the plan year.

(ii) *Other year limit.* In the case of an applicable limit that is applied on the basis of a year other than the plan year

(e.g., the calendar-year limit on elective deferrals under section 401(a)(30)), the determination of whether elective deferrals are in excess of the applicable limit is made on the basis of such other year.

(c) *Catch-up contribution limit*—(1) *General rule*. Elective deferrals with respect to a catch-up eligible participant in excess of an applicable limit under paragraph (b) of this section are treated as catch-up contributions under this section as of a date within a taxable year only to the extent that such elective deferrals do not exceed the catch-up contribution limit described in paragraphs (c)(1) and (2) of this section, reduced by elective deferrals previously treated as catch-up contributions for the taxable year, determined in accordance with paragraph (c)(3) of this section. The catch-up contribution limit for a taxable year is generally the applicable dollar catch-up limit for such taxable year, as set forth in paragraph (c)(2) of this section. However, an elective deferral is not treated as a catch-up contribution to the extent that the elective deferral, when added to all other elective deferrals for the taxable year under any applicable employer plan of the employer, exceeds the participant's compensation (determined in accordance with section 415(c)(3)) for the taxable year. See also paragraph (f) of this section for special rules for employees who participate in more than one applicable employer plan maintained by the employer.

(2) *Applicable dollar catch-up limit*—(i) *In general*. The applicable dollar catch-up limit for an applicable employer plan, other than a plan described in section 401(k)(11) or 408(p), is determined under the following table:

For taxable years beginning in	Applicable dollar catch-up limit
2002	$1,000
2003	2,000
2004	3,000
2005	4,000
2006	5,000

(ii) *SIMPLE plans*. The applicable dollar catch-up limit for a SIMPLE 401(k) plan described in section 401(k)(11) or a SIMPLE IRA plan as described in section 408(p) is determined under the following table:

For taxable years beginning in	Applicable dollar catch-up limit
2002	$ 500
2003	1,000
2004	1,500
2005	2,000
2006	2,500

(iii) *Cost of living adjustments*. For taxable years beginning after 2006, the applicable dollar catch-up limit is the applicable dollar catch-up limit for 2006 described in paragraph (c)(2)(i) or (ii) of this section increased at the same time and in the same manner as adjustments under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2005, and any increase that is not a multiple of $500 shall be rounded to the next lower multiple of $500.

(3) *Timing rules*. For purposes of determining the maximum amount of permitted catch-up contributions for a catch-up eligible participant, the determination of whether an elective deferral is a catch-up contribution is made as of the last day of the plan year (or in the case of section 415, as of the last day of the limitation year), except that, with respect to elective deferrals in excess of an applicable limit that is tested on the basis of the taxable year or calendar year (e.g., the section 401(a)(30) limit on elective deferrals), the determination of whether such elective deferrals are treated as catch-up contributions is made at the time they are deferred.

(d) *Treatment of catch-up contributions*—(1) *Contributions not taken into account for certain limits*. Catch-up contributions are not taken into account in applying the limits of section 401(a)(30), 402(h), 403(b), 408, 415(c), or 457(b)(2) (determined without regard to section 457(b)(3)) to other contributions or benefits under an applicable employer plan or any other plan of the employer.

(2) *Contributions not taken into account in application of ADP test*—(i) *Calculation of ADR*. Elective deferrals that are treated as catch-up contributions pursuant to paragraph (c) of this section with respect to a section 401(k) plan because they exceed a statutory or employer-provided limit described in

paragraph (b)(1)(i) or (ii) of this section, respectively, are subtracted from the catch-up eligible participant's elective deferrals for the plan year for purposes of determining the actual deferral ratio (ADR) (as defined in regulations under section 401(k)) of a catch-up eligible participant. Similarly, elective deferrals that are treated as catch-up contributions pursuant to paragraph (c) of this section with respect to a SEP because they exceed a statutory or employer-provided limit described in paragraph (b)(1)(i) or (ii) of this section, respectively, are subtracted from the catch-up eligible participant's elective deferrals for the plan year for purposes of determining the deferral percentage under section 408(k)(6)(D) of a catch-up eligible participant.

(ii) *Adjustment of elective deferrals for correction purposes.* For purposes of the correction of excess contributions in accordance with section 401(k)(8)(C), elective deferrals under the plan treated as catch-up contributions for the plan year and not taken into account in the ADP test under paragraph (d)(2)(i) of this section are subtracted from the catch-up eligible participant's elective deferrals under the plan for the plan year.

(iii) *Excess contributions treated as catch-up contributions.* A section 401(k) plan that satisfies the ADP test of section 401(k)(3) through correction under section 401(k)(8) must retain any elective deferrals that are treated as catch-up contributions pursuant to paragraph (c) of this section because they exceed the ADP limit in paragraph (b)(1)(iii) of this section. In addition, a section 401(k) plan is not treated as failing to satisfy section 401(k)(8) merely because elective deferrals described in the preceding sentence are not distributed or recharacterized as employee contributions. Similarly, a SEP is not treated as failing to satisfy section 408(k)(6)(A)(iii) merely because catch-up contributions are not treated as excess contributions with respect to a catch-up eligible participant under the rules of section 408(k)(6)(C). Notwithstanding the fact that elective deferrals described in this paragraph (d)(2)(iii) are not distributed, such elective deferrals are still considered to be excess contributions under section 401(k)(8), and accordingly, matching contributions with respect to such elective deferrals are permitted to be forfeited under the rules of section 411(a)(3)(G).

(3) *Contributions not taken into account for other nondiscrimination purposes*—(i) *Application for top-heavy.* Catch-up contributions with respect to the current plan year are not taken into account for purposes of section 416. However, catch-up contributions for prior years are taken into account for purposes of section 416. Thus, catch-up contributions for prior years are included in the account balances that are used in determining whether the plan is top-heavy under section 416(g).

(ii) *Application for section 410(b).* Catch-up contributions with respect to the current plan year are not taken into account for purposes of section 410(b). Thus, catch-up contributions are not taken into account in determining the average benefit percentage under §1.410(b)–5 for the year if benefit percentages are determined based on current year contributions. However, catch-up contributions for prior years are taken into account for purposes of section 410(b). Thus, catch-up contributions for prior years would be included in the account balances that are used in determining the average benefit percentage if allocations for prior years are taken into account.

(4) *Availability of catch-up contributions.* An applicable employer plan does not violate §1.401(a)(4)–4 merely because the group of employees for whom catch-up contributions are currently available (*i.e.*, the catch-up eligible participants) is not a group of employees that would satisfy section 410(b) (without regard to §1.410(b)–5). In addition, a catch-up eligible participant is not treated as having a right to a different rate of allocation of matching contributions merely because an otherwise nondiscriminatory schedule of matching rates is applied to elective deferrals that include catch-up contributions. The rules in this paragraph (d)(4) also apply for purposes of satisfying the requirements of section 403(b)(12).

(e) *Universal availability requirement*—(1) *General rule*—(i) *Effective opportunity.* An applicable employer plan

that offers catch-up contributions and that is otherwise subject to section 401(a)(4) (including a plan that is subject to section 401(a)(4) pursuant to section 403(b)(12)) will not satisfy the requirements of section 401(a)(4) unless all catch-up eligible participants who participate under any applicable employer plan maintained by the employer are provided with an effective opportunity to make the same dollar amount of catch-up contributions. A plan fails to provide an effective opportunity to make catch-up contributions if it has an applicable limit (e.g., an employer-provided limit) that applies to a catch-up eligible participant and does not permit the participant to make elective deferrals in excess of that limit. An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) solely because an employer-provided limit does not apply to all employees or different limits apply to different groups of employees under paragraph (b)(2)(i) of this section. However, a plan may not provide lower employer-provided limits for catch-up eligible participants.

(ii) *Certain practices permitted*—(A) *Proration of limit*. An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because the plan allows participants to defer an amount equal to a specified percentage of compensation for each payroll period and for each payroll period permits each catch-up eligible participant to defer a pro-rata share of the applicable dollar catch-up limit in addition to that amount.

(B) *Cash availability*. An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because it restricts the elective deferrals of any employee (including a catch-up eligible participant) to amounts available after other withholding from the employee's pay (e.g., after deduction of all applicable income and employment taxes). For this purpose, an employer limit of 75% of compensation or higher will be treated as limiting employees to amounts available after other withholdings.

(2) *Certain employees disregarded*. An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because employees described in section 410(b)(3) (e.g., collectively bargained employees) are not provided the opportunity to make catch-up contributions.

(3) *Exception for certain plans*. An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because another applicable employer plan that is a section 457 eligible governmental plan does not provide for catch-up contributions to the extent set forth in section 414(v)(6)(C) and paragraph (a)(3) of this section.

(4) *Exception for section 410(b)(6)(C)(ii) period*. If an applicable employer plan satisfies the universal availability requirement of this paragraph (e) before an acquisition or disposition described in §1.410(b)–2(f) and would fail to satisfy the universal availability requirement of this paragraph (e) merely because of such event, then the applicable employer plan shall continue to be treated as satisfying this paragraph (e) through the end of the period determined under section 410(b)(6)(C)(ii).

(f) *Special rules for an employer that sponsors multiple plans*—(1) *General rule*. For purposes of paragraph (c) of this section, all applicable employer plans, other than section 457 eligible governmental plans, maintained by the same employer are treated as one plan and all section 457 eligible governmental plans maintained by the same employer are treated as one plan. Thus, the total amount of catch-up contributions under all applicable employer plans of an employer (other than section 457 eligible governmental plans) is limited to the applicable dollar catch-up limit for the taxable year, and the total amount of catch-up contributions for all section 457 eligible governmental plans of an employer is limited to the applicable dollar catch-up limit for the taxable year.

(2) *Coordination of employer-provided limits*. An applicable employer plan is permitted to allow a catch-up eligible participant to defer amounts in excess of an employer-provided limit under that plan without regard to whether

elective deferrals made by the participant have been treated as catch-up contributions for the taxable year under another applicable employer plan aggregated with such plan under this paragraph (f). However, to the extent elective deferrals under another plan maintained by the employer have already been treated as catch-up contributions during the taxable year, the elective deferrals under the plan may be treated as catch-up contributions only up to the amount remaining under the catch-up limit for the year. Any other elective deferrals that exceed the employer-provided limit may not be treated as catch-up contributions and must satisfy the otherwise applicable nondiscrimination rules. For example, the right to make contributions in excess of the employer-provided limit is another right or feature which must satisfy §1.401(a)(4)–4 to the extent that the contributions are not catch-up contributions. Also, contributions in excess of the employer provided limit are taken into account under the ADP test to the extent they are not catch-up contributions.

(3) *Allocation rules.* If a catch-up eligible participant makes additional elective deferrals in excess of an applicable limit under paragraph (b)(1) of this section under more than one applicable employer plan that is aggregated under the rules of this paragraph (f), the applicable employer plan under which elective deferrals in excess of an applicable limit are treated as catch-up contributions is permitted to be determined in any manner that is not inconsistent with the manner in which such amounts were actually deferred under the plan.

(g) *Definitions*—(1) *Applicable employer plan.* The term applicable employer plan means a section 401(k) plan, a SIMPLE IRA plan as defined in section 408(p), a simplified employee pension plan as defined in section 408(k) (SEP), a plan or contract that satisfies the requirements of section 403(b), or a section 457 eligible governmental plan.

(2) *Elective deferral.* The term elective deferral means an elective deferral within the meaning of section 402(g)(3) or any contribution to a section 457 eligible governmental plan.

(3) *Catch-up eligible participant.* An employee is a catch-up eligible participant for a taxable year if—

(i) The employee is eligible to make elective deferrals under an applicable employer plan (without regard to section 414(v) or this section); and

(ii) The employee's 50th or higher birthday would occur before the end of the employee's taxable year.

(4) *Other definitions.* (i) The terms employer, employee, section 401(k) plan, and highly compensated employee have the meanings provided in §1.410(b)–9.

(ii) The term section 457 eligible governmental plan means an eligible deferred compensation plan described in section 457(b) that is established and maintained by an eligible employer described in section 457(e)(1)(A).

(h) *Examples.* The following examples illustrate the application of this section. For purposes of these examples, the limit under section 401(a)(30) is $15,000 and the applicable dollar catch-up limit is $5,000 and, except as specifically provided, the plan year is the calendar year. In addition, it is assumed that the participant's elective deferrals under all plans of the employer do not exceed the participant's section 415(c)(3) compensation, that the taxable year of the participant is the calendar year and that any correction pursuant to section 401(k)(8) is made through distribution of excess contributions. The examples are as follows:

Example 1. (i) Participant A is eligible to make elective deferrals under a section 401(k) plan, Plan P. Plan P does not limit elective deferrals except as necessary to comply with sections 401(a)(30) and 415. In 2006, Participant A is 55 years old. Plan P also provides that a catch-up eligible participant is permitted to defer amounts in excess of the section 401(a)(30) limit up to the applicable dollar catch-up limit for the year. Participant A defers $18,000 during 2006.

(ii) Participant A's elective deferrals in excess of the section 401(a)(30) limit ($3,000) do not exceed the applicable dollar catch-up limit for 2006 ($5,000). Under paragraph (a)(1) of this section, the $3,000 is a catch-up contribution and, pursuant to paragraph (d)(2)(i) of this section, it is not taken into account in determining Participant A's ADR for purposes of section 401(k)(3).

Example 2. (i) Participants B and C, who are highly compensated employees each earning $120,000, are eligible to make elective

deferrals under a section 401(k) plan, Plan Q. Plan Q limits elective deferrals as necessary to comply with section 401(a)(30) and 415, and also provides that no highly compensated employee may make an elective deferral at a rate that exceeds 10% of compensation. However, Plan Q also provides that a catch-up eligible participant is permitted to defer amounts in excess of 10% during the plan year up to the applicable dollar catch-up limit for the year. In 2006, Participants B and C are both 55 years old and, pursuant to the catch-up provision in Plan Q, both elect to defer 10% of compensation plus a pro-rata portion of the $5,000 applicable dollar catch-up limit for 2006. Participant B continues this election in effect for the entire year, for a total elective contribution for the year of $17,000. However, in July 2006, after deferring $8,500, Participant C discontinues making elective deferrals.

(ii) Once Participant B's elective deferrals for the year exceed the section 401(a)(30) limit ($15,000), subsequent elective deferrals are treated as catch-up contributions as they are deferred, provided that such elective deferrals do not exceed the catch-up contribution limit for the taxable year. Since the $2,000 in elective deferrals made after Participant B reaches the section 402(g) limit for the calendar year does not exceed the applicable dollar catch-up limit for 2006, the entire $2,000 is treated as a catch-up contribution.

(iii) As of the last day of the plan year, Participant B has exceeded the employer-provided limit of 10% (10% of $120,000 or $12,000 for Participant B) by an additional $3,000. Since the additional $3,000 in elective deferrals does not exceed the $5,000 applicable dollar catch-up limit for 2006, reduced by the $2,000 in elective deferrals previously treated as catch-up contributions, the entire $3,000 of elective deferrals is treated as a catch-up contribution.

(iv) In determining Participant B's ADR, the $5,000 of catch-up contributions are subtracted from Participant B's elective deferrals for the plan year under paragraph (d)(2)(i) of this section. Accordingly, Participant B's ADR is 10% ($12,000/$120,000). In addition, for purposes of applying the rules of section 401(k)(8), Participant B is treated as having elective deferrals of $12,000.

(v) Participant C's elective deferrals for the year do not exceed an applicable limit for the plan year. Accordingly, Participant C's $8,500 of elective deferrals must be taken into account in determining Participant C's ADR for purposes of section 401(k)(3).

Example 3. (i) The facts are the same as in *Example 2*, except that Plan Q is amended to change the maximum permitted deferral percentage for highly compensated employees to 7%, effective for deferrals after April 1, 2006. Participant B, who has earned $40,000 in the first 3 months of the year and has been deferring at a rate of 10% of compensation plus a pro-rata portion of the $5,000 applicable dollar catch-up limit for 2006, reduces the 10% of pay deferral rate to 7% for the remaining 9 months of the year (while continuing to defer a pro-rata portion of the $5,000 applicable dollar catch-up limit for 2006). During those 9 months, Participant B earns $80,000. Thus, Participant B's total elective deferrals for the year are $14,600 ($4,000 for the first 3 months of the year plus $5,600 for the last 9 months of the year plus an additional $5,000 throughout the year).

(ii) The employer-provided limit for Participant B for the plan year is $9,600 ($4,000 for the first 3 months of the year, plus $5,600 for the last 9 months of the year). Accordingly, Participant B's elective deferrals for the year that are in excess of the employer-provided limit are $5,000 (the excess of $14,600 over $9,600), which does not exceed the applicable dollar catch-up limit of $5,000.

(iii) Alternatively, Plan Q may provide that the employer-provided limit is determined as the time-weighted average of the different deferral percentage limits over the course of the year. In this case, the time-weighted average limit is 7.75% for all participants, and the applicable limit for Participant B is 7.75% of $120,000, or $9,300. Accordingly, Participant B's elective deferrals for the year that are in excess of the employer-provided limit are $5,300 (the excess of $14,600 over $9,300). Since the amount of Participant B's elective deferrals in excess of the employer-provided limit ($5,300) exceeds the applicable dollar catch-up limit for the taxable year, only $5,000 of Participant B's elective deferrals may be treated as catch-up contributions. In determining Participant B's actual deferral ratio, the $5,000 of catch-up contributions are subtracted from Participant B's elective deferrals for the plan year under paragraph (d)(2)(i) of this section. Accordingly, Participant B's actual deferral ratio is 8% ($9,600/$120,000). In addition, for purposes of applying the rules of section 401(k)(8), Participant B is treated as having elective deferrals of $9,600.

Example 4. (i) The facts are the same as in *Example 1*. In addition to Participant A, Participant D is a highly compensated employee who is eligible to make elective deferrals under Plan P. During 2006, Participant D, who is 60 years old, elects to defer $14,000.

(ii) The ADP test is run for Plan P (after excluding the $3,000 in catch-up contributions from Participant A's elective deferrals), but Plan P needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(B), the maximum deferrals which may be retained by any highly compensated employee in Plan P is $12,500.

(iii) Pursuant to paragraph (b)(1)(iii) of this section, the ADP limit under Plan P of $12,500 is an applicable limit. Accordingly, $1,500 of Participant D's elective deferrals exceed the applicable limit. Similarly, $2,500 of Participant A's elective deferrals (other than the $3,000 of elective deferrals treated as catch-up contributions because they exceed the section 401(a)(30) limit) exceed the applicable limit.

(iv) The $1,500 of Participant D's elective deferrals that exceed the applicable limit are less than the applicable dollar catch-up limit and are treated as catch-up contributions. Pursuant to paragraph (d)(2)(iii) of this section, Plan P must retain Participant D's $1,500 in elective deferrals and Plan P is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant D.

(v) The $2,500 of Participant A's elective deferrals that exceed the applicable limit are greater than the portion of the applicable dollar catch-up limit ($2,000) that remains after treating the $3,000 of elective deferrals in excess of the section 401(a)(30) limit as catch-up contributions. Accordingly, $2,000 of Participant A's elective deferrals are treated as catch-up contributions. Pursuant to paragraph (d)(2)(iii) of this section, Plan P must retain Participant A's $2,000 in elective deferrals and Plan P is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant A. However, $500 of Participant A's elective deferrals cannot be treated as catch-up contributions and must be distributed to Participant A in order to satisfy section 401(k)(8).

Example 5. (i) Participant E is a highly compensated employee who is a catch-up eligible participant under a section 401(k) plan, Plan R, with a plan year ending October 31, 2006. Plan R does not limit elective deferrals except as necessary to comply with section 401(a)(30) and section 415. Plan R permits all catch-up eligible participants to defer an additional amount equal to the applicable dollar catch-up limit for the year ($5,000) in excess of the section 401(a)(30) limit. Participant E did not exceed the section 401(a)(30) limit in 2005 and did not exceed the ADP limit for the plan year ending October 31, 2005. Participant E made $3,200 of deferrals in the period November 1, 2005 through December 31, 2005 and an additional $16,000 of deferrals in the first 10 months of 2006, for a total of $19,200 in elective deferrals for the plan year.

(ii) Once Participant E's elective deferrals for the calendar year 2006 exceed $15,000, subsequent elective deferrals are treated as catch-up contributions at the time they are deferred, provided that such elective deferrals do not exceed the applicable dollar catch-up limit for the taxable year. Since the $1,000 in elective deferrals made after Participant E reaches the section 402(g) limit for the calendar year does not exceed the applicable dollar catch-up limit for 2006, the entire $1,000 is a catch-up contribution. Pursuant to paragraph (d)(2)(i) of this section, $1,000 is subtracted from Participant E's $19,200 in elective deferrals for the plan year ending October 31, 2006 in determining Participant E's ADR for that plan year.

(iii) The ADP test is run for Plan R (after excluding the $1,000 in elective deferrals in excess of the section 401(a)(30) limit), but Plan R needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(C), the maximum deferrals that may be retained by any highly compensated employee under Plan R for the plan year ending October 31, 2006 (the ADP limit) is $14,800.

(iv) Under paragraph (d)(2)(ii) of this section, elective deferrals that exceed the section 401(a)(30) limit under Plan R are also subtracted from Participant E's elective deferrals under Plan R for purposes of applying the rules of section 401(k)(8). Accordingly, for purposes of correcting the failed ADP test, Participant E is treated as having contributed $18,200 of elective deferrals in Plan R. The amount of elective deferrals that would have to be distributed to Participant E in order to satisfy section 401(k)(8)(C) is $3,400 ($18,200 minus $14,800), which is less than the excess of the applicable dollar catch-up limit ($5,000) over the elective deferrals previously treated as catch-up contributions under Plan R for the taxable year ($1,000). Under paragraph (d)(2)(iii) of this section, Plan R must retain Participant E's $3,400 in elective deferrals and is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant E.

(v) Even though Participant E's elective deferrals for the calendar year 2006 have exceeded the section 401(a)(30) limit, Participant E can continue to make elective deferrals during the last 2 months of the calendar year, since Participant E's catch-up contributions for the taxable year are not taken into account in applying the section 401(a)(30) limit for 2006. Thus, Participant E can make an additional contribution of $3,400 ($15,000 minus ($16,000 minus $4,400)) without exceeding the section 401(a)(30) for the calendar year and without regard to any additional catch-up contributions. In addition, Participant E may make additional catch-up contributions of $600 (the $5,000 applicable dollar catch-up limit for 2006, reduced by the $4,400 ($1,000 plus $3,400) of elective deferrals previously treated as catch-up contributions during the taxable year). The $600 of catch-up contributions will not be taken into account in the ADP test for the plan year ending October 31, 2007.

Example 6. (i) The facts are the same as in *Example 5*, except that Participant E exceeded the section 401(a)(30) limit for 2005 by $1,300 prior to October 31, 2005, and made $600 of elective deferrals in the period November 1, 2005, through December 31, 2005 (which were catch-up contributions for 2005). Thus, Participant E made $16,600 of elective deferrals for the plan year ending October 31, 2006.

(ii) Once Participant E's elective deferrals for the calendar year 2006 exceed $15,000, subsequent elective deferrals are treated as catch-up contributions as they are deferred, provided that such elective deferrals do not exceed the applicable dollar catch-up limit for the taxable year. Since the $1,000 in elective deferrals made after Participant E reaches the section 402(g) limit for calendar year 2006 does not exceed the applicable dollar catch-up limit for 2006, the entire $1,000 is a catch-up contribution. Pursuant to paragraph (d)(2)(i) of this section, $1,000 is subtracted from Participant E's elective deferrals in determining Participant E's ADR for the plan year ending October 31, 2006. In addition, the $600 of catch-up contributions from the period November 1, 2005 to December 31, 2005 are subtracted from Participant E's elective deferrals in determining Participant E's ADR. Thus, the total elective deferrals taken into account in determining Participant E's ADR for the plan year ending October 31, 2006, is $15,000 ($16,600 in elective deferrals for the current plan year, less $1,600 in catch-up contributions).

(iii) The ADP test is run for Plan R (after excluding the $1,600 in elective deferrals in excess of the section 401(a)(30) limit), but Plan R needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(C), the maximum deferrals that may be retained by any highly compensated employee under Plan R (the ADP limit) is $14,800.

(iv) Under paragraph (d)(2)(ii) of this section, elective deferrals that exceed the section 401(a)(30) limit under Plan R are also subtracted from Participant E's elective deferrals under Plan R for purposes of applying the rules of section 401(k)(8). Accordingly, for purposes of correcting the failed ADP test, Participant E is treated as having contributed $15,000 of elective deferrals in Plan R. The amount of elective deferrals that would have to be distributed to Participant E in order to satisfy section 401(k)(8)(C) is $200 ($15,000 minus $14,800), which is less than the excess of the applicable dollar catch-up limit ($5,000) over the elective deferrals previously treated as catch-up contributions under Plan R for the taxable year ($1,000). Under paragraph (d)(2)(iii) of this section, Plan R must retain Participant E's $200 in elective deferrals and is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant E.

(v) Even though Participant E's elective deferrals for calendar year 2006 have exceeded the section 401(a)(30) limit, Participant E can continue to make elective deferrals during the last 2 months of the calendar year, since Participant E's catch-up contributions for the taxable year are not taken into account in applying the section 401(a)(30) limit for 2006. Thus Participant E can make an additional contribution of $200 ($15,000 minus ($16,000 minus $1,200)) without exceeding the section 401(a)(30) for the calendar year and without regard to any additional catch-up contributions. In addition, Participant E may make additional catch-up contributions of $3,800 (the $5,000 applicable dollar catch-up limit for 2006, reduced by the $1,200 ($1,000 plus $200) of elective deferrals previously treated as catch-up contributions during the taxable year). The $3,800 of catch-up contributions will not be taken into account in the ADP test for the plan year ending October 31, 2007.

Example 7. (i) Participant F, who is 58 years old, is a highly compensated employee who earns $100,000 per year. Participant F participates in a section 401(k) plan, Plan S, for the first 6 months of the year and then transfers to another section 401(k) plan, Plan T, sponsored by the same employer, for the second 6 months of the year. Plan S limits highly compensated employees' elective deferrals to 6% of compensation for the period of participation, but permits catch-up eligible participants to defer amounts in excess of 6% during the plan year, up to the applicable dollar catch-up limit for the year. Plan T limits highly compensated employees' elective deferrals to 8% of compensation for the period of participation, but permits catch-up eligible participants to defer amounts in excess of 8% during the plan year, up to the applicable dollar catch-up limit for the year. Participant F earned $50,000 in the first 6 months of the year and deferred $6,000 under Plan S. Participant F also deferred $6,500 under Plan T.

(ii) As of the last day of the plan year, Participant F has $3,000 in elective deferrals under Plan S that exceed the employer-provided limit of $3,000. Under Plan T, Participant F has $2,500 in elective deferrals that exceed the employer-provided limit of $4,000. The total amount of elective deferrals in excess of employer-provided limits, $5,500, exceeds the applicable dollar catch-up limit by $500. Accordingly, $500 of the elective deferrals in excess of the employer-provided limits are not catch-up contributions and are treated as regular elective deferrals (and are taken into account in the ADP test). The determination of which elective deferrals in excess of an applicable limit are treated as catch-up contributions is permitted to be made in any manner that is not inconsistent

with the manner in which such amounts were actually deferred under Plan S and Plan T.

Example 8. (i) Employer X sponsors Plan P, which provides for matching contributions equal to 50% of elective deferrals that do not exceed 10% of compensation. Elective deferrals for highly compensated employees are limited, on a payroll-by-payroll basis, to 10% of compensation. Employer X pays employees on a monthly basis. Plan P also provides that elective contributions are limited in accordance with section 401(a)(30) and other applicable statutory limits. Plan P also provides for catch-up contributions. Under Plan P, for purposes of calculating the amount to be treated as catch-up contributions (and to be excluded from the ADP test), amounts in excess of the 10% limit for highly compensated employees are determined at the end of the plan year based on compensation used for purposes of ADP testing (testing compensation), a definition of compensation that is different from the definition used under the plan for purposes of calculating elective deferrals and matching contributions during the plan year (deferral compensation).

(ii) Participant A, a highly compensated employee, is a catch-up eligible participant under Plan P with deferral compensation of $10,000 per monthly payroll period. Participant A defers 10% per payroll period for the first 10 months of the year, and is allocated a matching contribution each payroll period of $500. In addition, Participant A defers an additional $4,000 during the first 10 months of the year. Participant A then reduces deferrals during the last 2 months of the year to 5% of compensation. Participant A is allocated a matching contribution of $250 for each of the last 2 months of the plan year. For the plan year, Participant A has $15,000 in elective deferrals and $5,500 in matching contributions.

(iii) A's testing compensation is $118,000. At the end of the plan year, based on 10% of testing compensation, or $11,800, Plan P determines that A has $3,200 in deferrals that exceed the 10% employer provided limit. Plan P excludes $3,200 from ADP testing and calculates A's ADR as $11,800 divided by $118,000, or 10%. Although A has not been allocated a matching contribution equal to 50% of $11,800, because Plan P provides that matching contributions are calculated based on elective deferrals during a payroll period as a percentage of deferral compensation, Plan P is not required to allocate an additional $400 of matching contributions to A.

(i) *Effective date*—(1) *Statutory effective date.* Section 414(v) applies to contributions in taxable years beginning on or after January 1, 2002.

(2) *Regulatory effective date.* Paragraphs (a) through (h) of this section apply to contributions in taxable years beginning on or after January 1, 2004.

[T.D. 9072, 68 FR 40515, July 8, 2003]

§ 1.414(w)–1 Permissible withdrawals from eligible automatic contribution arrangements.

(a) *Overview.* Section 414(w) provides rules under which certain employees are permitted to elect to make a withdrawal of default elective contributions from an eligible automatic contribution arrangement. This section sets forth the rules applicable to permissible withdrawals from an eligible automatic contribution arrangement within the meaning of section 414(w). Paragraph (b) of this section defines an eligible automatic contribution arrangement. Paragraph (c) of this section describes a permissible withdrawal and addresses which employees are eligible to elect a withdrawal, the timing of the withdrawal election, and the amount of the withdrawal. Paragraph (d) of this section describes the tax and other consequences of the withdrawal. Paragraph (e) of this section includes the definitions applicable to this section.

(b) *Eligible automatic contribution arrangement*—(1) *In general.* An eligible automatic contribution arrangement is an automatic contribution arrangement under an applicable employer plan that is intended to be an eligible automatic contribution arrangement for the plan year and that satisfies the uniformity requirement under paragraph (b)(2) of this section, and the notice requirement under paragraph (b)(3) of this section. An eligible automatic contribution arrangement need not cover all employees who are eligible to elect to have contributions made on their behalf under the applicable employer plan.

(2) *Uniformity requirement*—(i) *In general.* An eligible automatic contribution arrangement must provide that the default elective contribution is a uniform percentage of compensation.

(ii) *Exception to uniform percentage requirement.* An arrangement does not violate the uniformity requirement of paragraph (b)(2)(i) of this section merely because the percentage varies in a manner that is permitted under § 1.401(k)–3(j)(2)(iii), except that the

rule of §1.401(k)–3(j)(2)(iii)(B) is applied without regard to whether the arrangement is intended to be a qualified automatic contribution arrangement.

(iii) *Rules of application.* For purposes of this paragraph (b)(2), all automatic contribution arrangements that are intended to be eligible automatic contribution arrangements within a plan (or within the disaggregated plan under §1.410(b)–7, in the case of a plan subject to section 410(b)) are aggregated. Thus, for example, if a single plan within the meaning of section 414(l) covering employees in two separate divisions has two different automatic contribution arrangements that are intended to be eligible automatic contributions arrangements, the two automatic contribution arrangements can constitute eligible automatic contribution arrangements only if the default elective contributions under the arrangements are the same percentage of compensation. However, if the different automatic contribution arrangements cover employees in portions of the plan that are mandatorily disaggregated under the rules of section 410(b), then there is no requirement to aggregate those automatic contribution arrangements under the uniformity requirements of this paragraph (b)(2).

(3) *Notice requirement*—(i) *General rule.* The notice requirement of this paragraph (b)(3) is satisfied for a plan year if each covered employee is given notice of the employee's rights and obligations under the arrangement. The notice must be sufficiently accurate and comprehensive to apprise the employee of such rights and obligations, and be written in a manner calculated to be understood by the average employee to whom the arrangement applies. The notice must be in writing; however, see §1.401(a)–21 for rules permitting the use of electronic media to provide applicable notices.

(ii) *Content requirement.* The notice must include the provisions found in §1.401(k)–3(d)(2)(ii) to the extent those provisions apply to the arrangement. A notice is not considered sufficiently accurate and comprehensive unless the notice accurately describes—

(A) The level of the default elective contributions which will be made on the employee's behalf if the employee does not make an affirmative election;

(B) The employee's rights to elect not to have default elective contributions made to the plan on his or her behalf or to have a different percentage of compensation or different amount of contribution made to the plan on his or her behalf;

(C) How contributions made under the arrangement will be invested in the absence of any investment election by the employee; and

(D) The employee's rights to make a permissible withdrawal, if applicable, and the procedures to elect such a withdrawal.

(iii) *Timing*—(A) *General rule.* The timing requirement of this paragraph (b)(3)(iii) is satisfied if the notice is provided within a reasonable period before the beginning of each plan year or, in the plan year the employee is first eligible to make a cash or deferred election (or first becomes covered under the automatic contribution arrangement as a result of a change in employment status), within a reasonable period before the employee becomes a covered employee. In addition, a notice satisfies the timing requirements of paragraph (b)(3) of this section only if it is provided sufficiently early so that the employee has a reasonable period of time after receipt of the notice in order to make the election described under paragraph (e)(2)(i) or (e)(2)(ii) of this section.

(B) *Deemed satisfaction of timing requirement.* The timing requirement of this paragraph (b)(3)(iii) is satisfied if at least 30 days (and no more than 90 days) before the beginning of each plan year, the notice is given to each employee covered under the automatic contribution arrangement for the plan year. In the case of an employee who does not receive the notice within the period described in the previous sentence because the employee becomes eligible to make a cash or deferred election (or becomes covered under the automatic contribution arrangement as a result of a change in employment status) after the 90th day before the beginning of the plan year, the timing requirement is deemed to be satisfied if the notice is provided no more than 90

days before the employee becomes eligible to make a cash or deferred election (or becomes covered under the automatic contribution arrangement as a result of a change in employment status), and no later than the date that affords the employee a reasonable period of time after receipt of the notice to make the election described under paragraph (e)(2)(i) or (e)(2)(ii) of this section. If it is not practicable for the notice to be provided on or before the date specified in the plan that an employee becomes eligible to make a cash or deferred election, the notice will nonetheless be treated as provided timely if it is provided as soon as practicable after that date and the employee is permitted to elect to defer from all types of compensation that may be deferred under the plan earned beginning on that date.

(c) *Permissible withdrawal*—(1) *In general.* If the plan so provides, any employee who has default elective contributions made under the eligible automatic contribution arrangement may elect to make a withdrawal of such contributions (and earnings attributable thereto) in accordance with the requirements of this paragraph (c). An applicable employer plan that includes an eligible automatic contribution arrangement will not fail to satisfy the prohibition on in-service withdrawals under section 401(k)(2)(B), 403(b)(7), 403(b)(11), or 457(d)(1) merely because it permits withdrawals that satisfy the timing requirement of paragraph (c)(2) of this section and the amount requirement of paragraph (c)(3) of this section.

(2) *Timing*—(i) *Last date to make election.* A covered employee's election to withdraw default elective contributions must be made no later than 90 days after the date of the first default elective contribution under the eligible automatic contribution arrangement and must be effective no later than the date set forth in paragraph (c)(2)(iii) of this section. A plan is permitted to set an earlier deadline for making this election, but if a plan provides that a covered employee may withdraw default elective contributions, then the election period for the covered employee must be at least 30 days.

(ii) *Determination of date of first default elective contribution.* For purposes of this paragraph (c)(2), the date of the first default elective contribution is the date that the compensation that is subject to the cash or deferred election would otherwise have been included in gross income.

(iii) *Latest effective date of the election.* The effective date of an election described in this paragraph (c)(2) cannot be after the earlier of—

(A) The pay date for the second payroll period that begins after the date the election is made; and

(B) The first pay date that occurs at least 30 days after the election is made.

(iv) *Special rules*—(A) *Treatment of periods without default elective contributions.* For purposes of determining the date of the first default elective contribution under the eligible automatic contribution arrangement, a plan is permitted to treat an employee who for an entire plan year did not have default elective contributions made under the eligible automatic contribution arrangement as if the employee had not had such contributions for any prior plan year as well.

(B) *Treatment relating to aggregation of arrangements.* The determination of whether an election is made no later than 90 days after the date of the first default elective contribution under the eligible automatic contribution arrangement must take into account any other eligible automatic contribution arrangement that is required to be aggregated with the eligible automatic contribution arrangement under the rules of paragraph (b)(2)(iii) of this section.

(3) *Amount and timing of distributions*—(i) *In general.* A distribution satisfies the requirement of this paragraph (c)(3) if the distribution is equal to the amount of default elective contributions made under the eligible automatic contribution arrangement through the effective date of the election described in paragraph (c)(2) of this section (adjusted for allocable gains and losses to the date of distribution). If default elective contributions are separately accounted for in the participant's account, the amount of the distribution will be the total amount in that account. However, if default

elective contributions are not separately accounted for under the plan, the amount of the allocable gains and losses will be determined under rules similar to those provided under § 1.401(k)–2(b)(2)(iv) for the distribution of excess contributions.

(ii) *Fees*. The distribution amount as determined under this paragraph (c)(3) may be reduced by any generally applicable fees. However, the plan may not charge a higher fee for a distribution under section 414(w) than would apply to any other distributions of cash.

(iii) *Date of distribution*. The distribution must be made in accordance with the plan's ordinary timing procedures for processing distributions and making distributions.

(d) *Consequences of the withdrawal*—(1) *Income tax consequences*—(i) *Year of inclusion*. The amount of the withdrawal is includible in the eligible employee's gross income for the taxable year in which the distribution is made. However, any portion of the distribution consisting of designated Roth contributions is not included in an employee's gross income a second time. The portion of the withdrawal that is treated as an investment in the contract is determined without regard to any plan contributions other than those distributed as a withdrawal of default elective contributions.

(ii) *No additional tax on early distributions from qualified retirement plans*. The withdrawal is not subject to the additional tax under section 72(t).

(iii) *Reporting*. The amount of the withdrawal is reported on Form 1099–R, ''Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.,'' as described in the applicable instructions.

(iv) *Disregarded for purposes of section 402(g)*. The amount of the withdrawal is not taken into account in determining the limitation on elective deferrals under section 402(g).

(2) *Forfeiture of matching contributions*. In the case of any withdrawal made under paragraph (c) of this section, employer matching contributions with respect to the amount withdrawn that have been allocated to the participant's account (adjusted for allocable gains and losses) must be forfeited. A plan is permitted to provide that employer matching contributions will not be made with respect to any withdrawal made under paragraph (c) of this section if the withdrawal has been made prior to the date as of which the match would otherwise be allocated.

(3) *Consent rules*. A withdrawal made under paragraph (c) of this section may be made without regard to any notice or consent otherwise required under section 401(a)(11) or 417.

(e) *Definitions*. Unless indicated otherwise, the following definitions apply for purposes of section 414(w) and this section.

(1) *Applicable employer plan*. An applicable employer plan means a plan that—

(i) Is qualified under section 401(a);

(ii) Satisfies the requirements of section 403(b);

(iii) Is a section 457(b) eligible governmental plan described in § 1.457–2(f);

(iv) Is a simplified employee pension the terms of which provide for a salary reduction arrangement described in section 408(k)(6); or

(v) Is a SIMPLE described in section 408(p).

(2) *Automatic contribution arrangement*. An automatic contribution arrangement means an arrangement that provides for a cash or deferred election and which specifies that, in the absence of a covered employee's affirmative election, a default election applies under which the employee is treated as having elected to have default elective contributions made on his or her behalf under the plan. The default election begins to apply with respect to an eligible employee no earlier than a reasonable period of time after receipt of the notice describing the automatic contribution arrangement. This default election ceases to apply with respect to an eligible employee for periods of time with respect to which the employee has an affirmative election that is currently in effect to—

(i) Not have any default elective contributions made on his or her behalf; or

(ii) Have contributions made in a different amount or percentage of compensation.

(3) *Covered employee*. Covered employee means an employee who is covered under the automatic contribution

arrangement, determined under the terms of the plan. A plan must provide whether an employee who makes an affirmative election remains a covered employee. If a plan provides that an employee who makes an affirmative election described in paragraph (e)(2)(i) or (e)(2)(ii) of this section remains a covered employee, then the employee must continue to receive the notice described in paragraph (b)(3) of this section and the plan may be eligible for the excise tax relief with respect to excess amounts distributed within 6 months after the end of the plan year under section 4979(f)(1). Such an employee will also have the default election reapply if the plan provides that the employee's prior affirmative election no longer remains in effect and the employee does not make a new affirmative election.

(4) *Default elective contributions.* Default elective contributions means the contributions that are made at a specified level or amount under an automatic contribution arrangement in the absence of a covered employee's affirmative election that are—

(i) Contributions described in section 402(g)(3); or

(ii) Contributions made to an eligible governmental plan within the meaning of §1.457–2(f) that would be elective contributions if they were made under a qualified plan.

(f) *Effective/applicability date*—(1) *Statutory effective date.* Section 414(w) applies to plan years beginning on or after January 1, 2008.

(2) *Regulatory effective date.* This section applies to plan years beginning on or after January 1, 2010. For plan years that begin in 2008, a plan must operate in accordance with a good faith interpretation of section 414(w). For this purpose, a plan that operates in accordance with this section will be treated as operating in accordance with a good faith interpretation of section 414(w).

[T.D. 9447, 74 FR 8212, Feb. 24, 2009]

§1.415(a)–1 General rules with respect to limitations on benefits and contributions under qualified plans.

(a) *Trusts.* Under sections 415 and 401(a)(16), a trust that forms part of a pension, profit-sharing, or stock bonus plan will not be qualified under section 401(a) if any of the following conditions exists:

(1) In the case of a defined benefit plan, the annual benefit with respect to any participant for any limitation year exceeds the limitations of section 415(b) and §1.415(b)–1.

(2) In the case of a defined contribution plan, the annual additions credited with respect to any participant for any limitation year exceed the limitations of section 415(c) and §1.415(c)–1.

(3) The trust has been disqualified under section 415(g) and §1.415(g)–1 for any year.

(b) *Certain annuities and accounts*—(1) *In general.* Under section 415, an employee annuity plan described in section 403(a), an annuity contract described in section 403(b), or a simplified employee pension described in section 408(k) will not be considered to be described in the otherwise applicable section if any of the following conditions exists:

(i) The annual benefit under a defined benefit plan with respect to any participant for any limitation year exceeds the limitations of section 415(b) and §1.415(b)–1.

(ii) The contributions and other additions credited under a defined contribution plan with respect to any participant for any limitation year exceed the limitations of section 415(c) and §1.415(c)–1.

(iii) The employee annuity plan, annuity contract, or simplified employee pension has been disqualified under section 415(g) and §1.415(g)–1 for any year.

(2) *Special rule for section 403(b) annuity contracts.* If the contributions and other additions under an annuity contract that otherwise satisfies the requirements of section 403(b) exceed the limitations of section 415(c) and §1.415(c)–1 with respect to any participant for any limitation year (regardless of whether the annuity contract is a defined contribution plan or a defined benefit plan), then the portion of the contract that includes such excess annual addition fails to be a section 403(b) annuity contract, and the remaining portion of the contract is a section 403(b) annuity contract. However, the status of the remaining portion of the contract as a section 403(b) annuity

contract is not retained unless, for the year of the excess and each year thereafter, the issuer of the contract maintains separate accounts for each such portion. In addition, if the benefit under an annuity contract that is a defined benefit plan and that otherwise satisfies the requirements of section 403(b) exceeds the limitations of section 415(b) and §1.415(b)–1 with respect to any participant for any limitation year, then the contract fails to be a section 403(b) annuity contract.

(3) *Section 403(b) annuity contract.* For purposes of section 415 and regulations promulgated under section 415, the term *section 403(b) annuity contract* includes arrangements that are treated as annuity contracts for purposes of section 403(b). Thus, such term includes custodial accounts described in section 403(b)(7) and retirement income accounts described in section 403(b)(9).

(c) *Regulations*—(1) *In general.* This section provides general rules regarding the application of section 415. For further rules regarding the application of section 415, see—

(i) Section 1.415(b)–1 (for general rules regarding the limits applicable to defined benefit plans);

(ii) Section 1.415(b)–2 (for special rules for defined benefit plans where a participant has multiple annuity starting dates);

(iii) Section 1.415(c)–1 (for general rules regarding the limits applicable to defined contribution plans);

(iv) Section 1.415(c)–2 (for rules regarding the definition of compensation for purposes of section 415);

(v) Section 1.415(d)–1 (for rules regarding cost-of-living adjustments to the various limits of section 415);

(vi) Section 1.415(f)–1 (for rules for aggregating plans for purposes of section 415);

(vii) Section 1.415(g)–1 (for rules regarding disqualification of plans that fail to satisfy the requirements of section 415); and

(viii) Section 1.415(j)–1 (for rules regarding limitation years).

(2) *Cross references to special rules for section 403(b) annuity contracts.* For special rules relating to section 403(b) annuity contracts, see—

(i) Section 1.415(c)–2(g)(1) and (3) (relating to the definition of compensation for section 403(b) annuity contracts);

(ii) Section 1.415(f)–1(f) (relating to rules for section 403(b) annuity contracts for purposes of aggregating plans);

(iii) Section 1.415(g)–1(b)(3)(iv)(C) (regarding disqualification of a section 403(b) annuity contract aggregated with a qualified defined contribution plan if the aggregated plans exceed the limitations of section 415(c));

(iv) Section 1.415(g)–1(c) (relating to the plan year for section 403(b) annuity contracts); and

(v) Section 1.415(j)–1(e) (relating to the limitation year for section 403(b) annuity contracts).

(3) *Cross references to special rules for governmental plans.* For special rules relating to governmental plans, see—

(i) Paragraph (f)(4) of this section (regarding permissive service credits);

(ii) Paragraph (g)(2) of this section (providing a delayed effective date for governmental plans);

(iii) Section 1.415(b)–1(a)(6)(i) (providing an exception from the compensation-based limit of section 415(b)(1)(B) for governmental plans);

(iv) Section 1.415(b)–1(a)(7)(ii) (regarding a special limitation for certain governmental plans making an election during 1990);

(v) Section 1.415(b)–1(b)(4) (regarding qualified governmental excess benefit arrangements);

(vi) Section 1.415(b)–1(d)(3) and (4) (regarding age adjustments to the dollar limit of section 415(b)(1)(A) for employees of police and fire departments and members of the Armed Forces of the United States, and for survivor and disability benefits);

(vii) Section 1.415(b)–1(g)(3) (regarding adjustments to applicable limitations for years of participation, and adjustments to applicable limitations for years of service for survivor and disability benefits under governmental plans);

(viii) Section 1.415(c)–1(b)(2)(ii) and (3)(iii) (regarding amounts not treated as annual additions under governmental plans); and

(ix) Section 1.415(c)–2(e)(5) (providing an alternative rule for inclusion of compensation after a severance from employment for governmental plans).

(4) *Cross references to special rules for multiemployer plans.* For special rules relating to multiemployer plans as defined in section 414(f), see—

(i) Paragraph (e) of this section (regarding benefits or contributions taken into account where a plan is maintained by more than one employer);

(ii) Paragraph (f)(5)(ii) of this section (providing a special definition of severance from employment for multiemployer plans);

(iii) Section 1.415(b)–1(a)(6)(ii) (providing an exception from the compensation-based limit for multiemployer plans);

(iv) Section 1.415(b)–1(f)(3) (regarding the application of the minimum $10,000 limitation on benefits in the case of a multiemployer plan);

(v) Section 1.415(f)–1(g) (providing special rules for aggregating multiemployer plans with other plans); and

(vi) Section 1.415(g)–1(b)(3)(ii) (regarding plan disqualification rules where a multiemployer plan is aggregated with a plan that is not a multiemployer plan and the aggregated plans exceed the limitations of section 415).

(5) *Cross references to special rules for plans that are not subject to the requirements of section 411.* For special rules relating to plans that are not subject to the requirements of section 411, see—

(i) Paragraph (d)(1) of this section and §1.415(b)–1(a)(7)(iii) (providing that the rule limiting accruals to the section 415(b) limits does not apply to plans that are not subject to the requirements of section 411); and

(ii) Section 1.415(b)–1(b)(2)(iii) (providing rules for applying the section 411(c) factors in determining the annual benefit attributable to employee contributions for plans that are not subject to the requirements of section 411).

(6) *Cross references to special rules for plans maintained by churches.* For special rules relating to plans maintained by churches as defined in section 3121(w)(3)(A), see §§1.415(b)–1(a)(6)(iv) and 1.415(b)–1(a)(7)(iv) (providing an exception from the compensation-based limit for participants who have never been a highly compensated employee of the church).

(d) *Plan provisions*—(1) *In general.* Although no specific plan provision is required under section 415 in order for a plan to establish or maintain its qualification, the plan provisions must preclude the possibility that any distribution under a defined benefit plan or annual addition under a defined contribution plan will exceed the limitations of section 415. In addition, a defined benefit plan that is subject to the requirements of section 411 must preclude the possibility that any accrual under the plan will exceed the limitations of section 415. A defined benefit plan may include provisions that automatically freeze or reduce the rate of benefit accrual (or limit the benefit payable in the case of a plan that is not subject to the requirements of section 411), and a defined contribution plan may include provisions that automatically limit the annual addition to a level necessary to prevent the limitations of section 415 from being exceeded with respect to any participant. For rules relating to this type of plan provision and the definitely determinable benefit requirement for pension plans, see §1.401(a)–1(b)(1)(iii). Because §1.401(a)–1(b)(1)(iii) requires that the operation of such a provision preclude discretion by the employer, if two defined benefit plans that are aggregated under the rules of section 415(f) would otherwise provide for aggregate benefits that might exceed the limits of section 415(b), the plan provisions must specify (without involving employer discretion) how benefits will be limited to prevent a violation of section 415(b).

(2) *Special rule for profit-sharing and stock bonus plans.* A provision of a profit-sharing or stock bonus plan that automatically freezes or reduces the amount of annual additions to ensure that the limitations of section 415 will not be exceeded must comply with the requirement set forth in §1.401–1(b)(1)(ii) or (iii) (as applicable) that such plans provide a definite predetermined formula for allocating the contributions made to the plan among the participants. If the operation of a provision that automatically freezes or reduces the amount of annual additions to ensure that the limitations of section 415 are not exceeded does not involve discretionary action on the part

of the employer, the definite predetermined allocation formula requirement is not violated by the provision. If the operation of such a provision involves discretionary action on the part of the employer, the definite predetermined allocation formula requirement is violated. For example, if two profit-sharing plans of one employer otherwise provide for aggregate contributions which may exceed the limits of section 415(c), the plan provisions must specify (without involving employer discretion) under which plan contributions and allocations will be reduced to prevent an excess annual addition and how the reduction will occur.

(3) *Incorporation by reference*—(i) *In general*. A plan is permitted to incorporate by reference the limitations of section 415, and will not fail to meet the definitely determinable benefit requirement or the definite predetermined allocation formula requirement, whichever applies to the plan, merely because it incorporates the limits of section 415 by reference.

(ii) *Section 415 can be applied in more than one manner, but a statutory or regulatory default rule exists*. Where a provision of section 415 is permitted to be applied in more than one manner but is to be applied in a specified manner in the absence of contrary plan provisions (in other words, a default rule exists), if a plan incorporates the limitations of section 415 by reference with respect to that provision of section 415 and does not specifically vary from the default rule, then the default rule applies. With respect to a provision of section 415 for which a default rule exists, if the limitations of section 415 are to be applied in a manner other than using the default rule, the plan must specify the manner in which the limitation is to be applied in addition to generally incorporating the limitations of section 415 by reference. For example, if a plan generally incorporates the limitations of section 415 by reference and does not restrict the accrued benefits to which the amendments to section 415(b)(2)(E) made by the Uruguay Round Agreements Act of 1994, Public Law 103–465 (108 Stat. 4809) (GATT), apply (as permitted by Q&A–12 of Rev. Rul. 98–1 (1998–1 CB 249) (see § 601.601(d)(2) of this chapter), which reflects the amendments to section 767 of GATT made by section 1449 of the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755)), then the amendments to section 415(b)(2)(E) made by GATT apply to all benefits under the plan.

(iii) *Section 415 can be applied in more than one manner with no statutory or regulatory default*. If a limitation of section 415 may be applied in more than one manner, and if there is no governing principle pursuant to which that limitation is applied in the absence of contrary plan provisions, then the plan must specify the manner in which the limitation is to be applied in addition to generally incorporating the limitations of section 415 by reference. For example, if an employer maintains two profit-sharing plans, and if any participant participates in more than one such plan, then both plans must specify (in a consistent manner) under which of the employer's two profit-sharing plans annual additions must be reduced if aggregate annual additions would otherwise exceed the limitations of section 415(c).

(iv) *Former requirements*. A plan is not permitted to incorporate by reference formerly applicable requirements of section 415 that are no longer in force (such as the limits of former section 415(e)).

(v) *Cost-of-living adjustments*—(A) *In general*. A plan is permitted to incorporate by reference the annual adjustments to the limitations of section 415 that are made pursuant to section 415(d). See § 1.415(d)–1 for additional rules relating to cost-of-living adjustments under section 415(d).

(B) *Cost-of-living adjustments not included in accrued benefit until effective*. Notwithstanding that a plan incorporates the increases to the applicable limits under section 415(d) by reference, the accrued benefit of a participant for purposes of section 411 and any amount payable to a participant for purposes of § 1.415(b)–1(a)(1) are not permitted to reflect increases pursuant to the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) or the compensation limit described in section 415(b)(1)(B) for any period before the annual increase becomes effective. See

§ 1.415(d)–1(a)(3) for rules relating to when the annual adjustments to the dollar and compensation limitations are effective. A plan amendment does not violate the requirements of section 411(d)(6) merely because it eliminates the incorporation by reference of the increases under section 415(d) with respect to increases that have not yet occurred.

(C) *Application of increase in defined benefit dollar limit to participants who have incurred a severance from employment or commenced receiving benefits.* If a plan incorporates by reference the annual adjustments to the limitations of section 415 pursuant to this paragraph (d)(3)(v), the plan will be treated as applying the section 415(d) cost-of-living adjustments to the maximum extent permitted under the safe harbor described in § 1.415(d)–1(a)(5), except to the extent provided in this paragraph (d)(3)(v)(C). Thus, such a plan is not subject to the requirements of § 1.415(b)–1(b)(1)(iii) (providing special rules for determining the annual benefit of an employee in the case of multiple annuity starting dates) with respect to benefit increases that result solely from an increase in the section 415(b) limits pursuant to section 415(d). If a plan incorporates by reference the annual adjustments to the limitations of section 415 pursuant to this paragraph (d)(3)(v), the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) does not apply with respect to a participant if the increase is effective after the participant's severance from employment with the employer maintaining the plan (or, if earlier, after the annuity starting date in the case of a participant who has commenced receiving benefits), unless the plan specifies that this annual increase applies. Similarly, if a plan incorporates by reference the annual adjustments to the limitations of section 415 pursuant to this paragraph (d)(3)(v), the annual increase under section 415(d) of the compensation-based limitation described in section 415(b)(1)(B) does not apply with respect to a participant for increases that are effective after the participant's severance from employment with the employer maintaining the plan (or, if earlier, after the annuity starting date in the case of a participant who has commenced receiving benefits), unless the plan specifies that this annual increase applies.

(D) *Treatment of cost-of-living adjustments for funding and deduction purposes.* In general, the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) and the compensation limitation described in section 415(b)(1)(B) is treated as a plan amendment, regardless of whether the plan reflects the increase automatically through operation of plan provisions in accordance with this paragraph (d)(3)(v) or the plan is amended to reflect the increase (pursuant to § 1.415(d)–1(a)(5)). However, where a plan reflects the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) or the compensation limitation described in section 415(b)(1)(B) automatically through operation of plan provisions pursuant to this paragraph (d)(3)(v), the funding method for the plan is permitted to provide for this annual increase to be treated as an experience loss for purposes of applying sections 404, 412, and 431.

(e) *Rules for plans maintained by more than one employer.* Except as provided in § 1.415(f)–1(g)(2)(i) (regarding aggregation of multiemployer plans with plans other than multiemployer plans), for purposes of applying the limitations of section 415 with respect to a participant in a plan maintained by more than one employer, benefits and contributions attributable to such participant from all of the employers maintaining the plan must be taken into account. Furthermore, in applying the limitations of section 415 with respect to a participant in such a plan, the total compensation received by the participant from all of the employers maintaining the plan is taken into account under the plan, unless the plan specifies otherwise.

(f) *Special rules*—(1) *Affiliated employers.* Pursuant to section 414(b) and § 1.414(b)–1, all employees of all corporations that are members of a controlled group of corporations (within the meaning of section 1563(a), as modified by section 1563(f)(5), and determined without regard to section 1563(a)(4) and (e)(3)(C)) are treated as

employed by a single employer for purposes of section 415. Similarly, pursuant to section 414(c) and regulations promulgated under section 414(c), all employees of trades or businesses that are under common control are treated as employed by a single employer. Thus, any defined benefit plan or defined contribution plan maintained by any member of a controlled group of corporations (within the meaning of section 414(b)) or by any trade or business (whether or not incorporated) that is part of a group of trades or businesses that are under common control (within the meaning of section 414(c)) is deemed maintained by all such members or such trades or businesses. Pursuant to section 415(h), for purposes of section 415, sections 414(b) and 414(c) are applied by using the phrase ''more than 50 percent'' instead of the phrase ''at least 80 percent'' each place the latter phrase appears in section 1563(a)(1) and in the regulations under section 414(c) (except for purposes of determining whether two or more organizations are a brother-sister group of trades or businesses under common control under the rules in § 1.414(c)–2(c)).

(2) *Affiliated service groups.* Any defined benefit plan or defined contribution plan maintained by any member of an affiliated service group (within the meaning of section 414(m)) is deemed maintained by all members of that affiliated service group.

(3) *Leased employees*—(i) *In general.* Pursuant to section 414(n), except as provided in paragraph (f)(3)(ii) of this section, with respect to any person (referred to as the recipient) for whom a leased employee (within the meaning of section 414(n)(2)) performs services, the leased employee is treated as an employee of the recipient, but contributions or benefits provided by the leasing organization that are attributable to services performed for the recipient are treated as provided under a plan maintained by the recipient.

(ii) *Exception for leased employees covered by safe harbor plans.* Pursuant to section 414(n)(5), the rule of paragraph (f)(3)(i) of this section does not apply to a leased employee with respect to services performed for a recipient if—

(A) The leased employee is covered by a plan that is maintained by the leasing organization and that meets the requirements of section 414(n)(5)(B); and

(B) Leased employees (determined without regard to this paragraph (f)(3)(ii)) do not constitute more than 20 percent of the recipient's nonhighly compensated workforce.

(4) *Permissive service credit under governmental plans.* See section 415(n) for rules regarding the application of the limitations of sections 415(b) and (c) where a participant makes contributions (including a transfer described in section 403(b)(13) or section 457(e)(17)) to a defined benefit governmental plan to purchase permissive service credit under the plan.

(5) *Definition of severance from employment*—(i) *General rule.* For purposes of this section and §§ 1.415(b)–1, 1.415(b)–2, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1, whether an employee has a severance from employment with the employer that maintains a plan is determined in the same manner as under § 1.401(k)–1(d)(2) except that, for purposes of determining the employer of an employee, the modifications provided under section 415(h) (described in paragraph (f)(1) of this section) to the employer aggregation rules apply. Thus, an employee has a severance from employment when the employee ceases to be an employee of the employer maintaining the plan, and an employee does not have a severance from employment if, in connection with a change of employment, the employee's new employer maintains such plan with respect to the employee. The determination of whether an employee ceases to be an employee of the employer maintaining the plan is based on all of the relevant facts and circumstances.

(ii) *Multiemployer plans.* A participant in a multiemployer plan (within the meaning of section 414(f)) is not treated as having incurred a severance from employment with the employer maintaining the multiemployer plan for purposes of this section and §§ 1.415(b)–1, 1.415(b)–2, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 if the participant continues to

be an employee of another employer maintaining the multiemployer plan.

(6) *Qualified domestic relations orders.* A benefit provided to an alternate payee (as defined in section 414(p)(8)) of a participant pursuant to a qualified domestic relations order (as defined in section 414(p)(1)(A)) is treated as if it were provided to the participant for purposes of applying the limitations of section 415. See § 1.401(a)–13(g)(4)(iv).

(7) *Effect on other requirements.* Except as provided in § 1.417(e)–1(d)(1), the application of section 415 does not relieve a plan from the obligation to satisfy other applicable qualification requirements. Accordingly, the terms of the plan must provide for the plan to satisfy section 415 as well as all other applicable requirements. For example, if a defined benefit plan has a normal retirement age of 62, and if a participant's benefit remains unchanged between the ages of 62 and 65 because of the application of the section 415(b)(1)(A) dollar limit, the plan satisfies the requirements of section 411 only if the plan either commences distribution of the participant's benefit at normal retirement age (without regard to severance from employment) or provides for a suspension of benefits at normal retirement age that satisfies the requirements of section 411(a)(3)(B) and 29 CFR 2530.203–3. Similarly, if the increase to a participant's benefit under a defined benefit plan in a year after the participant has attained normal retirement age is less than the actuarial increase to the participant's previously accrued benefit because of the application of the section 415(b)(1)(B) compensation limitation (which is not adjusted for commencement after age 65), the plan satisfies the requirements of section 411 only if the plan either commences distribution of the participant's benefit at normal retirement age (without regard to severance from employment) or provides for a suspension of benefits at normal retirement age that satisfies the requirements of section 411(a)(3)(B) and 29 CFR 2530.203–3.

(g) *Effective date*—(1) *General rule.* Except as otherwise provided, this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 apply to limitation years beginning on or after July 1, 2007.

(2) *Governmental plans.* In the case of a governmental plan as defined in section 414(d), this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 apply to limitation years that begin more than 90 days after the close of the first regular legislative session of the legislative body with authority to amend the plan that begins on or after July 1, 2007. A governmental plan is permitted to apply the provisions of this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 to limitation years beginning on or after July 1, 2007, provided the plan applies all the applicable provisions of this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 for such limitation years.

(3) *Option to apply regulations earlier.* A plan may apply the rules in § 1.415(c)–2(e) regarding post-severance compensation payments for limitation years prior to the effective date described in paragraphs (g)(1) and (2) of this section. This early application affects the rules relating to the definition of compensation in § 1.401(k)–1(e)(8) and § 1.457–4(d).

(4) *Grandfather rule for preexisting benefits.* A defined benefit plan is considered to satisfy the limitations of section 415(b) for a participant with respect to benefits accrued or payable under the plan as of the end of the limitation year that is immediately prior to the effective date of final regulations under this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 (as provided under paragraph (g)(1) or (2) of this section) pursuant to plan provisions (including plan provisions relating to the plan's limitation year) that were both adopted and in effect before April 5, 2007, but only if such plan provisions meet the applicable requirements of statutory provisions, regulations, and other published guidance relating to section 415 in effect immediately before the effective date of final regulations under this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 (as provided under paragraph

(g)(1) or (2) of this section). Plan provisions will not be treated as failing to satisfy these requirements merely because the plan has not been amended to reflect changes to section 415(b) made by the Pension Funding Equity Act of 2004, Public Law 108–218 (118 Stat. 596), and the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780). In addition, plan provisions will not be treated as failing to satisfy these requirements merely because the plan's definition of compensation for a limitation year that is used for purposes of applying the limitations of section 415(b)(1)(B) reflects compensation for a plan year that is in excess of the limitation under section 401(a)(17) that applies to that plan year. If benefits under a plan are accrued after the applicable effective date under paragraph (g)(1) or (2) of this section, then the sum of the benefits grandfathered under the first sentence of this paragraph (g)(4) and benefits accrued after the applicable effective date must satisfy the requirements of section 415, taking into account the requirements of this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1.

[T.D. 9319, 72 FR 16895, Apr. 5, 2007]

§ 1.415(b)–1 Limitations for defined benefit plans.

(a) *General rules*—(1) *Maximum limitations.* Except as otherwise provided under this section, a defined benefit plan fails to satisfy the requirements of section 415(a) for a limitation year if, during the limitation year, either the annual benefit (as defined in paragraph (b)(1)(i) of this section) accrued by a participant (whether or not the benefit is vested) or the annual benefit payable to a participant at any time under the plan exceeds the lesser of—

(i) $160,000 (as adjusted pursuant to section 415(d), § 1.415(d)–1(a), and this section); or

(ii) 100 percent of the participant's average compensation for the period of the participant's high-3 years of service (as adjusted pursuant to section 415(d), § 1.415(d)–1(a), and this section).

(2) *Defined benefit plan.* For purposes of section 415 and regulations promulgated under section 415, a defined benefit plan is any plan, contract, or account to which section 415 applies pursuant to § 1.415(a)–1(a) or (b) (or any portion thereof) that is not a defined contribution plan within the meaning of § 1.415(c)–1(a)(2). In addition, a section 403(b) annuity contract that is not described in section 414(i) is treated as a defined benefit plan for purposes of section 415 and regulations promulgated under section 415.

(3) *Plan provisions.* As required in § 1.415(a)–1(d)(1), in order to satisfy the limitations on benefits under this section, the plan provisions (including the provisions of any annuity) must preclude the possibility that any annual benefit exceeding these limitations will be accrued (except as provided in paragraph (a)(7)(iii) of this section), distributed, or otherwise payable in any optional form of benefit (including the normal form of benefit) at any time (from the plan, from an annuity contract that will make distributions to the participant on behalf of the plan, or from an annuity contract that has been distributed under the plan). Thus, for example, a plan that is subject to the requirements of section 411 will fail to satisfy the limitations of this section if the plan does not contain terms that preclude the possibility that any annual benefit exceeding these limitations will be accrued or payable in any optional form of benefit (including the normal form of benefit) at any time, even though no participant has actually accrued a benefit in excess of these limitations.

(4) *Adjustments to dollar limitation for commencement before age 62 or after age 65.* The age-adjusted section 415(b)(1)(A) dollar limit computed pursuant to paragraph (d) or (e) of this section is used in place of the dollar limitation described in section 415(b)(1)(A) and paragraph (a)(1)(i) of this section in the case of a benefit with an annuity starting date that occurs before the participant attains age 62 or after the participant attains age 65.

(5) *Average compensation for period of high-3 years of service*—(i) *In general.* Except as otherwise provided in this paragraph (a)(5), for purposes of applying the limitation on benefits described in this section, the period of a participant's high-3 years of service is the period of 3 consecutive calendar years

(taking into account the rule in paragraph (a)(5)(iii) of this section) during which the employee had the greatest aggregate compensation (as defined in §1.415(c)–2) from the employer, and the average compensation for the period of a participant's high-3 years of service is determined by dividing the aggregate compensation for this period by 3. For purposes of this paragraph (a)(5), in determining a participant's high-3 years of service, the plan may use any 12-month period to determine a year of service instead of the calendar year, provided that it is uniformly and consistently applied in a manner that is specified under the terms of the plan. As provided under §1.415(c)–2(f), because a plan is not permitted to base benefits on compensation in excess of the limitation under section 401(a)(17), a plan's definition of compensation for a year that is used for purposes of applying the limitations of section 415 is not permitted to reflect compensation for a year that is in excess of the limitation under section 401(a)(17) that applies to that year. See §§1.401(a)(17)–1(a)(3)(i) and 1.401(a)(17)–1(b)(3)(ii) for rules regarding the effective date of increases in the section 401(a)(17) compensation limitation for a plan year and for a 12-month period other than the plan year.

(ii) *Short periods of service.* For a participant who is employed with an employer for less than 3 consecutive years, the period of the participant's high-3 years of service is the actual number of consecutive years of service (including fractions of years, but not less than one year). In such a case, the limitation of section 415(b)(1)(B) of 100 percent of the participant's average compensation for the period of the participant's high-3 years of service is computed by dividing the participant's compensation during the participant's longest consecutive period of service by the number of years in that period (including fractions of years, but not less than one year). The rule in paragraph (a)(5)(iii) of this section is used for purposes of determining a participant's consecutive years of service.

(iii) *Break in service.* In the case of a participant who has had a severance from employment with an employer that maintains the plan and who is subsequently rehired by the employer, the period of the participant's high-3 years of service is calculated by excluding all years for which the participant performs no services for and receives no compensation from the employer maintaining the plan (referred to as the break period), and by treating the year of service immediately prior to and the year of service immediately after the break period as if such years of service were consecutive. See §1.415(d)–1(a)(2)(iii) for a special rule for determining a rehired participant's section 415(b)(1)(B) compensation limit in the case of a plan that adjusts the compensation limit for limitation years after the limitation year in which the participant incurs a severance from employment.

(iv) *Examples.* For purposes of these examples, except as otherwise stated, the plan year and the limitation year are the calendar year, and the plan uses the calendar year for purposes of determining the period of high-3 years of service. In addition, except as otherwise stated, it is assumed that the plan's normal retirement age is 65, and all participants discussed in these examples have at least ten years of service with the employer and at least ten years of participation in the plan at issue. It is also assumed that none of the plans in the examples are governmental plans. The following examples illustrate the rules of this paragraph (a)(5):

Example 1. (i) *Facts.* Plan A, which was established on January 1, 2008, covers Participant M, who was hired on January 1, 1990. Participant M's compensation (as defined in §1.415(c)–2) from the employer maintaining the plan is $140,000 each year for 1990 through 1992, is $120,000 each year for 1993 through 2007, and is $165,000 for 2008 and 2009. Assume that for Plan A's 2008 and 2009 limitation years, the section 415(b)(1)(A) age-adjusted dollar limit for M is $185,000 and $190,000, respectively, prior to the reduction of the age-adjusted dollar limit pursuant to paragraph (g)(1) of this section (which requires a reduction in the dollar limit if a participant has less than 10 years of participation in the plan).

(ii) *Conclusion.* As of the end of the 2008 limitation year, the period of M's high-3 consecutive years of service runs from January 1, 1990, through December 31, 1992, and M's average compensation for this period is $140,000. Thus, the limitation under section

415(b)(1)(B) for the 2008 limitation year is $140,000. As of the end of the 2009 limitation year, the period of M's high-3 consecutive years of service runs from January 1, 2007, through December 31, 2009, and M's average compensation for this period is $150,000. Thus, the limitation under section 415(b)(1)(B) for the 2009 limitation year is $150,000.

Example 2 (i) *Facts*. Participant N is a participant in Plan B. N's compensation for 2008, 2009, and 2010 is $300,000 for each year. N's average compensation for the period of N's high-3 years of service (determined before the application of section 401(a)(17)) is $300,000, based on N's compensation for 2008, 2009, and 2010. For all years before 2008, Participant N's compensation was less than the then-applicable section 401(a)(17) limit. On January 1, 2011, N commences receiving benefits from Plan B at the age of 75, 10 years after attaining N's normal retirement age under Plan B, when the age-adjusted section 415(b)(1)(A) dollar limit for benefits commencing at that age is $293,453.

(ii) *Conclusion*. Pursuant to §1.415(c)–2(f) and section 401(a)(17), Plan B is not permitted to provide for a definition of compensation that includes compensation for a year that is in excess of the limitation under section 401(a)(17) that applies to that year. Accordingly, the limitation under section 415(b)(1)(B) based on N's average compensation for the period of N's high three years of service must not reflect compensation for a year that is in excess of the limitation under section 401(a)(17) that applies to that year. Thus, if the limitation under section 401(a)(17) for years beginning in 2008, 2009, and 2010 is $230,000, $235,000, and $240,000, respectively, then the limitation under section 415(b)(1)(B) based on N's average compensation for the period of N's high three years of service is $235,000.

Example 3. (i) *Facts*. The facts are the same as in *Example 2*, except that N commences receiving benefits from Plan B on January 1, 2008, at the age of 75, 10 years after attaining N's normal retirement age under Plan B. In addition, N's period of high three years of service is from January 1, 2003, through December 31, 2005, and N's average compensation for this period is $300,000. The section 401(a)(17) limits for 2003, 2004 and 2005 are $200,000, $205,000, and $210,000, respectively. As of December 31, 2007, pursuant to plan provisions adopted and in effect on January 1, 2007, N's accrued benefit under Plan B, payable in the form of a straight life annuity, actuarially adjusted to reflect commencement 10 years after normal retirement age, is $300,000. Plan B has not been amended during 2007, and that as of December 31, 2007, Plan B satisfied all of the requirements of section 415(b) with respect to N's accrued benefit, pursuant to statutory provisions, regulations, and other published guidance in effect immediately before the limitation year beginning on January 1, 2008.

(ii) *Conclusion*. Under §1.415(a)–1(g)(4), Plan B is considered to satisfy the section 415(b)(1)(B) compensation limit with respect to N's benefit payable at age 75 of $300,000 (which N accrued prior to January 1, 2008), for limitation years beginning after December 31, 2007. This is because §1.415(a)–1(g)(4) provides that plan provisions will not be treated as failing to satisfy the requirements of section 415(b)(1)(B) merely because the plan's definition of compensation that is used for purposes of applying the limitations of section 415(b)(1)(B) reflects compensation in excess of the section 401(a)(17) limitation for limitation years beginning before January 1, 2008. N, however, cannot accrue any additional benefits under Plan B for limitation years beginning after December 31, 2007, until N's section 415(b)(1)(B) compensation limit, as limited by §1.415(c)–2(f) and section 401(a)(17), increases above $300,000.

Example 4. (i) *Facts*. Participant O participates in Plan C, maintained by Employer X. Plan C does not adjust a participant's section 415(b)(1)(B) compensation limit for limitation years after the limitation year in which the participant incurs a severance from employment. Prior to separating from employment with X in 2010, O's average compensation for O's period of high-3 years of service is $50,000, based on O's compensation for 2007, 2008, and 2009, which was $50,000 for each year. O's compensation for 2010 was $45,000. O's compensation is $0 for 2011. In 2012, O is rehired by X and resumes participation in Plan C. O's compensation in 2012 is $45,000, and is $70,000 in 2013.

(ii) *Conclusion*. As of the end of the 2013 limitation year, O's average compensation for O's period of high-3 years of service is $53,333, based on O's compensation in 2010, 2012, and 2013. See paragraph (a)(5)(iii) of this section.

Example 5. (i) *Facts*. The facts are the same as in *Example 4*, except that, in accordance with §1.415(a)–1(d)(3)(v), Plan C incorporates by reference section 415(d) adjustments to a participant's section 415(b)(1)(B) compensation limit for limitation years after the limitation year in which the participant incurs a severance from employment. Assume that the annual adjustment factor described in §1.415(d)–1(a)(2)(ii) for 2011 through 2013 is 1.03 for each year. Thus, disregarding O's rehire by X, O's average compensation for O's period of high-3 years of service for the 2013 limitation year is equal to $54,636 ($50,000 * 1.03 * 1.03 * 1.03).

(ii) *Conclusion*. Under §1.415(d)–1(a)(2)(iii), O's average compensation for O's period of high-3 years of service for the 2013 limitation year is $54,636.

(6) *Exceptions from compensation limit*. The limit under paragraph (a)(1)(ii) of

this section (100 percent of the participant's average compensation for the participant's high-3 years of service) does not apply to—

(i) A governmental plan (as defined in section 414(d));

(ii) A multiemployer plan (as defined in section 414(f));

(iii) A collectively bargained plan that is described in section 415(b)(7); or

(iv) A participant in a plan maintained by an organization described in section 3121(w)(3)(A) who has never been a highly compensated employee (within the meaning of section 414(q)) of the organization.

(7) *Special rules*—(i) *Total benefits not in excess of $10,000.* See section 415(b)(4) and paragraph (f) of this section for an exception from the limits of section 415(b)(1) and paragraph (a)(1) of this section with respect to retirement benefits that do not exceed $10,000 for the limitation year.

(ii) *Governmental plans electing during 1990.* For a special limitation applicable to certain governmental plans electing the application of this rule during the first plan year beginning after December 31, 1989, see section 415(b)(10).

(iii) *Defined benefit plans not subject to the requirements of section 411.* In the case of a defined benefit plan that is not subject to the requirements of section 411, the limitations described in this paragraph (a) are not required to be applied to the annual benefit accrued by a participant before the benefit is payable. However, such a defined benefit plan is subject to the limitations described in this paragraph (a) with respect to the annual benefit payable to a participant at any time under the plan.

(iv) *Application of compensation limitation exception to a church employee who becomes a highly compensated employee*—(A) *In general.* If a participant who was described in paragraph (a)(6)(iv) of this section for a prior limitation year later becomes a highly compensated employee (within the meaning of section 414(q)) of the organization that maintains the defined benefit plan, the plan is not treated as failing to satisfy the compensation-based limitation described in paragraph (a)(1)(ii) of this section with respect to the participant if the requirements of paragraph (a)(7)(iv)(B) of this section are satisfied with respect to the participant.

(B) *Limitation on accruals.* The requirements of this paragraph (a)(7)(iv)(B) are satisfied with respect to a participant if no plan amendments increasing the participant's benefits are adopted during the limitation year in which the participant first becomes a highly compensated employee (within the meaning of section 414(q)) of the organization that maintains the plan, and there is no increase in the participant's accrued benefit derived from employer contributions (including increases as a result of increased compensation or service) in subsequent limitation years.

(b) *Annual benefit*—(1) *In general*—(i) *Definition of annual benefit*—(A) *Straight life annuities.* For purposes of this section and §1.415(b)–2, the term *annual benefit* means a benefit that is payable in the form of a straight life annuity. A *straight life annuity* means an annuity payable in equal installments for the life of the participant that terminates upon the participant's death. Examples of benefits that are not in the form of a straight life annuity include an annuity with a post-retirement death benefit and an annuity providing a guaranteed number of payments. If a benefit is payable in the form of a straight life annuity, no adjustment is made to the benefit to account for differences in the timing of payments during a year (for example, no adjustment is made on account of the annuity being payable in annual or monthly installments).

(B) *Other benefit forms.* With respect to a benefit payable in a form other than a straight life annuity, the annual benefit is determined as the straight life annuity payable on the first day of each month that is actuarially equivalent to the benefit payable in such other form, determined under the rules of paragraph (c) of this section.

(ii) *Rules for determination of annual benefit.* The annual benefit does not include the annual benefit attributable to either employee contributions or rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4),

403(b)(8), 408(d)(3), and 457(e)(16)), determined pursuant to the rules of paragraph (b)(2) of this section. The treatment of transferred benefits is determined under the rules of paragraph (b)(3) of this section. Paragraph (b)(4) of this section discusses the treatment of qualified governmental excess benefit arrangements.

(iii) *Determination of annual benefit in the case of multiple annuity starting dates*—(A) *General rule*. If a participant has or will have distributions commencing at more than one annuity starting date, then the limitations of section 415 must be satisfied as of each of the annuity starting dates, taking into account the benefits that have been or will be provided at all of the annuity starting dates. This will happen, for example, where benefit distributions to a participant have previously commenced under a plan that is aggregated for purposes of section 415 with a plan under which the participant receives current accruals. In determining the annual benefit for such a participant as of a particular annuity starting date, the plan must actuarially adjust the past and future distributions with respect to the benefits that commenced at the other annuity starting dates. For limitation years to which §1.415(b)–2 applies, these adjustments must be made using the rules of §1.415(b)–2. For purposes of this paragraph (b)(1)(iii) and §1.415(b)–2, the determination of whether a new annuity starting date has occurred is made without regard to the rule of §1.401(a)–20, Q&A–10(d) (under which the commencement of certain distributions may not give rise to a new annuity starting date).

(B) *Scope of multiple annuity starting date rules*. The rules provided in this paragraph (b)(1)(iii) and §1.415(b)–2 apply for purposes of determining the annual benefit of a participant where a new distribution election is effective during the current limitation year with respect to a distribution that previously commenced. The rules of this paragraph (b)(1)(iii) and §1.415(b)–2 also apply for determining the annual benefit of a participant for purposes of applying the limitations of section 415(b) and this section where benefit payments are increased as a result of plan terms or a plan amendment applying a cost-of-living adjustment or similar benefit increase, unless the increase is described in paragraph (b)(1)(iii)(C) of this section.

(C) *Safe harbors for certain benefit increases*. An increase to benefit payments as a result of plan terms or a plan amendment applying a cost-of-living adjustment or similar benefit increase is described in this paragraph (b)(1)(iii)(C) if the increase—

(*1*) Has previously been accounted for as part of the annual benefit under the rules of paragraph (c) of this section;

(*2*) Is not required to be accounted for as part of the annual benefit, pursuant to the exception for certain automatic benefit increase features under paragraph (c)(5) of this section;

(*3*) Is pursuant to a plan provision that automatically incorporates section 415(d) cost-of-living adjustments under §1.415(a)–1(d)(3)(v); or

(*4*) Complies with one of the safe harbors described in §1.415(d)–1(a)(5) or (6) (providing safe harbors for annual and other periodic adjustments to distributions).

(2) *Determination of annual benefit attributable to employee contributions and rollover contributions*—(i) *In general*. If employee contributions (other than contributions described in paragraph (b)(2)(ii) of this section) or rollover contributions are made to the plan, the annual benefit attributable to these contributions is determined as provided in this paragraph (b)(2).

(ii) *Certain employee contributions disregarded*. For purposes of this paragraph (b)(2), the following are not treated as employee contributions:

(A) Contributions that are picked up by a governmental employer as provided under section 414(h)(2).

(B) Repayment of any loan made to a participant from the plan.

(C) Repayment of a previously distributed amount as described in section 411(a)(7)(B) in accordance with section 411(a)(7)(C).

(D) Repayment of a withdrawal of employee contributions as provided under section 411(a)(3)(D).

(E) Repayments that would have been described in paragraph (b)(2)(ii)(C) or (b)(2)(ii)(D) of this section except

that the plan does not restrict the timing of repayments to the maximum extent permitted by section 411(a).

(iii) *Annual benefit attributable to mandatory employee contributions.* In the case of mandatory employee contributions as defined in section 411(c)(2)(C) and §1.411(c)–1(c)(4) (or contributions that would be mandatory employee contributions if section 411 applied to the plan), the annual benefit attributable to those contributions is determined by applying the factors applicable to mandatory employee contributions as described in section 411(c)(2)(B) and (C) and regulations promulgated under section 411 to those contributions to determine the amount of a straight life annuity commencing at the annuity starting date, regardless of whether the requirements of sections 411 and 417 apply to that plan. For purposes of applying such factors to a plan that is not subject to the requirements of section 411, the applicable effective date of section 411(a)(2) (which is used under §1.411(c)–1(c)(3) to determine the beginning date from which statutorily specified interest must be credited to mandatory employee contributions) must be determined as if section 411 applied to the plan, and in determining the annual benefit that is actuarially equivalent to these accumulated contributions, the plan must determine the interest rate that would have been required under section 417(e)(3) as if section 417 applied to the plan. See §1.415(c)–1(a)(2)(ii)(B) and (b)(3) for rules regarding treatment of mandatory employee contributions to a defined benefit plan as annual additions under a defined contribution plan.

(iv) *Voluntary employee contributions.* If voluntary employee contributions are made to the plan, the portion of the plan to which voluntary employee contributions are made is treated as a defined contribution plan pursuant to section 414(k) and, accordingly, is a defined contribution plan pursuant to §1.415(c)–1(a)(2)(i). Accordingly, the portion of a plan to which voluntary employee contributions are made is not a defined benefit plan within the meaning of paragraph (a)(2) of this section and is not taken into account in determining the annual benefit under the portion of the plan that is a defined benefit plan.

(v) *Annual benefit attributable to rollover contributions.* The annual benefit attributable to rollover contributions from an eligible retirement plan, as defined in section 402(c)(8)(B) (for example, a contribution received pursuant to a direct rollover under section 401(a)(31)(A)), is determined in the same manner as the annual benefit attributable to mandatory employee contributions if the plan provides for a benefit derived from the rollover contribution (other than a benefit derived from a separate account to be maintained with respect to the rollover contribution and actual earnings and losses thereon). Thus, in the case of rollover contributions from a defined contribution plan to a defined benefit plan to provide an annuity distribution, the annual benefit attributable to those rollover contributions for purposes of section 415(b) is determined by applying the rules of section 411(c) as described in paragraph (b)(2)(iii) of this section, regardless of the assumptions used to compute the annuity distribution under the plan and regardless of whether the plan is subject to the requirements of sections 411 and 417. Accordingly, in such a case, if the plan uses more favorable factors than those specified in section 411(c) to determine the amount of annuity payments arising from rollover contributions, the annual benefit under the plan would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c). See §1.415(c)–1(b)(3)(i) for rules excluding rollover contributions maintained in a separate account that is treated as a defined contribution plan pursuant to section 414(k) from annual additions to a defined contribution plan.

(3) *Treatment of transferred benefits*—(i) *In general*—(A) *Treatment of transferor plan if transferred benefits are aggregated with transferor plan.* Except as provided in paragraph (b)(3)(ii) of this section, when there has been a transfer of benefits from one defined benefit plan to another plan, to the extent the benefits transferred to the transferee plan are otherwise required to be taken into account pursuant to section 415(f)

and §1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b) for a limitation year, the transferred benefits are not treated as being provided under the transferor plan. This will occur, for example, if the employer sponsoring the transferor plan and the employer sponsoring the transferee plan are in the same controlled group within the meaning of section 414(b).

(B) *Treatment of transferor plan if transferred benefits are not aggregated with transferor plan.* Except as provided in paragraph (b)(3)(ii) of this section, when there has been a transfer of benefits from one defined benefit plan to another plan, to the extent the benefits transferred to the transferee plan are not otherwise required to be taken into account pursuant to section 415(f) and §1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b) for a limitation year, the transferred benefits are treated by the transferor plan as if such benefits were provided under annuities purchased to provide benefits under a plan that must be aggregated with the transferor plan and that terminated immediately prior to the transfer with sufficient assets to pay all benefit liabilities under the plan, in accordance with the rules of paragraph (b)(5)(i) of this section. This will occur, for example, in the case of a transfer of benefits between defined benefit plans maintained by employers that are not required to be aggregated under sections 414(b) and (c) (as modified by section 415(h)) or sections 414(m).

(C) *Treatment of transferee plan.* Except as provided in paragraph (b)(3)(ii) of this section, where there has been a transfer of benefits from one defined benefit plan to another defined benefit plan, the transferee plan must take into account the transferred benefits in determining whether it satisfies the limitations of section 415(b).

(ii) *Elective transfer of distributable benefit.* Where, as described in §1.411(d)–4, Q&A–3(c) (permitting certain elective transfers of distributable benefits), a distributable benefit is transferred to a defined benefit plan from either a defined contribution plan or a defined benefit plan, the amount transferred is treated as a benefit paid from the transferor plan, and the annual benefit provided by the transferee defined benefit plan does not include the annual benefit attributable to the amount transferred (determined as if the transferred amount were a rollover contribution subject to the rules of paragraph (b)(2)(v) of this section). The rule in the preceding sentence applies regardless of whether the requirements of section 411 apply to the plan and, in the case of a transfer from a defined contribution plan that is not subject to the requirements of section 411 (such as a governmental plan) to a defined benefit plan, the rule applies even if the participant's benefits are not distributable from the defined contribution plan at the time of the transfer.

(4) *Treatment of qualified governmental excess benefit arrangements.* Pursuant to section 415(m), in determining whether a governmental plan (as defined in section 414(d)) meets the requirements of this section, the annual benefit does not include benefits provided under a qualified governmental excess benefit arrangement, as defined in section 415(m)(3). Thus, the limitation of section 415(b) does not apply to benefits to the extent the benefits are provided under a qualified governmental excess benefit arrangement.

(5) *Treatment of benefits provided under a terminated plan*—(i) *Terminated plan with sufficient assets.* If a defined benefit plan is terminated with sufficient assets for the payment of the benefit liabilities of all plan participants and a participant in the plan has not yet commenced benefits under the plan, for purposes of satisfying section 415(b) with respect to the participant, all other defined benefit plans maintained by the employer that maintained the terminated plan are required to take into account the benefits provided pursuant to the annuities purchased to provide benefits under the terminated plan at each possible annuity starting date. In such a case, see paragraph (b)(1)(iii) of this section for rules regarding the determination of a participant's annual benefit if the participant commences receiving benefits under the terminated plan.

(ii) *Terminated plan with insufficient assets.* If a defined benefit plan is terminated and there are not sufficient

assets for the payment of the benefit liabilities of all plan participants, for purposes of satisfying section 415(b) with respect to a participant, all other defined benefit plans maintained by the employer that maintained the terminated plan are required to take into account the benefits that are actually provided to the participant under the terminated plan. For example, in the case of a plan that is subject to title IV of the Employee Retirement Income Security Act of 1974 (88 Stat. 829), Public Law 93–406 (ERISA), and that terminates with insufficient assets for the payment of the benefit liabilities of all plan participants, all other defined benefit plans maintained by the employer that maintained the terminating plan must take into account benefits that are paid by the Pension Benefit Guaranty Corporation. In such a case, see paragraph (b)(1)(iii) of this section for rules regarding the determination of a participant's annual benefit if the participant commences receiving benefits under the terminated plan.

(iii) *Other guidance.* The Commissioner may provide guidance regarding the rules applicable to terminated plans (and plans that are deemed to have been terminated pursuant to paragraph (b)(3)(i)(B) of this section) in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin. See § 601.601(d) of this chapter.

(c) *Adjustment to form of benefit for forms other than a straight life annuity*—(1) *In general.* This paragraph (c) provides rules for adjusting a form of benefit other than a straight life annuity to an actuarially equivalent straight life annuity beginning at the same time for purposes of determining the annual benefit described in paragraph (b) of this section. Paragraph (c)(2) of this section describes how to adjust a benefit paid in a form to which section 417(e)(3) does not apply. Paragraph (c)(3) of this section describes how to adjust a benefit paid in a form to which section 417(e)(3) applies. Paragraph (c)(4) of this section describes benefit forms for which no adjustment is required. Paragraph (c)(5) of this section provides an exception from the requirements of this paragraph (c) with respect to certain automatic benefit increase features. Paragraph (c)(6) of this section sets forth examples illustrating the application of this paragraph (c). The Commissioner may, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin set forth simplified methods for adjusting a form of benefit other than a straight life annuity to an actuarially equivalent straight life annuity beginning at the same time for purposes of determining the annual benefit described in paragraph (b) of this section. See § 601.601(d)(2) of this chapter.

(2) *Benefits paid in a form to which section 417(e)(3) does not apply.* For a benefit paid in a form to which section 417(e)(3) does not apply, the actuarially equivalent straight life annuity benefit is the greater of—

(i) The annual amount of the straight life annuity (if any) payable to the participant under the plan commencing at the same annuity starting date as the form of benefit payable to the participant; or

(ii) The annual amount of the straight life annuity commencing at the same annuity starting date that has the same actuarial present value as the form of benefit payable to the participant, computed using a 5 percent interest assumption and the applicable mortality table described in § 1.417(e)–1(d)(2) for that annuity starting date.

(3) *Benefits paid in a form to which section 417(e)(3) applies*—(i) *In general.* Except as otherwise provided in this paragraph (c)(3), for a benefit paid in a form to which section 417(e)(3) applies, the actuarially equivalent straight life annuity benefit is the greatest of:

(A) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence;

(B) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using a 5.5 percent interest

assumption and the applicable mortality table for the distribution under §1.417(e)–1(d)(2); or

(C) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable (computed using the applicable interest rate for the distribution under §1.417(e)–1(d)(3) and the applicable mortality table for the distribution under §1.417(e)–1(d)(2)), divided by 1.05.

(ii) *Special rule for distributions in plan years beginning in 2004 and 2005.* For a distribution to which section 417(e)(3) applies and which has an annuity starting date occurring in plan years beginning in 2004 or 2005, except as provided in section 101(d)(3) of the Pension Funding Equity Act of 2004, Public Law 108–218 (118 Stat. 596), the actuarially equivalent straight life annuity benefit is the greater of—

(A) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence; or

(B) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using a 5.5 percent interest assumption and the applicable mortality table for the distribution under §1.417(e)–1(d)(2).

(4) *Certain benefit forms for which no adjustment is required*—(i) *In general.* For purposes of the adjustments described in this paragraph (c), the following benefits are not taken into account:

(A) Survivor benefits payable to a surviving spouse under a qualified joint and survivor annuity (as defined in section 417(b)) to the extent that such benefits would not be payable if the participant's benefit were not paid in the form of a qualified joint and survivor annuity.

(B) Ancillary benefits that are not directly related to retirement benefits, such as preretirement disability benefits not in excess of the qualified disability benefit, preretirement incidental death benefits (including a qualified preretirement survivor annuity), and post-retirement medical benefits.

(ii) *Rules of application*—(A) *Social security supplements.* Although a social security supplement described in section 411(a)(9) and §1.411(a)–7(c)(4) may be an ancillary benefit, it is included in determining the annual benefit because it is payable upon retirement and therefore is directly related to retirement income benefits.

(B) *Qualified joint and survivor annuities combined with other distributions.* If benefits are paid partly in the form of a qualified joint and survivor annuity (QJSA) and partly in some other form (such as a single-sum distribution), the rule of paragraph (c)(4)(i)(A) of this section (under which survivor benefits are not included in determining the annual benefit) applies to the survivor annuity payments under the portion of the benefit that is paid in the form of a QJSA.

(5) *Exception for certain automatic benefit increase features*—(i) *General rule.* Notwithstanding paragraph (b)(1)(i)(B) of this section, no adjustment is required to a benefit that is paid in a form that is not a straight life annuity to take into account the inclusion in that form of an automatic benefit increase feature, as described in paragraph (c)(5)(ii) of this section, if:

(A) The benefit is paid in a form to which section 417(e)(3) does not apply.

(B) The plan satisfies the requirements of paragraph (c)(5)(iii) of this section.

(ii) *Definition of automatic benefit increase feature.* An automatic benefit increase feature is included in a form of benefit if that form provides for automatic, periodic increases to the benefits paid in that form, such as a form of benefit that automatically increases the benefit paid under that form annually according to a specified percentage or objective index, or a form of benefit that automatically increases the benefit paid in that form to share favorable investment returns on plan assets.

(iii) *Requirements.* A plan satisfies the requirements of this paragraph

(c)(5)(iii) with respect to a form of benefit that includes an automatic benefit increase feature if the form of benefit without regard to the automatic benefit increase feature satisfies the requirements of section 415(b) and this section, and the plan provides that in no event will the amount payable to the participant under the form of benefit in any limitation year be greater than the section 415(b) limit applicable at the annuity starting date (which is the lesser of the age-adjusted section 415(b)(1)(A) dollar limit described in paragraph (a)(1)(i) of this section or the section 415(b)(1)(B) compensation limit described in paragraph (a)(1)(ii) of this section), as increased in subsequent years pursuant to section 415(d) and §1.415(d)–1. If the form of benefit without regard to the automatic benefit increase feature is not a straight life annuity, then the preceding sentence is applied by reducing the section 415(b) limit applicable at the annuity starting date to an actuarially equivalent amount (determined using the assumptions specified in paragraph (c)(2)(ii) of this section) that takes into account the death benefits under the form of benefit (other than the survivor portion of a QJSA).

(6) *Examples*. The following examples illustrate the provisions of this paragraph (c). For purposes of these examples, except as otherwise stated, actuarial equivalence under the plan is determined using a 5 percent interest assumption and the mortality table that applies under section 417(e)(3) as of January 1, 2003. It is assumed for purposes of these examples that the interest rate that applies under section 417(e)(3) and §1.417(e)–1(d)(3) for relevant time periods is 5.25 percent and that the mortality table that applies under section 417(e)(3) and §1.417(e)–1(d)(2) for relevant time periods is the mortality table that applies under section 417(e)(3) as of January 1, 2003. In addition, it is assumed that all participants discussed in these examples have at least ten years of service with the employer and at least ten years of participation in the plan at issue, all payments other than a payment of a single sum are made monthly, on the first day of each calendar month, and each plan's normal retirement age is 65. The examples are as follows:

Example 1. (i) *Facts*. Plan A provides a single-sum distribution determined as the actuarial present value of the straight life annuity payable at the actual retirement date. Plan A provides that a participant's single sum is determined as the greater of the present value determined using the otherwise applicable actuarial assumptions of the plan and the present value determined using the applicable interest rate and the applicable mortality table for the distribution under section 417(e)(3). In accordance with §1.417(e)–1(d)(1), Plan A also provides that the single sum is not less than the actuarial present value of the accrued benefit payable at normal retirement age, determined using the applicable interest rate and the applicable mortality table under section 417(e)(3) and §1.417(e)–1(d). Participant M retires at age 65 with a benefit under the plan formula (and before the application of section 415) of $152,619 and elects to receive a distribution in the form of a single sum. Under the plan and before the application of section 415, the amount of the single sum is $1,800,002 (which is based on the 5 percent interest rate and applicable mortality table as of January 1, 2003, since that present value is greater than the present value that would have been determined using the applicable interest rate (5.25 percent) and the applicable mortality table (the January 1, 2003, table) for the distribution under section 417(e)(3)).

(ii) *Conclusion*. For purposes of this section, the annual benefit is the greatest of the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the plan's actuarial factors), the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using a 5.5 percent interest assumption and the applicable mortality table for the distribution under §1.417(e)–1(d)(2)), and the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the applicable interest rate and applicable mortality table for the distribution under §§1.417(e)–1(d)(2) and (d)(3)) divided by 1.05. Based on the factors used in the plan to determine the actuarially equivalent lump sum (in this case, an interest rate of 5 percent and the applicable mortality table as of January 1, 2003), $1,800,002 payable as a single sum is actuarially equivalent to an immediate straight life annuity at age 65 of $152,619. A single sum payment of $1,800,002 is actuarially equivalent to an immediate straight life annuity at age 65 of $159,105, using a 5.5 percent interest assumption and the applicable mortality table under §1.417(e)–1(d)(2). Based on the applicable interest rate and the applicable mortality table for the distribution under

§§ 1.417(e)–1(d)(2) and (d)(3), $1,800,002 payable as a single sum is actuarially equivalent to an immediate straight life annuity at age 65 of $155,853. $148,432 is the result when this annual amount is divided by 1.05. With respect to the single-sum distribution, M's annual benefit for purposes of section 415(b) is equal to the greatest of the three resulting amounts ($152,619, $159,105, and $148,432), or $159,105.

Example 2. (i) *Facts.* The facts are the same as in *Example 1*, except that Participant M elects to receive his benefit in the form of a 10-year certain and life annuity. Applying the plan's actuarial equivalence factors, the benefit payable in this form is $146,100.

(ii) *Conclusion.* Since the form of benefit elected by M is a form of benefit to which section 417(e)(3) does not apply, the annual benefit for purposes of this section is the greater of the annual amount of the plan's straight life annuity commencing at the same age or the annual amount of the actuarially equivalent straight life annuity commencing at the same age, determined using a 5 percent interest rate and the applicable mortality table described in § 1.417(e)–1(d)(2) for that annuity starting date. In this case, the straight life annuity payable under the plan commencing at the same age is $152,619. Because the plan's factors for actuarial equivalence in this case are the same standardized actuarial factors required to be applied to determine the actuarially equivalent straight life annuity, the actuarially equivalent straight life annuity using the required standardized factors is also $152,619. With respect to the 10-year certain and life annuity distribution, M's annual benefit is equal to the greater of the two resulting amounts ($152,619 and $152,619), or $152,619.

Example 3. (i) *Facts.* The facts are the same as in *Example 1.* Participant M retires at age 62 with a benefit under the plan (before the application of section 415) of $100,000 (after application of the plan's early retirement factors) and a Social Security supplement of $10,000 per year payable until age 65. N chooses to receive the accrued benefit in the form of a straight life annuity. The Plan has no provisions under which the actuarial value of the Social Security supplement can be paid as a level annuity for life.

(ii) *Conclusion.* Because the form of benefit elected by M is a form of benefit to which section 417(e)(3) does not apply and because the plan does not provide for a straight life annuity beginning at age 62, the annual benefit for purposes of this section is the annual amount of the straight life annuity commencing at age 62 that is actuarially equivalent to the distribution stream of $110,000 for three years and $100,000 thereafter, where actuarial equivalence is determined using a 5 percent interest rate and the applicable mortality table described in § 1.417(e)–1(d)(2) for the annuity starting date. In this case, the actuarially equivalent straight life annuity is $102,180. Accordingly, with respect to this distribution stream, N's annual benefit is equal to $102,180. The results are the same without regard to whether the Social Security supplement is a QSUPP (as defined in § 1.401(a)(4)–12).

Example 4. (i) *Facts.* Plan B is a defined benefit plan that provides a benefit equal to 100 percent of a participant's average compensation for the period of the participant's high–3 years of service, payable as a straight life annuity. For a married participant who does not elect another form of benefit, the benefit is payable in the form of a joint and 100 percent survivor annuity benefit that is a QJSA within the meaning of section 417 and that is reduced from the straight life annuity. For purposes of determining the amount of this QJSA, the plan provides that the reduction is only half of the reduction that would normally apply under the actuarial assumptions specified in the plan for determining actuarial equivalence of optional forms. The plan also provides that a married participant can elect to receive the plan benefits as a straight life annuity, or in the form of a single sum distribution that is the actuarial equivalent of the joint and 100 percent survivor annuity determined using the applicable interest rate and the applicable mortality table under section 417(e)(3) and § 1.417(e)–1(d). Participant O elects, with spousal consent, a single-sum distribution.

(ii) *Conclusion.* The special rule that disregards the value of the survivor portion of a QJSA set forth in paragraph (c)(4)(i) of this section only applies to a benefit that is payable in the form of a qualified joint and survivor annuity. Any other form of benefit must be adjusted to a straight life annuity in accordance with paragraph (c)(1) of this section. Accordingly, because the benefit payable under the plan in the form of a single-sum distribution is actuarially equivalent to a straight life annuity that is greater than 100 percent of a participant's average compensation for the period of the participant's high-3 years of service, the limitation of section 415(b)(1)(B) has been exceeded.

Example 5. (i) *Facts.* Plan C is a defined benefit plan that provides an option to receive the benefit in the form of a joint and 100 percent survivor annuity with a 10-year certain feature, where the survivor beneficiary is the participant's spouse.

(ii) *Conclusion.* Since this form of benefit is not subject to section 417(e)(3), for a participant at age 65, the annual benefit with respect to the joint and 100 percent survivor annuity with a 10-year certain feature is determined for purposes of this section as the greater of the annual amount of the straight life annuity payable to the participant under the plan at age 65 (if any), or the annual

amount of the straight life annuity commencing at age 65 that has the same actuarial present value as the joint and 100 percent survivor annuity with a 10-year certain feature (but excluding the survivor annuity payments pursuant to paragraph (c)(4)(i)(A) of this section), computing using a 5 percent interest assumption and the applicable mortality table described in §1.417(e)–1(d)(2) for the annuity starting date. This latter amount is equal to the product of the annual payments under this optional form of benefit and the factor that provides for actuarial equivalence between a straight life annuity and a 10-year certain and life annuity (with no annuity for the survivor) computed using a 5 percent interest rate and the applicable mortality table described in §1.417(e)–1(d)(2) for the annuity starting date.

Example 6. (i) *Facts.* Plan E provides a benefit at age 65 of a straight life annuity equal to the lesser of 90 percent of the participant's average compensation for the period of the participant's high-3 years of service and $148,500. Upon retirement at age 65, the optional forms of benefit available to a participant include payment of a QJSA with annual payments equal to 50 percent of the annual payments under the straight life annuity, along with a single-sum distribution that is actuarially equivalent (determined as the greater of the single sum calculated using a 5 percent interest assumption and the section 417(e)(3)(A)(ii)(I) mortality table in effect on January 1, 2003, and the single sum calculated using the section 417(e)(3)(A)(ii)(II) applicable interest rate and the section 417(e)(3)(A)(ii)(I) applicable mortality table for the distribution) to 50 percent of the annual payments under the straight life annuity. Participant Q retires at age 65. Q's average compensation for the period of Q's high-3 years of service is $100,000. Q elects to receive a distribution in the optional form of benefit described above, under which the annual payments under the QJSA are $45,000 and the single-sum distribution is equal to $530,734. Q's spouse is 3 years younger than Q.

(ii) *Determination of annual benefit.* Q's annual benefit under Plan E for purposes of section 415(b) is determined as the sum of the annual benefit attributable to the QJSA portion of the distribution and the annual benefit attributable to the single-sum portion of the distribution.

(iii) *Annual benefit attributable to QJSA portion.* Because survivor benefits are not taken into account in determining the annual benefit attributable to the QJSA portion of the distribution, the annual benefit attributable to the QJSA portion of the distribution is determined as if that distribution were a straight life annuity of $45,000 per year commencing at age 65. Thus, no form adjustment is needed to determine the annual benefit attributable to the QJSA portion of the distribution, and the annual benefit attributable to the QJSA portion of the benefit is $45,000.

(iv) *Annual benefit attributable to single sum portion.* The annual benefit attributable to the single sum portion of the distribution is determined as the greatest of the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the plan's actuarial factors), the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using a 5.5 percent interest assumption and the applicable mortality table under §1.417(e)–1(d)(2) for the distribution), and the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the applicable interest rate and applicable mortality table under section 417(e)(3) and §§1.417(e)–1(d)(2) and (d)(3) for the distribution) divided by 1.05. With respect to the single-sum distribution, the annual amount of the actuarially equivalent straight life annuity commencing at the same age determined using the plan's actuarial factors is equal to $45,000. The annual amount of the actuarially equivalent straight life annuity commencing at the same age determined using a 5.5 percent interest assumption and the applicable mortality table under §1.417(e)–1(d)(2) for the distribution is $46,912. The actuarially equivalent straight life annuity commencing at the same age determined using the applicable interest rate and the applicable mortality table under section 417(e)(3) and §§1.417(e)–1(d)(2) and (d)(3) for the distribution is equal to $45,954. This amount divided by 1.05 is equal to $43,766. Thus, the annual benefit attributable to the single sum portion of the benefit is $46,912.

(v) *Conclusion.* Q's annual benefit under the optional form of benefit for purposes of section 415(b) is equal to the sum of the annual benefit attributable to the QJSA portion of the distribution and the annual benefit attributable to the single sum portion of the distribution, or $91,912. Because Q's average compensation for the period of Q's high-3 years of service is $100,000, the distribution satisfies the compensation limit of section 415(b)(1)(B).

Example 7. (i) *Facts.* Plan D is a defined benefit plan with a normal retirement age of 65. The normal retirement benefit under Plan D (and the only life annuity available under Plan D) is a life annuity with a fixed increase of 2 percent per year. The increase applies to the benefit provided in the prior year and is thus compounded. The plan provides that the benefit is limited to the lesser of 84 percent of the participant's average compensation for the period of the participant's high-3 years of service or 84 percent of the age-adjusted section 415(b)(1)(A) dollar limit (which is assumed to be $180,000 at age

65). Plan D does not incorporate the section 415(d) cost-of-living adjustments to the section 415(b) limits for limitation years following the limitation year in which a participant incurs a severance from employment. Participant P retires at age 65, at which time P's average compensation for the period of P's high-3 years of service is $165,000. Under Plan D, P commences receiving benefits in the form of a life annuity of $138,600 with a fixed increase of 2 percent per year.

(ii) *Conclusion*. Because Plan D does not provide for a straight life annuity and the form of benefit is not subject to section 417(e)(3), P's annual benefit for purposes of section 415(b) is the annual amount of the straight life annuity, commencing at age 65, that is actuarially equivalent to the distribution stream of $138,600 with a fixed increase of 2 percent per year, where actuarial equivalence is determined using a 5 percent interest rate and the applicable mortality table for the distribution under section 417(e)(3) and § 1.417(e)–1(d)(2). In order to satisfy the requirements of section 415 and this section, this annual benefit must not exceed 100 percent of the average compensation for the period of the participant's high-3 years of service, or $165,000. Using a 5 percent interest rate and the section 417(e)(3) applicable mortality table for the distribution, the actuarially equivalent straight life annuity is $165,453, which exceeds $165,000. Accordingly, the plan fails to satisfy the compensation-based limitation of section 415(b)(1)(B).

Example 8. (i) *Facts*. The facts are the same as in *Example* 7, except that Plan D incorporates by reference the section 415(d) cost-of-living adjustments to the section 415(b) limits as described in § 1.415(a)–1(d)(3)(v) and Plan D provides that the benefit is limited to the applicable section 415(b) limit. Under Plan D, P commences receiving benefits at age 65 in the form of a life annuity of $138,221 with a fixed increase of 2 percent per year.

(ii) *Conclusion*. Because Plan D does not provide for a straight life annuity and the form of benefit is not subject to section 417(e)(3), P's annual benefit for purposes of section 415(b) is the annual amount of the straight life annuity, commencing at age 65, that is actuarially equivalent to the distribution stream of $138,221 with a fixed increase of 2 percent per year, where actuarial equivalence is determined using a 5 percent interest rate and the applicable mortality table for P's annuity starting date under section 417(e)(3) and § 1.417(e)–1(d)(2). In order to satisfy the requirements of section 415(b) and this section, this annual benefit must not exceed 100 percent of P's average compensation for the period of P's high-3 years of service, or $165,000. Using a 5 percent interest rate and the section 417(e)(3) applicable mortality table for the distribution, the actuarially equivalent straight life annuity is $165,000, which does not exceed $165,000. Accordingly, the plan satisfies the compensation-based limitation of section 415(b)(1)(B).

(iii) *Section 415(d) adjustments*. In addition to the fixed 2 percent per year automatic increase, P's benefit will be increased in limitation years following the limitation year in which P retires in accordance with the plan provisions that incorporate by reference the section 415(d) cost-of-living adjustments to the section 415(b) limits (or, if Plan D did not incorporate by reference the section 415(d) adjustments, P's benefit may be increased pursuant to plan amendments that comply with the safe harbors provided in § 1.415(d)–1(a)(5) or (6)), and such increases will not cause P's benefit to violate the requirements of section 415(b). For example, if in a later limitation year the applicable section 415(b) limit is increased by 3 percent pursuant to section 415(d) and § 1.415(d)–1, P's benefit payable under Plan D will be increased by both the fixed automatic 2 percent per year increase and by the 3 percent section 415(d) cost-of-living adjustment. The effect of the combined increases may result in P's benefits for a year exceeding the then applicable dollar limit under section 415(b), but the plan will not violate section 415(b).

Example 9. (i) *Facts*. The facts are the same as in *Example* 7, except that the plan provides that benefits are limited to the lesser of 100 percent of the participant's average compensation for the period of the participant's high-3 years of service or 100 percent of the age-adjusted section 415(b)(1)(A) dollar limit. Assume that P retires at age 65 with a benefit in the form of a life annuity of $165,000 per year with a fixed increase of 2 percent per year. Additionally, assume that Plan D incorporates by reference the section 415(d) cost-of-living adjustments to the section 415(b) limits as described in § 1.415(a)–1(d)(3)(v) and the plan provides pursuant to paragraph (c)(5) of this section that in no event will a benefit payable from the plan, as increased by the fixed increase of 2 percent per year, be greater than the section 415(b) limit applicable as of the annuity starting date for the benefit (increased pursuant to the rules of section 415(d) and § 1.415(d)–1).

(ii) *Conclusion*. The benefit payable to P at age 65 is not required to be adjusted to take into account the fixed increase of 2 percent per year. This is because the benefit payable to P satisfies the requirements of section 415(b) without regard to the fixed increase of 2 percent per year, and pursuant to paragraph (c)(5) of this section, the plan provides that the benefit payable to P, as increased by the fixed increase of 2 percent per year, will never be greater than the section 415(b) limit applicable as of P's annuity starting date (increased in subsequent limitation years pursuant to the rules of section 415(d) and § 1.415(d)–1).

(iii) *Section 415(d) adjustments.* In addition to the fixed 2 percent per year automatic increase, P's benefit will be increased in limitation years following the limitation year in which P retires in accordance with the plan provisions that incorporate by reference the section 415(d) cost-of-living adjustments to the section 415(b) limits (or, if Plan D did not incorporate by reference the section 415(d) adjustments, P's benefit may be increased pursuant to plan amendments that comply with the safe harbors provided in §1.415(d)–1(a)(5) or (6)), and such increases will not cause P's benefit to violate the requirements of section 415(b). However, pursuant to paragraph (c)(5)(iii) of this section, P's benefit during any limitation year, as increased by the 2 percent per year automatic increase feature and any plan provisions that incorporate by reference the section 415(d) cost-of-living adjustments or any plan amendments that increase P's benefits, cannot exceed the then applicable section 415(b) limit (as increased pursuant to section 415(d) and §1.415(d)–1).

Example 10. (i) *Facts.* Employer T maintains a defined benefit plan. Under the terms of the plan, all benefits in pay status (other than single sum payments) are adjusted upwards or downwards annually depending on an annual comparison of actual return on plan assets and an assumed interest rate of 4 percent. Thus, the plan does not offer a straight life annuity form of benefit, and the plan must determine for purposes of applying the section 415(b) limits the actuarially equivalent straight life annuity for benefits provided under the plan.

(ii) *Conclusion.* Benefits under the plan are paid in a form to which section 417(e)(3) does not apply. In determining the actuarially equivalent straight life annuity of benefits that are subject to the annual investment performance adjustment, the plan must assume a 5 percent return on plan assets. See paragraph (c)(2) of this section. Therefore, in determining the actuarially equivalent straight life annuity, the plan must assume that the form of benefit payable under the plan will be an annuity that increases annually by a factor equal to 1.05 divided by 1.04. This increasing annuity is then converted to an actuarially equivalent straight life annuity under paragraph (c)(2) of this section using a 5 percent interest rate and the applicable mortality table described in §1.417(e)–1(d)(2) for the relevant annuity starting date.

Example 11. (i) *Facts.* R is a participant in a defined benefit plan maintained by R's employer. Under the terms of the plan, R must make contributions to the plan in a stated amount to accrue benefits derived from employer contributions.

(ii) *Conclusion.* R's contributions are mandatory employee contributions within the meaning of section 411(c)(2)(C) and, thus, the annual benefit attributable to these contributions is not taken into account for purposes of testing the annual benefit derived from employer contributions against the applicable limitation on benefits. However, these contributions are treated as contributions to a defined contribution plan maintained by R's employer for purposes of section 415(c). See §1.415(c)–1(a)(2)(ii)(B). Accordingly, with respect to the current limitation year, the limitation on benefits (as described in paragraph (a)(1) of this section) is applicable to the annual benefit attributable to employer contributions to the defined benefit plan, and the limitation on contributions and other additions (as described in §1.415(c)–1) is applicable to the portion of the plan treated as a defined contribution plan, which consists of R's mandatory contributions. These same limitations would also apply if, instead of providing for mandatory employee contributions, the plan permitted voluntary employee contributions, because the portion of the plan attributable to voluntary employee contributions and earnings thereon is treated as a defined contribution plan maintained by the employer pursuant to section 414(k), and thus is not subject to the limitations of section 415(b).

Example 12. (i) *Facts.* V is a participant in a defined benefit plan maintained by V's employer. Under the terms of the plan, V must make contributions to the plan in a stated amount to accrue benefits derived from employer contributions. V's contributions are mandatory employee contributions within the meaning of section 411(c)(2)(C). Thus, the annual benefit attributable to these contributions is not taken into account for purposes of testing the annual benefit derived from employer contributions against the applicable limitation on benefits. V terminates employment and receives a distribution from the plan that includes V's mandatory employee contributions. Subsequently, V resumes employment with the employer maintaining the plan. V recommences participation in the plan and repays the prior distribution from the plan (including the portion of the distribution that included V's prior mandatory employee contributions to the plan) with reasonable interest.

(ii) *Conclusion.* In determining V's annual benefit under the plan for purposes of applying the limitations of section 415(b), no portion of V's repayment of the prior distribution is treated as employee contributions. See paragraphs (b)(2)(ii)(C), (D) and (E) of this section. However, V's annual benefit under the plan is determined by excluding the portion of the annual benefit attributable to V's employee contributions to the plan made both prior to the first distribution and during V's subsequent recommencement of plan participation.

(d) *Adjustment to section 415(b)(1)(A) dollar limit for commencement before age*

62—(1) *General rule*—(i) *Calculation using statutory factors*. For a distribution with an annuity starting date that occurs before the participant attains the age of 62, the age-adjusted section 415(b)(1)(A) dollar limit generally is determined as the actuarial equivalent of the annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as a deferred straight life annuity commencing at age 62, where annual payments under the straight life annuity commencing at age 62 are equal to the dollar limitation of section 415(b)(1)(A) (as adjusted pursuant to section 415(d) and §1.415(d)–1 for the limitation year), and where the actuarially equivalent straight life annuity is computed using a 5 percent interest rate and the applicable mortality table under §1.417(e)–1(d)(2) that is effective for that annuity starting date (and expressing the participant's age based on completed calendar months as of the annuity starting date). However, if the plan has an immediately commencing straight life annuity payable both at age 62 and the age of benefit commencement, then the age-adjusted section 415(b)(1)(A) dollar limit is equal to the lesser of—

(A) The limit as otherwise determined under this paragraph (d)(1)(i); and

(B) The amount determined under paragraph (d)(1)(ii) of this section.

(ii) *Calculation using plan factors*. The amount determined under this paragraph (d)(1)(ii) is equal to the section 415(b)(1)(A) dollar limit (as adjusted pursuant to section 415(d) and §1.415(d)–1 for the limitation year) multiplied by the ratio of the annual amount of the immediately commencing straight life annuity under the plan to the annual amount of the straight life annuity under the plan commencing at age 62, with both annual amounts determined without applying the rules of section 415.

(2) *Mortality adjustments*—(i) *In general*. For purposes of determining the actuarially equivalent amount described in paragraph (d)(1)(i) of this section, to the extent that a forfeiture does not occur upon the participant's death before the annuity starting date, no adjustment is made to reflect the probability of the participant's death between the annuity starting date and the participant's attainment of age 62, unless the plan provides for such an adjustment. To the extent that a forfeiture occurs upon the participant's death before the annuity starting date, an adjustment must be made to reflect the probability of the participant's death between the annuity starting date and the participant's attainment of age 62.

(ii) *No forfeiture deemed to occur where qualified preretirement survivor annuity payable*. For purposes of paragraphs (d)(2)(i) and (e)(2)(i) of this section, a plan is permitted to treat no forfeiture as occurring upon a participant's death if the plan does not charge participants for providing a qualified preretirement survivor annuity (QPSA) (as defined in section 417(c)) on the participant's death, but only if the plan applies this treatment both for adjustments before age 62 and adjustments after age 65. Thus, in such a case, the plan is permitted to provide that, in computing the adjusted dollar limitation under section 415(b)(1)(A), no adjustment is made to reflect the probability of a participant's death after the annuity starting date and before age 62 or after age 65 and before the annuity starting date.

(3) *Exception for certain participants of certain governmental plans*. Pursuant to section 415(b)(2)(G) and (H), no age adjustment is made to the dollar limit for commencement before age 62 for any qualified participant. For this purpose, a qualified participant is a participant in a defined benefit plan that is maintained by a state, Indian tribal government (as defined in section 7701(a)(40)), or any political subdivision of a state or Indian tribal government with respect to whom the service taken into account in determining the amount of the benefit under the defined benefit plan includes at least 15 years of service of the participant—

(i) As a full-time employee of any police department or fire department that is organized and operated by the state, Indian tribal government, or political subdivision maintaining such defined benefit plan to provide police protection, firefighting services, or emergency medical services for any

area within the jurisdiction of such state, Indian tribal government, or political subdivision; or

(ii) As a member of the Armed Forces of the United States.

(4) *Exception for survivor and disability benefits under governmental plans.* Pursuant to section 415(b)(2)(I), no age adjustment is made to the dollar limit for commencement before age 62 for a distribution from a governmental plan (as defined in section 414(d)) on account of the participant's becoming disabled by reason of personal injuries or sickness, or as a result of the death of the participant.

(5) *Special rule for commercial airline pilots.* Pursuant to section 415(b)(9), no age adjustment is made to the dollar limit for early commencement on or after age 60 for a participant if—

(i) The participant is a commercial airline pilot;

(ii) The participant separates from service upon or after attaining age 60; and

(iii) As of the time of the participant's retirement, regulations prescribed by the Federal Aviation Administration require an individual to separate from service as a commercial airline pilot after attaining any age occurring on or after age 60 and before age 62.

(6) *No decrease in age-adjusted section 415(b)(1)(A) dollar limit on account of age or service.* Notwithstanding any other provision of this paragraph (d), the age-adjusted section 415(b)(1)(A) dollar limit applicable to a participant does not decrease on account of an increase in age or the performance of additional service.

(7) *Examples.* The following examples illustrate the application of this paragraph (d). For purposes of these examples, it is assumed that the dollar limitation under section 415(b)(1)(A) for all relevant years is $180,000, that the normal form of benefit under the plan is a straight life annuity payable beginning at age 65, and that all payments other than a payment of a single sum are made monthly, on the first day of each calendar month. The examples are as follows:

Example 1. (i) Plan A provides that early retirement benefits are determined by reducing the accrued benefit by 4 percent for each year that the early retirement age is less than age 65. Participant M retires at age 60 with exactly 30 years of service with a benefit (prior to the application of section 415) in the form of a straight life annuity of $100,000 payable at age 65, and is permitted to elect to commence benefits at any time between M's retirement and M's attainment of age 65. For example, M can elect to commence benefits at age 60 in the amount of $80,000, can wait until age 62 and commence benefits in the amount of $88,000, or can wait until age 65 and commence benefits in the amount of $100,000. Plan A provides a QPSA to all married participants without charge. Plan A provides (consistent with paragraph (d)(2)(ii) of this section) that, for purposes of adjusting the dollar limitation under section 415(b)(1)(A) for commencement before age 62 or after age 65, no forfeiture is treated as occurring upon a participant's death before retirement and, therefore, in computing the adjusted dollar limitation under section 415(b)(1)(A), no adjustment is made to reflect the probability of a participant's death after the annuity starting date and before age 62 or after age 65 and before the annuity starting date.

(ii) The age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 60 to the annuity payable at age 62, or the straight life annuity payable at age 60 that is actuarially equivalent, using 5 percent interest and the applicable mortality table effective for that annuity starting date under section 417(e)(3)(A)(ii)(I) and §1.417(e)–1(d)(2), to the deferred annuity payable at age 62 of $180,000 per year. In this case, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 is $156,229 (the lesser of $163,636 ($180,000* $80,000/$88,000) and $156,229 (the straight life annuity at age 60 that is actuarially equivalent to a deferred annuity of $180,000 commencing at age 62, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 60 and 62)).

Example 2. (i) The facts are the same as in *Example 1*, except that participant M elects to retire at age 60, 6 months, and 21 days.

(ii) Under paragraph (d)(1)(i) of this section, M is treated as age 60 and 6 months (or, age 60.5). Absent the rule provided in paragraph (d)(6) of this section, the age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60.5 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 60.5 to the annuity payable at age 62, or the straight life annuity payable at age 60.5 that is actuarially equivalent, using 5 percent interest and the applicable mortality table for that annuity starting date under section 417(e)(3)(A)(ii)(I) and

§ 1.417(e)–1(d)(2), to the deferred annuity payable at age 62 of $180,000 per year. The age-adjusted section 415(b)(1)(A) dollar limit at age 60.5 is $161,769 (the lesser of $167,727 ($180,000* $82,000/$88,000) and $161,769 (the straight life annuity at age 60.5 that is actuarially equivalent to a deferred annuity of $180,000 commencing at age 62, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 60.5 and 62).

Example 3. (i) The facts are the same as in *Example 1*, except the plan provides that, if a participant has 30 or more years of service, no reduction applies for benefits commencing at age 62 and later.

(ii) Absent the rule provided in paragraph (d)(6) of this section, the age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 60 to the annuity payable at age 62, or the straight life annuity payable at age 60 that is actuarially equivalent, using 5 percent interest and the applicable mortality table for that annuity starting date under section 417(e)(3)(A)(ii)(I) and § 1.417(e)–1(d)(2), to the deferred annuity payable at age 62 of $180,000 per year. In this case, because M has 30 years of service and would be eligible for the unreduced early retirement benefit at age 62, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 would be $144,000 (the lesser of $144,000 ($180,000* $80,000/$100,000) and $156,229 (the straight life annuity at age 60 that is actuarially equivalent to a deferred annuity of $180,000 commencing at age 62, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 60 and 62)).

(iii) However, at age 59 11/12 with 29 11/12 years of service, the age-adjusted section 415(b)(1)(A) dollar limit for M is $155,311 (the lesser of $162,955 ($180,000* $79,667/$88,000) and $155,311 (the straight life annuity at age 59 11/12 that is actuarially equivalent to a deferred annuity of $180,000 commencing at age 62, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 59 and 62)). Thus, after applying the rule provided in paragraph (d)(6) of this section, the age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60 is $155,311.

Example 4. (i) The facts are the same as in *Example 1*, except that the plan provides that, if a participant has 30 or more years of service, then no reduction is made in early retirement benefits if the early retirement age is at least age 62 and, in the case of an early retirement age before age 62, the early retirement benefit is determined by reducing the accrued benefit by 4 percent for each year that the early retirement age is less than age 62.

(ii) The age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 60 to the annuity payable at age 62, or the straight life annuity payable at age 60 that is actuarially equivalent, using 5 percent interest and the applicable mortality table for that annuity starting date under section 417(e)(3)(A)(ii)(I) and § 1.417(e)–1(d)(2), to the deferred annuity payable at age 62 of $180,000 per year. In this case, because M has 30 years of service and would be eligible for the unreduced early retirement benefit at age 62, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 is $156,229 (the lesser of $165,600 ($180,000* $92,000/$100,000) and $156,229 (the straight life annuity at age 60 that is actuarially equivalent to a deferred annuity of $180,000 commencing at age 62, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 60 and 62)).

Example 5. (i) The facts are the same as in *Example 1*, except that Participant M chooses to receive benefits in the form of a 10-year certain and life annuity under which payments are 97 percent of the periodic payments that would be made under the immediately commencing straight life annuity. Annual payments to M are 97 percent of $80,000, or $77,600. Additionally, M's average compensation for the period of M's high-3 years of service is $120,000. As in *Example 1*, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 is $156,229.

(ii) In the case of a form of benefit to which section 417(e)(3) does not apply, the annual benefit for purposes of this section is the greater of the annual amount of the plan's straight life annuity commencing at the same age or the annual amount of the actuarially equivalent straight life annuity commencing at the same age, determined using a 5 percent interest rate and the applicable mortality table for that annuity starting date under section 417(e)(3)(A)(ii)(I) and § 1.417(e)–1(d)(2). In this case, the straight life annuity payable under the plan commencing at the same age is $80,000. The annual amount of the straight life annuity that is actuarially equivalent to the $77,600 benefit payable as a 10-year certain and life annuity is determined by applying the required standardized factors (a 5 percent interest assumption and the applicable mortality under section 417(e)(3)(A)(ii)(I) and § 1.417(e)–1(d)(2), and is $79,416. With respect to the 10-year certain and life annuity commencing at age 62, M's annual benefit is equal to the greater of the two resulting amounts ($80,000 and $79,416), or $80,000. Because M's annual benefit is less than the age-adjusted section 415(b)(1)(A) dollar limit and is less than the

section 415(b)(1)(B) compensation limit, M's benefit satisfies section 415.

Example 6. (i) Participant O is a full-time civilian employee of the Harbor Police Division of the State of X Port Authority. The Harbor Police Division provides police protection services. O performs clerical services for the Harbor Police Division. O is a participant in the defined benefit plan that is maintained by the State of X with respect to whom the years of service taken into account in determining the amount of the benefit under the plan includes 10 years of service working for the Harbor Police Division and 5 years of service as a member of the Armed Forces of the United States.

(ii) For a distribution with an annuity starting date that occurs before O attains the age of 62, there is no age adjustment to the section 415(b)(1)(A) dollar limit.

Example 7. (i) Participant R is a full-time employee of the Emergency Medical Service Department of County Y (which is not a part of a police or fire department) who performs services as a driver of an ambulance. R is a participant in the defined benefit plan that is maintained by County Y with respect to whom the years of service taken into account in determining the amount of the benefit under the plan includes 15 years of service working for County Y. R does not have service credit for time in the Armed Forces of the United States.

(ii) The age adjustments to the limitations of section 415(b)(1)(A) pursuant to section 415(b)(2)(C) and (D) will apply if R commences receiving a distribution at an age to which either of those adjustments applies.

(e) *Adjustment to section 415(b)(1)(A) dollar limit for commencement after age 65*—(1) *General rule*—(i) *Calculation using statutory factors.* For a distribution with an annuity starting date that occurs after the participant attains the age of 65, the age-adjusted section 415(b)(1)(A) dollar limit generally is determined as the actuarial equivalent of the annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as a straight life annuity commencing at age 65, where annual payments under the straight life annuity commencing at age 65 are equal to the dollar limitation of section 415(b)(1)(A) (as adjusted pursuant to section 415(d) and § 1.415(d)–1 for the limitation year), and where the actuarially equivalent straight life annuity is computed using a 5 percent interest rate and the applicable mortality table under § 1.417(e)–1(d)(2) that is effective for that annuity starting date (and expressing the participant's age based on completed calendar months as of the annuity starting date). However, if the plan has an immediately commencing straight life annuity payable as of the annuity starting date and an immediately commencing straight life annuity payable at age 65, then the age-adjusted section 415(b)(1)(A) dollar limit is equal to the lesser of—

(A) The limit as otherwise determined under this paragraph (e)(1)(i); and

(B) The amount determined under paragraph (e)(1)(ii) of this section.

(ii) *Calculation using plan factors.* The amount determined under this paragraph (e)(1)(ii) is equal to the section 415(b)(1)(A) dollar limit (as adjusted pursuant to section 415(d) and § 1.415(d)–1 for the limitation year) multiplied by the adjustment ratio described in paragrap. (e)(2)(i) of this section.

(2) *Adjustment ratio*—(i) *General rule.* For purposes of applying the rule of paragraph (e)(1)(ii) of this section, the adjustment ratio is equal to the ratio of the annual amount of the adjusted immediately commencing straight life annuity under the plan described in paragraph (e)(2)(ii) of this section to the adjusted age 65 straight life annuity described in paragraph (e)(2)(iii) of this section.

(ii) *Adjusted immediately commencing straight life annuity.* The adjusted immediately commencing straight life annuity that is used for purposes of paragraph (e)(2)(i) of this section is the annual amount of the immediately commencing straight life annuity payable to the participant, computed disregarding the participant's accruals after age 65 but including actuarial adjustments even if those actuarial adjustments are applied to offset accruals. For this purpose, the annual amount of the immediately commencing straight life annuity is determined without applying the rules of section 415.

(iii) *Adjusted age 65 straight life annuity.* The adjusted age 65 straight life annuity that is used for purposes of paragraph (e)(2)(i) of this section is the annual amount of the straight life annuity that would be payable under the plan to a hypothetical participant who

is 65 years old and has the same accrued benefit (with no actuarial increases for commencement after age 65) as the participant receiving the distribution (determined disregarding the participant's accruals after age 65 and without applying the rules of section 415).

(3) *Mortality adjustments*—(i) *In general*. For purposes of determining the actuarially equivalent amount described in paragraph (e)(1)(i) of this section, to the extent that a forfeiture does not occur upon the participant's death before the annuity starting date, no adjustment is made to reflect the probability of the participant's death between the participant's attainment of age 65 and the annuity starting date. To the extent that a forfeiture occurs upon the participant's death before the annuity starting date, an adjustment must be made to reflect the probability of the participant's death between the participant's attainment of age 65 and the annuity starting date.

(ii) *No forfeiture deemed to occur where QPSA payable*. See paragraph (d)(2)(ii) of this section for a rule deeming no forfeiture to occur if the plan does not charge participants for providing a QPSA on the participant's death.

(4) *Examples*. The following examples illustrate the application of this paragraph (e):

Example 1. (i) Plan A provides that monthly benefits payable upon commencement after normal retirement age (which is age 65) are increased by 0.5 percent for each month of delay in commencement after attainment of normal retirement age. Plan A provides a QPSA to all married participants without charge. Plan A provides (consistent with paragraph (d)(2)(ii) of this section) that, for purposes of adjusting the dollar limitation under section 415(b)(1)(A) for commencement before age 62 or after age 65, no adjustment is made to reflect the probability of a participant's death between the annuity starting date and the participant's attainment of age 62 or between the age of 65 and the annuity starting date. The normal form of benefit under Plan A is a straight life annuity commencing at age 65. Plan A does not provide additional benefit accruals once a participant is credited with 30 years of service. Participant M was credited with 30 years of service under Plan A when M attained age 65. M retires at age 70 on January 1, 2008, with a benefit (prior to the application of section 415) that is payable monthly in the form of a straight life annuity of $195,000, which reflects the actuarial increase of 30 percent applied to the accrued benefit of $150,000. It is assumed that all payments under Plan A, other than a payment of a single sum, are made monthly, on the first day of each calendar month. It is also assumed that the dollar limit in 2008 is $185,000.

(ii) The age-adjusted section 415(b)(1)(A) dollar limit at age 70 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the adjusted immediately commencing straight life annuity payable at age 70 (computed disregarding the rules of section 415 and accruals after age 65, but including actuarial adjustments) to the adjusted age 65 straight life annuity (computed disregarding the rules of section 415 and any accruals after age 65), or the straight life annuity payable at age 70 that is actuarially equivalent, using 5 percent interest and the applicable mortality table for that annuity starting date under section 417(e)(3)(A)(ii)(I) and §1.417(e)–1(d)(2), to the straight life annuity payable at age 65, where annual payments under the straight life annuity payable at age 65 are equal to the dollar limitation of section 415(b)(1)(A). In this case, the age-adjusted section 415(b)(1)(A) dollar limit at age 70 is $240,500 (the lesser of $240,500 ($185,000* $195,000/$150,000) and $271,444 (the straight life annuity at age 70 that is actuarially equivalent to an annuity of $185,000 commencing at age 65, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 65 and 70)).

Example 2. (i) The facts are the same as in Example 1, except that Plan A does not limit benefit accruals to 30 years of credited service, and thus M accrues benefits between ages 65 and 70.

(ii) Since M's accruals after attaining age 65 are disregarded for purposes of determining the age-adjusted section 415(b)(1)(A) dollar limit applicable to M at age 70, the result is the same as in *Example 1*.

Example 3. (i) The facts are the same as in *Example 1*, except that Plan A does not limit benefit accruals to 30 years of credited service. However, benefit accruals after an employee has reached normal retirement age (age 65), are offset by the actuarial increase that the plan provides for commencement of benefits after normal retirement age.

(ii) The result is the same as in *Example 1*, even if the actuarial increases for post-age 65 benefit commencement provided under Plan A do or do not fully offset M's benefit accruals after attaining age 65. This is because benefit accruals after age 65 are disregarded for purposes of determining the age-adjusted section 415(b)(1)(A) dollar limit applicable to M after age 65.

(f) *Total annual payments not in excess of $10,000*—(1) *In general*. Pursuant to section 415(b)(4), the annual benefit

(without regard to the age at which benefits commence) payable with respect to a participant under any defined benefit plan is not considered to exceed the limitations on benefits described in section 415(b)(1) and in paragraph (a)(1) of this section if—

(i) The benefits (other than benefits not taken into account in the computation of the annual benefit under the rules of paragraph (b) or (c) of this section) payable with respect to the participant under the plan and all other defined benefit plans of the employer do not in the aggregate exceed $10,000 (as adjusted under paragraph (g) of this section) for the limitation year, or for any prior limitation year; and

(ii) The employer (or a predecessor employer) has not at any time maintained a defined contribution plan in which the participant participated.

(2) *Computation of benefits for purposes of applying the $10,000 amount.* For purposes of paragraph (f)(1)(i) of this section, the benefits payable with respect to the participant under a plan for a limitation year reflect all amounts payable under the plan for the limitation year (other than benefits not taken into account in the computation of the annual benefit under the rules of paragraph (b) or (c) of this section), and are not adjusted for form of benefit or commencement date.

(3) *Special rule with respect to participants in multiemployer plans.* The special $10,000 exception set forth in paragraph (f)(1) of this section applies to a participant in a multiemployer plan described in section 414(f) without regard to whether that participant ever participated in one or more other plans maintained by an employer who also maintains the multiemployer plan, provided that none of such other plans were maintained as a result of collective bargaining involving the same employee representative as the multiemployer plan.

(4) *Special rule with respect to employee contributions.* Notwithstanding §§ 1.415(c)–1(a)(2)(ii)(B) and 1.415(c)–1(b)(3), mandatory employee contributions under a defined benefit plan described in paragraph (b)(2)(iii) of this section are not considered a separate defined contribution plan maintained by the employer for purposes of paragraph (f)(1)(ii) of this section. Thus, the special dollar limitation provided for in this paragraph (f) applies to a contributory defined benefit plan.

Similarly, for purposes of this paragraph (f), an individual medical account under section 401(h) or an account for postretirement medical benefits established pursuant to section 419A(d)(1) is not considered a separate defined contribution plan maintained by the employer.

(5) *Examples.* The application of this paragraph (f) may be illustrated by the following examples. For purposes of these examples, it is assumed that each participant has 10 years of participation in the plan and service with the employer. The examples are as follows:

Example 1. (i) B is a participant in a defined benefit plan maintained by X Corporation, which provides for a benefit payable in the form of a straight life annuity beginning at age 65. B's average compensation for the period of B's high-3 years of service is $6,000. The plan does not provide for mandatory employee contributions, and at no time has B been a participant in a defined contribution plan maintained by X. With respect to the current limitation year, B's benefit under the plan (before the application of section 415) is $9,500.

(ii) Because annual payments under B's benefit do not exceed $10,000, and because B has at no time participated in a defined contribution plan maintained by X, the benefits payable under the plan are not considered to exceed the limitation on benefits otherwise applicable to B ($6,000).

(iii) This result would remain the same even if, under the terms of the plan, B's benefit of $9,500 were payable at age 60, or if the plan provided for mandatory employee contributions.

Example 2. (i) The facts are the same as in *Example 1*, except that the plan provides for a benefit payable in the form of a life annuity with a 10-year certain feature with annual payments of $9,500. Assume that, after the adjustment described in paragraph (c) of this section, B's actuarially equivalent straight life annuity (which is the annual benefit used for demonstrating compliance with section 415) for the current limitation year is $10,400.

(ii) For purposes of applying the special rule provided in this paragraph for total benefits not in excess of $10,000, there is no adjustment required if the retirement benefit payable under the plan is not in the form of a straight life annuity. Therefore, because B's retirement benefit does not exceed $10,000, B may receive the full $9,500 benefit

without the otherwise applicable benefit limitations of this section being exceeded.

Example 3. (i) The facts are the same as in *Example 1*, except that the plan provides for a benefit payable in the form of a single sum and the amount of the single sum that is the actuarial equivalent of the straight life annuity payable to B ($9,500 annually), determined in accordance with the rules of section 417(e)(3) and § 1.417(e)–1(d), is $95,000.

(ii) Because the amount payable to B for the limitation year would exceed $10,000, the rule of this paragraph (f) does not provide an exception from the generally applicable limits of section 415(b)(1) for the single-sum distribution. Thus, the otherwise applicable limits apply to the single-sum distribution, and a single-sum distribution of $95,000 would not satisfy the requirements of section 415(b). Limiting the single-sum distribution to $60,000 (the present value of the annuity that complies with the compensation-based limitation of section 415(b)(1)(B)) in order to satisfy section 415 would be an impermissible forfeiture under the requirements of section 411(a). Accordingly, the plan should not provide for a single-sum distribution in these circumstances.

(g) *Special rule for participation or service of less than 10 years*—(1) *Proration of dollar limit based on years of participation*—(i) *In general.* Pursuant to section 415(b)(5)(A), where a participant has less than 10 years of participation in the plan, the dollar limit described in paragraph (a)(1)(i) of this section (as adjusted pursuant to section 415(d), § 1.415(d)–1, and paragraphs (d) and (e) of this section) is reduced by multiplying the otherwise applicable limitation by a fraction—

(A) The numerator of which is the number of years of participation in the plan (or 1, if greater); and

(B) The denominator of which is 10.

(ii) *Years of participation.* The following rules apply for purposes of determining a participant's years of participation for purposes of this paragraph (g)(1)—

(A) A participant is credited with a year of participation (computed to fractional parts of a year) for each accrual computation period for which the participant is credited with at least the number of hours of service (or period of service if the elapsed time method is used for benefit accrual purposes) required under the terms of the plan in order to accrue a benefit for the accrual computation period, and the participant is included as a plan participant under the eligibility provisions of the plan for at least one day of the accrual computation period. If these two conditions are met, the portion of a year of participation credited to the participant is equal to the amount of benefit accrual service credited to the participant for such accrual computation period. For example, if under the terms of a plan, a participant receives 1/10 of a year of benefit accrual service for an accrual computation period for each 200 hours of service, and the participant is credited with 1,000 hours of service for the period, the participant is credited with ½ a year of participation for purposes of section 415(b)(5)(A) and this paragraph (g)(1).

(B) A participant who is permanently and totally disabled within the meaning of section 415(c)(3)(C)(i) for an accrual computation period is credited with a year of participation with respect to that period for purposes of section 415(b)(5)(A) and this paragraph (g)(1).

(C) For a participant to receive a year of participation (or part thereof) for an accrual computation period for purposes of section 415(b)(5)(A) and this paragraph (g)(1), the plan must be established no later than the last day of such accrual computation period.

(D) No more than one year of participation may be credited for any 12-month period for purposes of section 415(b)(5)(A) and this paragraph (g)(1).

(2) *Proration of compensation limit and special rule for total annual payments less than $10,000 based on years of service*—(i) *In general.* Pursuant to section 415(b)(5)(B), where a participant has less than 10 years of service with the employer, the compensation limit described in paragraph (a)(1)(ii) of this section and the $10,000 amount under the special rule for small annual payments under paragraph (f) of this section are reduced by multiplying the otherwise applicable limitation by a fraction—

(A) The numerator of which is the number of years of service with the employer (or 1, if greater); and

(B) The denominator of which is 10.

(ii) *Years of service*—(A) *In general.* For purposes of applying this paragraph (g)(2), years of service must be

determined on a reasonable and consistent basis. A plan is considered to be determining years of service on a reasonable and consistent basis for this purpose if, subject to the limits of paragraph (g)(2)(ii)(B) of this section, a participant is credited with a year of service (computed to fractional parts of a year) for each accrual computation period for which the participant is credited with at least the number of hours of service (or period of service if the elapsed time method is used for benefit accrual purposes) required under the terms of the plan in order to accrue a benefit for the accrual computation period.

(B) *Rules of application*. No more than one year of service may be credited for any 12-month period for purposes of section 415(b)(5)(B). In addition, only the participant's service with the employer or a predecessor employer (as defined in §1.415(f)–1(c)) may be taken into account in determining the participant's years of service for this purpose. Thus, if an employer does not maintain a former employer's plan, a participant's service with the former employer may be taken into account in determining the participant's years of service for purposes of this paragraph (g)(2) only if the former employer is a predecessor employer with respect to the employer pursuant to §1.415(f)–1(c)(2) (which defines predecessor employer to include, under certain circumstances, a former entity that antedates the employer).

(C) *Period of disability*. Notwithstanding the rules of paragraph (g)(2)(ii)(B) of this section, a plan is permitted to provide that a participant who is permanently and totally disabled within the meaning of section 415(c)(3)(C)(i) for an accrual computation period is credited with service with respect to that period for purposes of section 415(b)(5)(B).

(3) *Exception for survivor and disability benefits under governmental plans*. The requirements of this paragraph (g) (regarding participation or service of less than 10 years) do not apply to a distribution from a governmental plan (as defined in section 414(d)) on account of the participant's becoming disabled by reason of personal injuries or sickness, or as a result of the death of the participant.

(4) *Examples*. The provisions of this paragraph (g) may be illustrated by the following examples:

Example 1. (i) C begins employment with Employer A on January 1, 2005, at the age of 58. Employer A maintains only a noncontributory defined benefit plan which provides for a straight life annuity beginning at age 65 and uses the calendar year for the limitation and plan year. Employer A has never maintained a defined contribution plan. C becomes a participant in Employer A's plan on January 1, 2006, and works through December 31, 2011, when C is age 65. C begins to receive benefits under the plan in 2012. C's average compensation for the period of C's high-3 years of service is $40,000. Furthermore, under the terms of Employer A's plan, for purposes of computing C's nonforfeitable percentage in C's accrued benefit derived from employer contributions, C has only 7 years of service with Employer A (2005–2011).

(ii) Because C has only 7 years of service with Employer A at the time he begins to receive benefits under the plan, the maximum permissible annual benefit payable with respect to C is $28,000 ($40,000 multiplied by 7/10).

Example 2. (i) The facts are the same as in *Example 1*, except that C's average compensation for the period of his high-3 years of service is $8,000.

(ii) Because C has only 7 years of service with Employer A at the time he begins to receive benefits, the maximum benefit payable with respect to C would be reduced to $5,600 ($8,000 multiplied by 7/10). However, the special rule for total benefits not in excess of $10,000, provided in paragraph (f) of this section, is applicable in this case. Accordingly, C may receive an annual benefit of $7,000 ($10,000 multiplied by 7/10) without the benefit limitations of this section being exceeded.

Example 3. (i) Employer B maintains a defined benefit plan. Benefits under the plan are computed based on months of service rather than years of service. Accordingly, for purposes of applying the reduction based on years of service less than 10 to the limitations under section 415(b), the plan provides that the otherwise applicable limitation is multiplied by a fraction, the numerator of which is the number of completed months of service with the employer (but not less than 12 months), and the denominator of which is 120. The plan further provides that months of service are computed in the same manner for this purpose as for purposes of computing plan benefits.

(ii) The manner in which the plan applies the reduction based on years of service less than 10 to the limitations under section

415(b) is consistent with the requirements of this paragraph (g).

Example 4. (i) G begins employment with Employer D on January 1, 2003, at the age of 58. Employer D maintains a noncontributory defined benefit plan which provides for a straight life annuity beginning at age 65 and uses the calendar year for the limitation and plan year. G becomes a participant in Employer D's plan on January 1, 2004, and works through December 31, 2009, when G is age 65. G performs sufficient service to be credited with a year of service under the plan for each year during 2003 through 2009 (although G is not credited with a year of service for 2003 because G is not yet a plan participant). G begins to receive benefits under the plan during 2010. The plan's accrual computation period is the plan year. The plan provides that, for purposes of applying the rules of section 415(b)(5)(B), a participant is credited with a year of service (computed to fractional parts of a year) for each plan year for which the participant is credited with sufficient service to accrue a benefit for the plan year. G's average compensation for the period of G's high-3 years of service is $200,000. It is assumed for purposes of this example that the dollar limitation of section 415(b)(1)(A) for limitation years ending in 2010 is $195,000.

(ii) G has 7 years of service and 6 years of participation in the plan at the time G begins to receive benefits under the plan. Accordingly, the limitation under section 415(b)(1)(B) based on G's average compensation for the period of G's high-3 years of service that applies pursuant to the adjustment required under section 415(b)(5)(B) is $140,000 ($200,000 multiplied by 7/10), and the dollar limitation under section 415(b)(1)(A) that applies to G pursuant to the adjustment required under section 415(b)(5)(A) is $117,000 ($195,000 multiplied by 6/10).

(h) *Retirement Protection Act of 1994 transition rules.* For special rules affecting the actuarial adjustment for form of benefit under paragraph (c) of this section and the adjustment to the dollar limit for early or late commencement under paragraphs (d) and (e) of this section for certain plans adopted and in effect before December 8, 1994, see section 767(d)(3)(A) of the Uruguay Round Agreements Act of 1994, Public Law 103–465 (108 Stat. 4809) as amended by section 1449(a) of the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755). The Commissioner may provide guidance regarding these special rules in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin. See § 601.601(d) of this chapter.

[T.D. 9319, 72 FR 16899, Apr. 5, 2007; 72 FR 28854, May 23, 2007]

§ 1.415(b)–2 Multiple annuity starting dates. [Reserved]

§ 1.415(c)–1 Limitations for defined contribution plans.

(a) *General rules*—(1) *Maximum limitations.* Under section 415(c) and this section, to satisfy the provisions of section 415(a) for any limitation year, except as provided by paragraph (a)(3) of this section, the annual additions (as defined in paragraph (b) of this section) credited to the account of a participant in a defined contribution plan for the limitation year must not exceed the lesser of—

(i) $40,000 (adjusted pursuant to section 415(d) and § 1.415(d)–1(b)); or

(ii) 100 percent of the participant's compensation (as defined in § 1.415(c)–2) for the limitation year.

(2) *Defined contribution plan*—(i) *Definition.* For purposes of section 415 and regulations promulgated under section 415, the term *defined contribution plan* means a defined contribution plan within the meaning of section 414(i) (including the portion of a plan treated as a defined contribution plan under the rules of section 414(k)) that is—

(A) A plan described in section 401(a) which includes a trust which is exempt from tax under section 501(a);

(B) An annuity plan described in section 403(a); or

(C) A simplified employee pension described in section 408(k).

(ii) *Additional plans treated as defined contribution plans*—(A) *In general.* Contributions to the types of arrangements described in paragraphs (a)(2)(ii)(B) through (D) of this section are treated as contributions to defined contribution plans for purposes of section 415 and regulations promulgated under section 415.

(B) *Employee contributions to a defined benefit plan.* Mandatory employee contributions (as defined in section 411(c)(2)(C) and § 1.411(c)–1(c)(4), regardless of whether the plan is subject to the requirements of section 411) to a defined benefit plan are treated as contributions to a defined contribution

plan. For this purpose, contributions that are picked up by the employer as described in section 414(h)(2) are not considered employee contributions.

(C) *Individual medical benefit accounts under section 401(h).* Pursuant to section 415(l)(1), contributions allocated to any individual medical benefit account which is part of a pension or annuity plan established pursuant to section 401(h) are treated as contributions to a defined contribution plan.

(D) *Post-retirement medical accounts for key employees.* Pursuant to section 419A(d)(2), amounts attributable to medical benefits allocated to an account established for a key employee (any employee who, at any time during the plan year or any preceding plan year, is or was a key employee as defined in section 416(i)) pursuant to section 419A(d)(1) are treated as contributions to a defined contribution plan.

(iii) *Section 403(b) annuity contracts.* Annual additions under an annuity contract described in section 403(b) are treated as annual additions under a defined contribution plan for purposes of this section.

(3) *Alternative contribution limitations*—(i) *Church plans.* For alternative contribution limitations relating to church plans, see paragraph (d) of this section.

(ii) *Special rules for medical benefits.* For additional rules relating to certain medical benefits, see paragraph (e) of this section.

(iii) *Employee stock ownership plans.* For additional rules relating to employee stock ownership plans, see paragraph (f) of this section.

(b) *Annual additions*—(1) *In general*—(i) *General definition.* The term *annual addition* means, for purposes of this section, the sum, credited to a participant's account for any limitation year, of—

(A) Employer contributions;

(B) Employee contributions; and

(C) Forfeitures.

(ii) *Certain excess amounts treated as annual additions.* Contributions do not fail to be annual additions merely because they are excess contributions (as described in section 401(k)(8)(B)) or excess aggregate contributions (as described in section 401(m)(6)(B)), or merely because excess contributions or excess aggregate contributions are corrected through distribution.

(iii) *Direct transfers.* The direct transfer of a benefit or employee contributions from a qualified plan to a defined contribution plan does not give rise to an annual addition.

(iv) *Reinvested employee stock ownership plan dividends.* The reinvestment of dividends on employer securities under an employee stock ownership plan pursuant to section 404(k)(2)(A)(iii)(II) does not give rise to an annual addition.

(2) *Employer contributions*—(i) *Amounts treated as an annual addition.* For purposes of paragraph (b)(1)(i)(A) of this section, the term *annual addition* includes employer contributions credited to the participant's account for the limitation year and other allocations described in paragraph (b)(4) of this section that are made during the limitation year. See paragraph (b)(6) of this section for timing rules applicable to annual additions with respect to employer contributions.

(ii) *Amounts not treated as annual additions*—(A) *Certain restorations of accrued benefits.* The restoration of an employee's accrued benefit by the employer in accordance with section 411(a)(3)(D) or section 411(a)(7)(C) or resulting from the repayment of cashouts (as described in section 415(k)(3)) under a governmental plan (as defined in section 414(d)) is not considered an annual addition for the limitation year in which the restoration occurs. This treatment of a restoration of an employee's accrued benefit as not giving rise to an annual addition applies regardless of whether the plan restricts the timing of repayments to the maximum extent allowed by section 411(a).

(B) *Catch-up contributions.* A catch-up contribution made in accordance with section 414(v) and §1.414(v)–1 does not give rise to an annual addition.

(C) *Restorative payments.* A restorative payment that is allocated to a participant's account does not give rise to an annual addition for any limitation year. For this purpose, restorative payments are payments made to restore losses to a plan resulting from actions by a fiduciary for which there is reasonable risk of liability for breach of a

fiduciary duty under title I of the Employee Retirement Income Security Act of 1974 (88 Stat. 829), Public Law 93–406 (ERISA) or under other applicable federal or state law, where plan participants who are similarly situated are treated similarly with respect to the payments. Generally, payments to a defined contribution plan are restorative payments only if the payments are made in order to restore some or all of the plan's losses due to an action (or a failure to act) that creates a reasonable risk of liability for such a breach of fiduciary duty (other than a breach of fiduciary duty arising from failure to remit contributions to the plan). This includes payments to a plan made pursuant to a Department of Labor order, the Department of Labor's Voluntary Fiduciary Correction Program, or a court-approved settlement, to restore losses to a qualified defined contribution plan on account of the breach of fiduciary duty (other than a breach of fiduciary duty arising from failure to remit contributions to the plan). Payments made to a plan to make up for losses due merely to market fluctuations and other payments that are not made on account of a reasonable risk of liability for breach of a fiduciary duty under title I of ERISA are not restorative payments and generally constitute contributions that give rise to annual additions under paragraph (b)(4) of this section.

(D) *Excess deferrals*. Excess deferrals that are distributed in accordance with § 1.402(g)–1(e)(2) or (3) do not give rise to annual additions.

(3) *Employee contributions*. For purposes of paragraph (b)(1)(i)(B) of this section, the term *annual addition* includes mandatory employee contributions (as defined in section 411(c)(2)(C) and regulations promulgated under section 411) as well as voluntary employee contributions. The term *annual addition* does not include—

(i) Rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16));

(ii) Repayments of loans made to a participant from the plan;

(iii) Repayments of amounts described in section 411(a)(7)(B) (in accordance with section 411(a)(7)(C)) and section 411(a)(3)(D) or repayment of contributions to a governmental plan (as defined in section 414(d)) as described in section 415(k)(3);

(iv) Repayments that would have been described in paragraph (b)(3)(iii) of this section except that the plan does not restrict the timing of repayments to the maximum extent permitted by section 411(a); or

(v) Employee contributions to a qualified cost of living arrangement within the meaning of section 415(k)(2)(B).

(4) *Transactions with plan*. The Commissioner may in an appropriate case, considering all of the facts and circumstances, treat transactions between the plan and the employer, transactions between the plan and the employee, or certain allocations to participants' accounts as giving rise to annual additions. Further, where an employee or employer transfers assets to a plan in exchange for consideration that is less than the fair market value of the assets transferred to the plan, there is an annual addition in the amount of the difference between the value of the assets transferred and the consideration. A transaction described in this paragraph (b)(4) may constitute a prohibited transaction with the meaning of section 4975(c)(1).

(5) *Contributions other than cash*. For purposes of this paragraph (b), a contribution by the employer or employee of property rather than cash is considered to be a contribution in an amount equal to the fair market value of the property on the date the contribution is made. For this purpose, the fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. In addition, a contribution described in this paragraph (b)(5) may constitute a prohibited transaction within the meaning of section 4975(c)(1).

(6) *Timing rules*—(i) *In general*—(A) *Date of allocation*. For purposes of this paragraph (b), an annual addition is credited to the account of a participant for a particular limitation year if it is allocated to the participant's account under the terms of the plan as of any

date within that limitation year. Similarly, an annual addition that is made pursuant to a corrective amendment that complies with the requirements of §1.401(a)(4)–11(g) is credited to the account of a participant for a particular limitation year if it is allocated to the participant's account under the terms of the corrective amendment as of any date within that limitation year. However, if the allocation of an annual addition is dependent upon the satisfaction of a condition (such as continued employment or the occurrence of an event) that has not been satisfied by the date as of which the annual addition is allocated under the terms of the plan, then the annual addition is considered allocated for purposes of this paragraph (b) as of the date the condition is satisfied.

(B) *Date of employer contributions.* For purposes of this paragraph (b), employer contributions are not treated as credited to a participant's account for a particular limitation year unless the contributions are actually made to the plan no later than 30 days after the end of the period described in section 404(a)(6) applicable to the taxable year with or within which the particular limitation year ends. If, however, contributions are made by an employer exempt from Federal income tax (including a governmental employer), the contributions must be made to the plan no later than the 15th day of the tenth calendar month following the end of the calendar year or fiscal year (as applicable, depending on the basis on which the employer keeps its books) with or within which the particular limitation year ends. If contributions are made to a plan after the end of the period during which contributions can be made and treated as credited to a participant's account for a particular limitation year, allocations attributable to those contributions are treated as credited to the participant's account for the limitation year during which those contributions are made.

(C) *Date of employee contributions.* For purposes of this paragraph (b), employee contributions, whether voluntary or mandatory, are not treated as credited to a participant's account for a particular limitation year unless the contributions are actually made to the plan no later than 30 days after the close of that limitation year.

(D) *Date for forfeitures.* A forfeiture is treated as an annual addition for the limitation year that contains the date as of which it is allocated to a participant's account as a forfeiture.

(E) *Treatment of elective contributions as plan assets.* The extent to which elective contributions constitute plan assets for purposes of the prohibited transaction provisions of section 4975 and title I of ERISA, is determined in accordance with regulations and rulings issued by the Department of Labor. See 29 CFR 2510.3–102.

(ii) *Special timing rules*—(A) *Corrective contributions.* For purposes of this section, if, in a particular limitation year, an employer allocates an amount to a participant's account because of an erroneous forfeiture in a prior limitation year, or because of an erroneous failure to allocate amounts in a prior limitation year, the corrective allocation will not be considered an annual addition with respect to the participant for that particular limitation year, but will be considered an annual addition for the prior limitation year to which it relates. An example of a situation in which an employer contribution might occur under the circumstances described in the preceding sentence is a retroactive crediting of service for an employee under 29 CFR 2530.200b–2(a)(3) in accordance with an award of back pay. For purposes of this paragraph (b)(6)(ii), if the amount so contributed in the particular limitation year takes into account actual investment gains attributable to the period subsequent to the year to which the contribution relates, the portion of the total contribution that consists of such gains is not considered as an annual addition for any limitation year.

(B) *Contributions for accumulated funding deficiencies and previously waived contributions*—(*1*) *Accumulated funding deficiency.* In the case of a defined contribution plan to which the rules of section 412 apply, a contribution made to reduce an accumulated funding deficiency will be treated as if it were timely made for purposes of determining the limitation year in which the annual additions arising from the contribution are made, but only if the

contribution is allocated to those participants who would have received an annual addition if the contribution had been timely made.

(*2*) *Previously waived contributions.* In the case of a defined contribution plan to which the rules of section 412 apply and for which there has been a waiver of the minimum funding standard in a prior limitation year in accordance with section 412(d), that portion of an employer contribution in a subsequent limitation year which, if not for the waiver, would have otherwise been required in the prior limitation year under section 412(a) will be treated as if it were timely made (without regard to the funding waiver) for purposes of determining the limitation year in which the annual additions arising from the contribution are made, but only if the contribution is allocated to those participants who would have received an annual addition if the contribution had been timely made (without regard to the funding waiver).

(*3*) *Interest.* For purposes of determining the amount of the annual addition under paragraphs (b)(6)(ii)(B)(*1*) and (*2*) of this section, a reasonable amount of interest paid by the employer is disregarded. However, any interest paid by the employer that is in excess of a reasonable amount, as determined by the Commissioner, is taken into account as an annual addition for the limitation year during which the contribution is made.

(C) *Simplified employee pensions.* For purposes of this paragraph (b), amounts contributed to a simplified employee pension described in section 408(k) are treated as allocated to the individual's account as of the last day of the limitation year ending with or within the taxable year for which the contribution is made.

(D) *Treatment of certain contributions made pursuant to veterans' reemployment rights.* If, in a particular limitation year, an employer contributes an amount to an employee's account with respect to a prior limitation year and such contribution is required by reason of such employee's rights under chapter 43 of title 38, United States Code, resulting from qualified military service, as specified in section 414(u)(1), then such contribution is not considered an annual addition with respect to the employee for that particular limitation year in which the contribution is made, but, in accordance with section 414(u)(1)(B), is considered an annual addition for the limitation year to which the contribution relates.

(c) *Examples.* The following examples illustrate the rules of paragraphs (a) and (b) of this section:

Example 1. (i) P is a participant in a qualified profit-sharing plan maintained by his employer, ABC Corporation. The limitation year for the plan is the calendar year. P's compensation (as defined in §1.415(c)–2) for the current limitation year is $30,000.

(ii) Because the compensation limitation described in section 415(c)(1)(B) applicable to P for the current limitation year is lower than the dollar limitation described in section 415(c)(1)(A), the maximum annual addition which can be allocated to P's account for the current limitation year is $30,000 (100 percent of $30,000).

Example 2. (i) The facts are the same as in *Example 1*, except that P's compensation for the current limitation year is $140,000.

(ii) The maximum amount of annual additions that may be allocated to P's account in the current limitation year is the lesser of $140,000 (100 percent of P's compensation) or the dollar limitation of section 415(c)(1)(A) as in effect as of January 1 of the calendar year in which the current limitation year ends. If, for example, the dollar limitation of section 415(c)(1)(A) in effect as of January 1 of the calendar year in which the current limitation year ends is $45,000, then the maximum annual addition that can be allocated to P's account for the current limitation year is $45,000.

Example 3. (i) Employer N maintains a qualified profit-sharing plan that uses the calendar year as its plan year and its limitation year. N's taxable year is a fiscal year beginning June 1 and ending May 31. Under the terms of the profit-sharing plan maintained by N, employer contributions are made to the plan two months after the close of N's taxable year and are allocated as of the last day of the plan year ending within the taxable year (and are not dependent on the satisfaction of a condition). Thus, employer contributions for the 2008 calendar year limitation year are made on July 31, 2009 (the date that is two months after the close of N's taxable year ending May 31, 2009) and are allocated as of December 31, 2008.

(ii) Because the employer contributions are actually made to the plan no later than 30 days after the end of the period described in section 404(a)(6) with respect to N's taxable year ending May 31, 2009, the contributions will be considered annual additions for the 2008 calendar year limitation year.

Example 4. (i) The facts are the same as in *Example 3,* except that the plan year for the profit-sharing plan maintained by N is the 12-month period beginning on February 1 and ending on January 31. The limitation year continues to be the calendar year. Under the terms of the plan, an employer contribution which is made to the plan on July 31, 2009, is allocated to participants' accounts as of January 31, 2009.

(ii) Because the last day of the plan year is in the 2009 calendar year limitation year, and because, under the terms of the plan, employer contributions are allocated to participants' accounts as of the last day of the plan year, the contributions are considered annual additions for the 2009 calendar year limitation year.

Example 5. (i) XYZ Corporation maintains a profit-sharing plan to which a participant may make voluntary employee contributions for any year not to exceed 10 percent of the participant's compensation for the year. The plan permits a participant to make retroactive make-up contributions for any year for which the participant contributed less than 10 percent of compensation. XYZ uses the calendar year as the plan year and the limitation year. Under the terms of the plan, voluntary employee contributions are credited to a participant's account for a particular limitation year if such contributions are allocated to the participant's account as of any date within that limitation year. Participant A's compensation is as follows—

Limitation year	Compensation
2008	$30,000
2009	$32,000
2010	$34,000
2011	$36,000

(ii) Participant A makes no voluntary employee contributions during limitation years 2008, 2009, and 2010. On October 1, 2011, participant A makes a voluntary employee contribution of $13,200 (10 percent of A's aggregate compensation for limitation years 2008, 2009, 2010, and 2011 of $132,000). Under the terms of the plan, $3,000 of this 2011 contribution is allocated to A's account as of limitation year 2008; $3,200 is allocated to A's account of limitation year 2009; $3,400 is allocated to A's account as of limitation year 2010, and $3,600 is allocated to A's account as of limitation year 2011.

(iii) Under the rule set forth in paragraph (b)(6)(i)(C) of this section, employee contributions will not be considered credited to a participant's account for a particular limitation year for section 415 purposes unless the contributions are actually made to the plan no later than 30 days after the close of that limitation year. Thus, A's voluntary employee contribution of $13,200 made on October 1, 2011, would be considered as credited to A's account only for the 2011 calendar year limitation year, notwithstanding the plan provisions.

(d) *Special rules relating to church plans*—(1) *Alternative contribution limitation*—(i) *In general.* Pursuant to section 415(c)(7)(A), notwithstanding the general rule of paragraph (a)(1) of this section, additions for a section 403(b) annuity contract for a year with respect to a participant who is an employee of a church or a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), when expressed as an annual addition to such participant's account, are treated as not exceeding the limitation of paragraph (a)(1) of this section if such annual additions for the year are not in excess of $10,000.

(ii) *$40,000 aggregate limitation.* With respect to any participant, the total amount of annual additions that are in excess of the limitation of paragraph (a)(1) of this section but, pursuant to the rule of paragraph (d)(1)(i) of this section, are treated as not exceeding that limitation (taking into account the rule of paragraph (d)(3) of this section) cannot exceed $40,000. Thus, the aggregate of annual additions for all limitation years that would exceed the limitation of this section but for this paragraph (d)(1) is limited to $40,000.

(2) *Years of service taken into account for duly ordained, commissioned, or licensed ministers or lay employees.* For purposes of this paragraph (d)—

(i) All years of service by an individual as an employee of a church, or a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), are considered as years of service for one employer; and

(ii) All amounts contributed for annuity contracts by each such church (or convention or association of churches) during such years for the employee are considered to have been contributed by one employer.

(3) *Foreign missionaries.* Pursuant to section 415(c)(7)(C), in the case of any individual described in paragraph (d)(1) of this section performing any services for the church outside the United States during the limitation year, additions for an annuity contract under section 403(b) for any year are not treated as exceeding the limitation of

paragraph (a)(1) of this section if such annual additions for the year do not exceed $3,000. The preceding sentence shall not apply with respect to any taxable year to any individual whose adjusted gross income for such taxable year (determined separately and without regard to community property law) exceeds $17,000.

(4) *Church, convention or association of churches.* For purposes of this paragraph (d), the terms ''church'' and ''convention or association of churches'' have the same meaning as when used in section 414(e).

(5) *Examples.* The following examples illustrate the rules of this paragraph (d):

Example 1. (i) E is an employee of ABC Church earning $7,000 during each calendar year. E participates in a section 403(b) annuity contract maintained by ABC Church beginning in the year 2008. E's taxable year is the calendar year, and the limitation year for the plan coincides with the calendar year. ABC Church contributes $10,000 to be allocated to E's account under the plan for the year 2008.

(ii) Under paragraph (d)(1) of this section, this allocation is treated as not violating the limits established in paragraph (a)(1) of this section because it does not exceed $10,000. Moreover, since an annual addition of $10,000 would otherwise exceed the limitation of paragraph (a)(1) of this section by $3,000, $3,000 is counted toward the aggregate limitation specified in paragraph (d)(1)(ii) of this section for year 2008. Accordingly, ABC Church may make such allocations for 13 years (for example, for years 2008 through 2020) without exceeding the aggregate limitation of $40,000 specified in paragraph (d) of this section. For the fourteenth year, ABC Church could allocate only $8,000 to E's account (the sum of the $7,000 limitation computed under paragraph (a)(1)(ii) of this section and the remaining $1,000 of the $40,000 aggregate limitation under paragraph (d)(1)(ii) of this section on annual additions in excess of the limits under paragraph (a)(1) of this section).

Example 2. (i) F is an employee of XYZ Church and F's taxable year is the calendar year. F earns $2,000 during each calendar year for services he provides to XYZ Church, all of which are performed outside the United States during each calendar year. F participates in a section 403(b) annuity contract maintained by ABC Church beginning in the year 2008. The limitation year for the plan coincides with the calendar year. ABC Church contributes $10,000 to be allocated to F's account under the plan for the year 2008. F's adjusted gross income for each taxable year (determined separately and without regard to community property law) does not exceed $17,000.

(ii) Under paragraph (d)(1) of this section, this allocation is treated as not violating the limits established in paragraph (a)(1) of this section because it does not exceed $10,000. Moreover, since an annual addition of $10,000 would otherwise exceed the limitation of paragraph (a)(1) of this section by $7,000 (the excess of $10,000 over the greater of the $2,000 compensation limitation under section 415(c)(1)(B) or the $3,000 section 415(c)(7)(C) amount), XYZ Church may make such allocations for 5 years (for example, for years 2008 through 2012) without exceeding the aggregate limitation of $40,000 specified in paragraph (d) of this section. In year 2013, XYZ church may contribute $8,000 to be allocated to F's account under the plan (the sum of the $3,000 limitation computed under paragraph (d)(3) of this section and the remaining $5,000 of the $40,000 aggregate limitation under paragraph (d)(1)(ii) of this section on annual additions in excess of the limits under paragraph (a)(1) of this section). For years after 2013, pursuant to paragraph (d)(3) of this section, XYZ Church could allocate $3,000 per year to F's account.

(e) *Special rules for medical benefits.* The limit under paragraph (a)(1)(ii) of this section (100 percent of the participant's compensation for the limitation year) does not apply to—

(1) An individual medical benefit account (as defined in section 415(l)); or

(2) A post-retirement medical benefits account for a key employee (as defined in section 419A(d)(1)).

(f) *Special rules for employee stock ownership plans*—(1) *In general.* Special rules apply to employee stock ownership plans, as provided in paragraphs (f)(2) through (f)(4) of this section.

(2) *Determination of annual additions for leveraged employee stock ownership plans*—(i) *In general.* Except as provided in this paragraph (f) of this section, in the case of an employee stock ownership plan to which an exempt loan as described in § 54.4975–7(b) of this chapter has been made, the amount of employer contributions that is considered an annual addition for the limitation year is calculated with respect to employer contributions of both principal and interest used to repay that exempt loan for the limitation year.

(ii) *Employer stock that has decreased in value.* A plan may provide that, in lieu of computing annual additions in accordance with paragraph (f)(2)(i) of

this section, annual additions with respect to a loan repayment described in paragraph (f)(2)(i) of this section are determined as the fair market value of shares released from the suspense account on account of the repayment and allocated to participants for the limitation year if that amount is less than the amount determined in accordance with paragraph (f)(2)(i) of this section.

(3) *Exclusions from annual additions for certain employee stock ownership plans that allocate to a broad range of participants*—(i) *General rule.* Pursuant to section 415(c)(6), in the case of an employee stock ownership plan (as described in section 4975(e)(7)) that meets the requirements of paragraph (f)(3)(ii) of this section for a limitation year, the limitations imposed by this section do not apply to—

(A) Forfeitures of employer securities (within the meaning of section 409(l)) under such an employee stock ownership plan if such securities were acquired with the proceeds of a loan (as described in section 404(a)(9)(A)); or

(B) Employer contributions to such an employee stock ownership plan which are deductible under section 404(a)(9)(B) and charged against the participant's account.

(ii) *Employee stock ownership plans to which the special exclusion applies.* An employee stock ownership plan meets the requirements of this paragraph (f)(3)(ii) for a limitation year if no more than one-third of the employer contributions for the limitation year that are deductible under section 404(a)(9) are allocated to highly compensated employees (within the meaning of section 414(q)).

(4) *Gratuitous transfers under section 664(g)(1).* The amount of any qualified gratuitous transfer (as defined in section 664(g)(1)) allocated to a participant for any limitation year is not taken into account in determining whether any other annual addition exceeds the limitations imposed by this section, but only if the amount of the qualified gratuitous transfer does not exceed the limitations imposed by section 415.

[T.D. 9319, 72 FR 16911, Apr. 5, 2007]

§ 1.415(c)–2 Compensation.

(a) *General definition.* Except as otherwise provided in this section, *compensation from the employer within the meaning of section 415(c)(3), which is used for purposes of section 415 and regulations promulgated under section 415*, means all items of remuneration described in paragraph (b) of this section, but excludes the items of remuneration described in paragraph (c) of this section. Paragraph (d) of this section provides safe harbor definitions of compensation that are permitted to be provided in a plan in lieu of the generally applicable definition of compensation. Paragraph (e) of this section provides timing rules relating to compensation. Paragraph (f) of this section provides rules regarding the application of the rules of section 401(a)(17) to the definition of compensation for purposes of section 415. Paragraph (g) of this section provides special rules relating to the determination of compensation, including rules for determining compensation for a section 403(b) annuity contract, rules for determining the compensation of employees of controlled groups or affiliated service groups, rules for disabled employees, rules relating to foreign compensation, rules regarding deemed section 125 compensation, rules for employees in qualified military service, and rules relating to back pay.

(b) *Items includible as compensation.* For purposes of applying the limitations of section 415, except as otherwise provided in this section, the term *compensation* means remuneration for services of the following types—

(1) The employee's wages, salaries, fees for professional services, and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the employer maintaining the plan, to the extent that the amounts are includible in gross income (or to the extent amounts would have been received and includible in gross income but for an election under section 125(a), 132(f)(4), 402(e)(3), 402(h)(1)(B), 402(k), or 457(b)). These amounts include, but are not limited to, commissions paid to salespersons, compensation for services on the basis of a percentage of profits, commissions on insurance premiums,

tips, bonuses, fringe benefits, and reimbursements or other expense allowances under a nonaccountable plan as described in § 1.62–2(c).

(2) In the case of an employee who is an employee within the meaning of section 401(c)(1) and regulations promulgated under section 401(c)(1), the employee's earned income (as described in section 401(c)(2) and regulations promulgated under section 401(c)(2)), plus amounts deferred at the election of the employee that would be includible in gross income but for the rules of section 402(e)(3), 402(h)(1)(B), 402(k), or 457(b).

(3) Amounts described in section 104(a)(3), 105(a), or 105(h), but only to the extent that these amounts are includible in the gross income of the employee.

(4) 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 not deductible by the employee under section 217.

(5) The value of a nonstatutory option (which is an option other than a statutory option as defined in § 1.421–1(b)) granted to an employee by the employer, but only to the extent that the value of the option is includible in the gross income of the employee for the taxable year in which granted.

(6) The amount includible in the gross income of an employee upon making the election described in section 83(b).

(7) Amounts that are includible in the gross income of an employee under the rules of section 409A or section 457(f)(1)(A) or because the amounts are constructively received by the employee.

(c) *Items not includible as compensation*. The term *compensation* does not include—

(1) Contributions (other than elective contributions described in section 402(e)(3), section 408(k)(6), section 408(p)(2)(A)(i), or section 457(b)) made by the employer to a plan of deferred compensation (including a simplified employee pension described in section 408(k) or a simple retirement account described in section 408(p), and whether or not qualified) to the extent that the contributions are not includible in the gross income of the employee for the taxable year in which contributed. In addition, any distributions from a plan of deferred compensation (whether or not qualified) are not considered as compensation for section 415 purposes, regardless of whether such amounts are includible in the gross income of the employee when distributed. However, if the plan so provides, any amounts received by an employee pursuant to a nonqualified unfunded deferred compensation plan are permitted to be considered as compensation for section 415 purposes in the year the amounts are actually received, but only to the extent such amounts are includible in the employee's gross income.

(2) Amounts realized from the exercise of a nonstatutory option (which is an option other than a statutory option as defined in § 1.421–1(b)), or when restricted stock or other property held by an employee either becomes freely transferable or is no longer subject to a substantial risk of forfeiture (see section 83 and regulations promulgated under section 83).

(3) Amounts realized from the sale, exchange, or other disposition of stock acquired under a statutory stock option (as defined in § 1.421–1(b)).

(4) Other amounts that receive special tax benefits, such as premiums for group-term life insurance (but only to the extent that the premiums are not includible in the gross income of the employee and are not salary reduction amounts that are described in section 125).

(5) Other items of remuneration that are similar to any of the items listed in paragraphs (c)(1) through (c)(4) of this section.

(d) *Safe harbor rules with respect to plan's definition of compensation*—(1) *In general*. Paragraphs (d)(2) through (4) of this section contain safe harbor definitions of compensation that are automatically considered to satisfy section 415(c)(3) if specified in the plan. The Commissioner may, in revenue rulings, notices, and other guidance of general applicability published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), provide additional definitions of compensation that are treated as satisfying section 415(c)(3).

(2) *Simplified compensation*. The safe harbor definition of compensation under this paragraph (d)(2) includes only those items specified in paragraph (b)(1) or (2) of this section and excludes all those items listed in paragraph (c) of this section.

(3) *Section 3401(a) wages*. The safe harbor definition of compensation under this paragraph (d)(3) includes wages within the meaning of section 3401(a) (for purposes of income tax withholding at the source), plus amounts that would be included in wages but for an election under section 125(a), 132(f)(4), 402(e)(3), 402(h)(1)(B), 402(k), or 457(b). However, any rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in section 3401(a)(2)) are disregarded for this purpose.

(4) *Information required to be reported under sections 6041, 6051 and 6052*. The safe harbor definition of compensation under this paragraph (d)(4) includes amounts that are compensation under the safe harbor definition of paragraph (d)(3) of this section, plus all other payments of compensation to an employee by his employer (in the course of the employer's trade or business) for which the employer is required to furnish the employee a written statement under sections 6041(d), 6051(a)(3), and 6052. See §§ 1.6041–1(a), 1.6041–2(a)(1), 1.6052–1, and 1.6052–2, and also see § 31.6051–1(a)(1)(i)(C) of this chapter. This safe harbor 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 section 217.

(e) *Timing rules*—(1) *In general*—(i) *Payment during the limitation year*. Except as otherwise provided in this paragraph (e), in order to be taken into account for a limitation year, compensation within the meaning of section 415(c)(3) must be actually paid or made available to an employee (or, if earlier, includible in the gross income of the employee) within the limitation year. For this purpose, compensation is treated as paid on a date if it is actually paid on that date or it would have been paid on that date but for an election under section 125, 132(f)(4), 401(k), 403(b), 408(k), 408(p)(2)(A)(i), or 457(b).

(ii) *Payment prior to severance from employment*. Except as otherwise provided in this paragraph (e), in order to be taken into account for a limitation year, compensation within the meaning of section 415(c)(3) must be paid or treated as paid to the employee (in accordance with the rules of paragraph (e)(1)(i) of this section) prior to the employee's severance from employment with the employer maintaining the plan. See § 1.415(a)–1(f)(5) for the definition of severance from employment.

(2) *Certain minor timing differences*. Notwithstanding the provisions of paragraph (e)(1)(i) of this section, a plan may provide that compensation for a limitation year includes amounts earned during that limitation year but not paid during that limitation year solely because of the timing of pay periods and pay dates if—

(i) These amounts are paid during the first few weeks of the next limitation year;

(ii) The amounts are included on a uniform and consistent basis with respect to all similarly situated employees; and

(iii) No compensation is included in more than one limitation year.

(3) *Compensation paid after severance from employment*—(i) *In general*. Any compensation described in paragraph (e)(3)(ii) of this section does not fail to be compensation (within the meaning of section 415(c)(3)) pursuant to the rule of paragraph (e)(1)(ii) of this section merely because it is paid after the employee's severance from employment with the employer maintaining the plan, provided the compensation is paid by the later of 2½ months after severance from employment with the employer maintaining the plan or the end of the limitation year that includes the date of severance from employment with the employer maintaining the plan. In addition, the plan may provide that amounts described in paragraph (e)(3)(iii) of this section are included in compensation (within the meaning of section 415(c)(3)) if—

(A) Those amounts are paid by the later of 2½ months after severance

from employment with the employer maintaining the plan or the end of the limitation year that includes the date of severance from employment with the employer maintaining the plan; and

(B) Those amounts would have been included in the definition of compensation if they were paid prior to the employee's severance from employment with the employer maintaining the plan.

(ii) *Regular pay after severance from employment.* An amount is described in this paragraph (e)(3)(ii) if—

(A) The payment is regular compensation for services during the employee's regular working hours, or compensation for services outside the employee's regular working hours (such as overtime or shift differential), commissions, bonuses, or other similar payments; and

(B) The payment would have been paid to the employee prior to a severance from employment if the employee had continued in employment with the employer.

(iii) *Leave cashouts and deferred compensation.* An amount is described in this paragraph (e)(3)(iii) if the amount is either—

(A) Payment for unused accrued bona fide sick, vacation, or other leave, but only if the employee would have been able to use the leave if employment had continued; or

(B) Received by an employee pursuant to a nonqualified unfunded deferred compensation plan, but only if the payment would have been paid to the employee at the same time if the employee had continued in employment with the employer and only to the extent that the payment is includible in the employee's gross income.

(iv) *Other post-severance payments.* Any payment that is not described in paragraph (e)(3)(ii) or (iii) of this section is not considered compensation under paragraph (e)(3)(i) of this section if paid after severance from employment with the employer maintaining the plan, even if it is paid within the time period described in paragraph (e)(3)(i) of this section. Thus, compensation does not include severance pay, or parachute payments within the meaning of section 280G(b)(2), if they are paid after severance from employment with the employer maintaining the plan, and does not include post-severance payments under a nonqualified unfunded deferred compensation plan unless the payments would have been paid at that time without regard to the severance from employment.

(4) *Salary continuation payments for military service and disabled participants.* The rule of paragraph (e)(1)(ii) of this section does not apply to payments to an individual who does not currently perform services for the employer by reason of qualified military service (as that term is used in section 414(u)(1)) to the extent those payments do not exceed the amounts the individual would have received if the individual had continued to perform services for the employer rather than entering qualified military service, but only if the plan so provides. In addition, the rule of paragraph (e)(1)(ii) of this section does not apply to compensation paid to a participant who is permanently and totally disabled (as defined in section 22(e)(3)) if the conditions set forth in paragraph (g)(4)(ii)(A) of this section are satisfied (applied by substituting a continuation of compensation for the continuation of contributions), but only if the plan so provides.

(5) *Special rule for governmental plans.* For purposes of applying the rules of paragraph (e)(3) of this section, a governmental plan (as defined in section 414(d)) may provide for the substitution of the calendar year in which the severance from employment with the employer maintaining the plan occurs for the limitation year in which the severance from employment with the employer maintaining the plan occurs.

(6) *Examples.* The provisions of this paragraph (e) are illustrated by the following examples:

Example 1. (i) *Facts.* Participant A was a common law employee of Employer X, performing services as a script writer for Employer X from January 1, 2005 to December 31, 2005. Pursuant to a collective bargaining agreement, Employer X, Employer Y and Employer Z maintain and contribute to Plan T, a multiemployer plan (as defined in section 414(f)) in which Participant A participates. Under the collective bargaining agreement, Participant A is entitled to residual payments whenever television shows that

Participant A wrote are re-used commercially (These residual payments constitute compensation described in paragraph (b) of this section and do not constitute compensation described in paragraph (c) of this section.). In the year 2008, Participant A receives residual payments from Employer X for television programs using the scripts that Participant A wrote in the year 2005 that were rebroadcast in the year 2008. In the years 2006, 2007, and 2008, Participant A was a common law employee of Employer Y, and did not perform any services for Employer X.

(ii) *Conclusion*. The residual payments received from Employer X by Participant A in the year 2008 are compensation for purposes of section 415(c)(3). The payments are not treated as made after severance from employment because Plan T is a multiemployer plan (as defined in section 414(f)) and Participant A continues to be employed by an employer maintaining Plan T.

Example 2. (i) *Facts*. The facts are the same as in *Example 1*, except that Participant A: ceased employment with Employer Y in the year 2006; subsequently moved away from the area in which A formerly worked; performs no services as an employee for any employer; and commenced receiving distributions under Plan T in March, 2006.

(ii) *Conclusion*. Based on the facts and circumstances, A has ceased employment with any employer maintaining Plan T. Pursuant to paragraph (e)(1)(ii) of this section, compensation must be paid prior to an employee's severance from employment with the employer maintaining the plan. Accordingly, the residual payments received by Participant A in the year 2008 are not compensation for purposes of section 415(c)(3).

(f) *Interaction with section 401(a)(17)*. Because a plan may not base allocations (in the case of a defined contribution plan) or benefits (in the case of a defined benefit plan) on compensation in excess of the limitation under section 401(a)(17), a plan's definition of compensation for a year that is used for purposes of applying the limitations of section 415 is not permitted to reflect compensation for a year that is in excess of the limitation under section 401(a)(17) that applies to that year. See §§1.401(a)(17)–1(a)(3)(i) and 1.401(a)(17)–1(b)(3)(ii) for rules regarding the effective date of increases in the section 401(a)(17) compensation limitation for a plan year and for a 12-month period other than the plan year.

(g) *Special rules*—(1) *Compensation for section 403(b) annuity contract*. In the case of an annuity contract described in section 403(b), the term *participant's compensation* means the participant's includible compensation determined under section 403(b)(3). Accordingly, the rules for determining a participant's compensation pursuant to section 415(c)(3) (other than section 415(c)(3)(E)) and this section do not apply to a section 403(b) annuity contract.

(2) *Employees of controlled groups of corporations, etc*. In the case of an employee of two or more corporations which are members of a controlled group of corporations (as defined in section 414(b) as modified by section 415(h)), the term *compensation* for such employee includes compensation from all employers that are members of the group, regardless of whether the employee's particular employer has a qualified plan. This special rule is also applicable to an employee of two or more trades or businesses (whether or not incorporated) that are under common control (as defined in section 414(c) as modified by section 415(h)), to an employee of two or more members of an affiliated service group as defined in section 414(m), and to an employee of two or more members of any group of employers who must be aggregated and treated as one employer pursuant to section 414(o).

(3) *Aggregation of section 403(b) annuity with qualified plan of controlled employer*. If a section 403(b) annuity contract is aggregated with a qualified plan of a controlled employer in accordance with §1.415(f)–1(f)(2), then, in applying the limitations of section 415(c) in connection with the aggregation of the section 403(b) annuity with a qualified plan, the total compensation from both employers is permitted to be taken into account.

(4) *Permanent and total disability of defined contribution plan participant*—(i) *In general*. Pursuant to section 415(c)(3)(C), if the conditions set forth in paragraph (g)(4)(ii) of this section are satisfied, then, in the case of a participant in any defined contribution plan who is permanently and totally disabled (as defined in section 22(e)(3)), the *participant's compensation* means the compensation the participant would have received for the year if the participant was paid at the rate of compensation paid immediately before

becoming permanently and totally disabled, if such compensation is greater than the participant's compensation determined without regard to this paragraph (g)(4).

(ii) *Conditions for deemed disability compensation.* The rule of paragraph (g)(4)(i) of this section applies only if the following conditions are satisfied—

(A) Either the participant is not a highly compensated employee (as defined in section 414(q)) immediately before becoming disabled, or the plan provides for the continuation of contributions on behalf of all participants who are permanently and totally disabled for a fixed or determinable period;

(B) The plan provides that the rule of this paragraph (g)(4) (treating certain amounts as compensation for a disabled participant) applies with respect to the participant; and

(C) Contributions made with respect to amounts treated as compensation under this paragraph (g)(4) are nonforfeitable when made.

(5) *Foreign compensation, etc.*—(i) *In general.* Amounts paid to an individual as compensation for services do not fail to be treated as compensation under paragraphs (b)(1) and (2) of this section (and are not excluded from the definition of compensation pursuant to paragraph (c)(4) of this section) merely because those amounts are not includible in the individual's gross income on account of the location of the services. Similarly, compensation for services do not fail to be treated as compensation under paragraphs (b)(1) and (2) of this section (and are not excluded from the definition of compensation pursuant to paragraph (c)(4) of this section) merely because those amounts are paid by an employer with respect to which all compensation paid to the participant by such employer is excluded from gross income. Thus, for example, the determination of whether an amount is treated as compensation under paragraph (b)(1) or (2) of this section is made without regard to the exclusions from gross income under sections 872, 893, 894, 911, 931, and 933.

(ii) *Exclusion of non-participant compensation by the plan.* With respect to a nonresident alien who is not a participant in a plan, the plan may provide that the compensation described in paragraph (g)(5)(i) of this section is not treated as compensation for purposes of paragraphs (b)(1) and (b)(2) of this section to the extent the compensation is excludable from gross income and is not effectively connected with the conduct of a trade or business within the United States, but only if the plan applies this rule uniformly to all such employees. For purposes of this paragraph (g)(5)(ii), nonresident alien has the same meaning as in section 7701(b)(1)(B).

(6) *Deemed section 125 compensation*—(i) *General rule.* A plan is permitted to provide that deemed section 125 compensation (as defined in paragraph (g)(6)(ii) of this section) is compensation within the meaning of section 415(c)(3), but only if the plan applies this rule uniformly to all employees with respect to whom amounts subject to section 125 are included in compensation.

(ii) *Definition of deemed section 125 compensation.* Deemed section 125 compensation is an amount that is excludable from the income of the participant under section 106 that is not available to the participant in cash in lieu of group health coverage under a section 125 arrangement solely because that participant is not able to certify that the participant has other health coverage. Under this definition, amounts are deemed section 125 compensation only if the employer does not otherwise request or collect information regarding the participant's other health coverage as part of the enrollment process for the health plan.

(7) *Employees in qualified military service.* See section 414(u)(7) for special rules regarding compensation of employees who are in qualified military service within the meaning of section 414(u)(5).

(8) *Back pay.* Payments awarded by an administrative agency or court or pursuant to a bona fide agreement by an employer to compensate an employee for lost wages are compensation within the meaning of section 415(c)(3) for the limitation year to which the back pay relates, but only to the extent such payments represent wages

and compensation that would otherwise be included in compensation under this section.

[T.D. 9319, 72 FR 16916, Apr. 5, 2007]

§ 1.415(d)–1 Cost-of-living adjustments.

(a) *Defined benefit plans*—(1) *Dollar limitation*—(i) *Determination of adjusted limit*. Under section 415(d)(1)(A), the dollar limitation described in section 415(b)(1)(A) applicable to defined benefit plans is adjusted annually to take into account increases in the cost of living. The adjustment of the dollar limitation is made by multiplying the adjustment factor for the year, as described in paragraph (a)(1)(ii)(A) of this section, by $160,000, and rounding the result in accordance with paragraph (a)(1)(iii) of this section. The adjusted dollar limitation is prescribed by the Commissioner and published in the Internal Revenue Bulletin. See § 601.601(d)(2) of this chapter.

(ii) *Determination of adjustment factor*—(A) *Adjustment factor*. The adjustment factor for a calendar year is equal to a fraction, the numerator of which is the value of the applicable index for the calendar quarter ending September 30 of the preceding calendar year, and the denominator of which is the value of such index for the base period. The applicable index is determined consistent with the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act, Public Law 92–336 (86 Stat. 406), as amended. If, however, the value of that fraction is less than one for a calendar year, then the adjustment factor for the calendar year is equal to one.

(B) *Base period*. For the purpose of adjusting the dollar limitation pursuant to paragraph (a)(1)(ii)(A) of this section, the base period is the calendar quarter beginning July 1, 2001.

(iii) *Rounding*. Any increase in the $160,000 amount specified in section 415(b)(1)(A) which is not a multiple of $5,000 is rounded to the next lowest multiple of $5,000.

(2) *Average compensation for high-3 years of service limitation*—(i) *Determination of adjusted limit*. Under section 415(d)(1)(B), with regard to participants who have had a severance from employment with the employer maintaining the plan, the compensation limitation described in section 415(b)(1)(B) is permitted to be adjusted annually to take into account increases in the cost of living. For any limitation year beginning after the severance occurs, the adjustment of the compensation limitation is made by multiplying the annual adjustment factor (as defined in paragraph (a)(2)(ii) of this section) by the compensation limitation applicable to the participant in the prior limitation year. The annual adjustment factor is prescribed by the Commissioner and published in the Internal Revenue Bulletin. See § 601.601(d)(2) of this chapter.

(ii) *Annual adjustment factor*. The annual adjustment factor for a calendar year is equal to a fraction, the numerator of which is the value of the applicable index for the calendar quarter ending September 30 of the preceding calendar year, and the denominator of which is the value of such index for the calendar quarter ending September 30 of the calendar year prior to that preceding calendar year. The applicable index is determined consistent with the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act. If the value of the fraction described in the first sentence of this paragraph (a)(2)(ii) is less than one for a calendar year, then the adjustment factor for the calendar year is equal to one. In such a case, the annual adjustment factor for future calendar years will be determined in accordance with revenue rulings, notices, or other published guidance prescribed by the Commissioner and published in the Internal Revenue Bulletin. See § 601.601(d)(2) of this chapter.

(iii) *Special rule for rehired employees*. If, after having a severance from employment with the employer maintaining the plan, an employee is rehired by the employer maintaining the plan, the employee's compensation limit under section 415(b)(1)(B) is the greater of—

(A) 100 percent of the participant's average compensation for the period of the participant's high-3 years of service, as determined prior to the employee's severance from employment with the employer maintaining the plan, as adjusted pursuant to paragraph (a)(2)(i) of this section (if the plan so provides); or

(B) 100 percent of the participant's average compensation for the period of the participant's high-3 years of service, with the period of the participant's high-3 years of service determined pursuant to § 1.415(b)–1(a)(5)(iii).

(3) *Effective date of adjustment.* The adjusted dollar limitation applicable to defined benefit plans and the adjusted compensation limit applicable to a participant are effective as of January 1 of each calendar year and apply with respect to limitation years ending with or within that calendar year. However, benefit payments (and, in the case of plans that are subject to the requirements of section 411, accrued benefits for a limitation year) cannot exceed the currently applicable dollar limitation or compensation limitation (as in effect before the January 1 adjustment) prior to January 1. Thus, where there is an increase in the limitation under section 415(b)(1), any increase in a participant's benefits associated with the limitation increase is permitted to occur as of a date no earlier than January 1 of the calendar year for which the increase in the limitation is effective, and can only be applied for payments due on or after January 1 of such calendar year. For example, assume that a participant in a defined benefit plan is currently receiving a benefit in the form of a straight life annuity, payable monthly, in an amount equal to the section 415(b)(1)(A) dollar limit, and the defined benefit plan has a limitation year that runs from July 1 to June 30. If the plan is amended to reflect the section 415(d) increase to the section 415(b)(1)(A) dollar limit that is effective as of January 1, 2009, the associated increase in the participant's monthly benefit payments is only effective for payments due on or after January 1, 2009, and the participant's benefit cannot be increased to reflect the section 415(d) increase that is effective January 1, 2009, with respect to any monthly payment due prior to January 1, 2009.

(4) *Application of adjusted figure*—(i) *In general.* If the dollar limitation of section 415(b)(1)(A) or the compensation limitation of section 415(b)(1)(B) is adjusted pursuant to section 415(d) for a limitation year, the adjustment is applied as provided in this paragraph (a)(4).

(ii) *Application of adjusted limitations to benefits that have not commenced.* An adjustment to the dollar limitation of section 415(b)(1)(A) is permitted to be applied to a participant who has not commenced benefits before the date on which the adjustment is effective. Annual adjustments to the compensation limit of section 415(b)(1)(B) as described in paragraph (a)(2) of this section are permitted to be made for all limitation years that begin after the participant's severance from employment, and apply to distributions that commence after the effective dates of such adjustments. However, no adjustment to the compensation limit of section 415(b)(1)(B) is made for any limitation year that begins on or before the date of the participant's severance from employment with the employer maintaining the plan.

(iii) *Application of adjusted dollar limitation to remaining payments under benefits that have commenced.* With respect to a distribution of accrued benefits that commenced before the date on which an adjustment to the section 415(b)(1)(A) dollar limitation is effective, a plan is permitted to apply the adjusted limitations to that distribution, but only to the extent that benefits have not been paid. Thus, for example, a plan cannot provide that the adjusted dollar limitation applies to a participant who has previously received the entire plan benefit in a single-sum distribution. However, a plan can provide for an increase in benefits to a participant who accrues additional benefits under the plan that could have been accrued without regard to the adjustment of the dollar limitation (including benefits that accrue as a result of a plan amendment) on or after the effective date of the adjusted limitation.

(iv) *Manner of adjustment for benefits that have commenced.* If a plan is amended to increase benefits payable under the plan in accordance with paragraphs (a)(5) or (a)(6) of this section (or the plan is treated as applying paragraph (a)(5) of this section because the plan incorporates the section 415(d) cost-of-living adjustments automatically by reference pursuant to

§ 1.415(a)–1(d)(3)(v)), or if benefits payable under the plan are increased pursuant to a form of benefit that is described in § 1.415(b)–1(c)(5), then the distribution as increased will be treated as continuing to satisfy the requirements of section 415(b). If benefits payable under a plan are increased in a manner other than as described in the preceding sentence, the plan must satisfy the requirements of § 1.415(b)–1(b)(1)(iii), treating the commencement of the additional benefit as the commencement of a new distribution that gives rise to a new annuity starting date.

(5) *Safe harbor for annual adjustments to distributions.* An amendment to a plan to incorporate adjustments to the section 415(b) limits that increases a distribution that has previously commenced is described in this paragraph (a)(5) if—

(i) The employee has received one or more distributions that satisfy the requirements of section 415(b) before the date the adjustment to the applicable limits is effective (as determined under paragraph (a)(3) of this section);

(ii) The increased distribution is solely as a result of the amendment of the plan to reflect the adjustment to the applicable limits pursuant to section 415(d); and

(iii) The amounts payable to the employee on and after the effective date of the adjustment (as determined under paragraph (a)(3) of this section) are not greater than the amounts that would otherwise be payable without regard to the adjustment, multiplied by a fraction determined for the limitation year, the numerator of which is the limitation under section 415(b) (which is the lesser of the applicable dollar limitation under section 415(b)(1)(A), as adjusted for age at commencement, and the applicable compensation-based limitation under section 415(b)(1)(B)) in effect with respect to the distribution taking into account the section 415(d) adjustment, and the denominator of which is the limitation under section 415(b) in effect for the distribution immediately before the adjustment.

(6) *Safe harbor for periodic adjustments to distributions*—(i) *General rule.* An amendment to a plan that increases a distribution that has previously commenced is made using the safe harbor methodology of this paragraph (a)(6) if—

(A) The employee has received one or more distributions that satisfy the requirements of section 415(b) before the date on which the increase is effective; and

(B) The amounts payable to the employee on and after the effective date of the increase are not greater than the amounts that would otherwise be payable without regard to the increase, multiplied by the cumulative adjustment fraction.

(ii) *Cumulative adjustment fraction.* The cumulative adjustment fraction for purposes of this paragraph (a)(6) is equal to the product of all of the fractions described in paragraph (a)(5)(iii) of this section that would have applied after benefits commence if the plan had been amended each year to incorporate the section 415(d) adjustments to the applicable section 415(b) limits and had otherwise satisfied the safe harbor methodology described in paragraph (a)(5) of this section. For purposes of the preceding sentence, if for the limitation year for which the increase to the section 415(b)(1)(A) dollar limitation pursuant to section 611(a)(1)(A) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (115 Stat. 38), Public Law 107–16 (EGTRRA), is first effective (generally, the first limitation year beginning after December 31, 2001), the section 415(b)(1)(A) dollar limit applicable to a participant is less than the section 415(b)(1)(B) compensation limit for the participant, then the fraction described in paragraph (a)(5)(iii) of this section for that limitation year is 1.0.

(7) *Examples.* The following examples illustrate the application of this paragraph (a):

Example 1. (i) X is a participant in a qualified defined benefit plan maintained by X's employer. The plan has a calendar year limitation year. Under the terms of the plan, X is entitled to a benefit consisting of a straight life annuity equal to 100 percent of X's average compensation for the period of X's high-3 years of service. X's average compensation for the period of X's high-3 years of service is $50,000. X incurs a severance from employment with the employer maintaining the plan on October 3, 2007, at age 65 with a nonforfeitable right to the accrued

benefit after more than 10 years of participation in the plan. X begins to receive annual benefit payments (payable monthly) of $50,000, commencing on November 1, 2007. The dollar limitation for the 2007 limitation year (as adjusted pursuant to section 415(d)) is $180,000. Assume that the dollar limitation for the 2008 limitation year (as adjusted pursuant to section 415(d)) is $185,000 and the annual adjustment factor for adjusting the compensation limitation of section 415(b)(1)(B) for the 2008 limitation year is 1.0334. Effective January 1, 2008, the plan is amended to incorporate these adjustments to the dollar and compensation limitations, and accordingly, X's annual benefit payment is increased, effective for payments due on or after January 1, 2008. Prior to the plan amendment incorporating the application of the adjusted dollar and compensation limitations, X has received one or more distributions that satisfy the requirements of section 415(b). In addition, the adjustment to X's annual benefit payments is solely on account of the plan amendment incorporating the adjusted limitations.

(ii) For the limitation year beginning January 1, 2008, the dollar limit applicable to X under section 415(b)(1)(A) is $185,000, and the compensation limit applicable to X under section 415(b)(1)(B) is $51,670 ($50,000 multiplied by the annual adjustment factor of 1.0334). Accordingly, the adjustment to X's benefit satisfies the safe harbor for cost-of-living adjustments under paragraph (a)(5) of this section if, after the adjustment, X's benefit payable in the 2008 limitation year is no greater than $50,000 multiplied by $51,670 (X's section 415(b) limitation for 2008)/$50,000 (X's section 415(b) limitation for 2007).

Example 2. (i) The facts are the same as in *Example 1*, except that X's average compensation for the period of X's high-3 consecutive years of service is $200,000. Consequently, X's annual benefit payments commencing on November 1, 2007, are limited to $180,000.

(ii) For the limitation year beginning January 1, 2008, the dollar limit applicable to X under section 415(b)(1)(A) is $185,000, and the compensation limit applicable to X under section 415(b)(1)(B) is $206,680 ($200,000 multiplied by the annual adjustment factor of 1.0334). Accordingly, the adjustment to X's benefit satisfies the safe harbor for cost-of-living adjustments under paragraph (a)(5) of this section if, after the adjustment, X's benefit payable in 2008 is no greater than $180,000 multiplied by $185,000 (X's section 415(b) limitation for 2008)/$180,000 (X's section 415(b) limitation for 2007).

Example 3. (i) X is a participant in Plan T, a qualified defined benefit plan maintained by X's employer. In the year 2008, X receives a single-sum distribution of X's entire accrued benefit under the plan. At the time that X receives the single-sum distribution, X's accrued benefit under Plan T is limited by the section 415(b)(1)(A) age-adjusted dollar limit. X accrues no further benefits under Plan T after X receives the single-sum distribution. In the 2009 limitation year, pursuant to section 415(d) and §1.415(d)–1, the section 415(b)(1)(A) dollar limit is increased.

(ii) In the 2009 limitation year, Plan T may not provide additional benefits to X on account of the increase in the section 415(b)(1)(A) dollar limit pursuant to section 415(d) and §1.415(d)–1.

Example 4. (i) X is a participant in Plan T, a qualified defined benefit plan maintained by X's employer, Employer S. Plan T has a calendar limitation year. In 2008, X incurs a severance from employment with Employer S and X commences receiving distributions from Plan T in the form of a single life annuity in an annual amount of $30,000. At the time that X commences receiving distributions from Plan T, X's accrued benefit under Plan T is limited by the section 415(b)(1)(B) compensation limit. In 2009, the annual adjustment factor described in paragraph (a)(2) of this section (which is the factor for adjusting the compensation limit described in section 415(b)(1)(B)) is 1.03. Employer S amends Plan T, effective as of January 1, 2009, to increase the annual benefit of all participants who, prior to January 1, 2009, incurred a severance from employment with Employer S and who have commenced receiving benefits from Plan T by a factor of 1.015. Assume that for limitation years prior to 2009, X's distributions from Plan T satisfy the requirements of section 415(b).

(ii) The increase in X's annual benefit pursuant to the amendment effective January 1, 2009, is within the safe harbor described in paragraph (a)(6) of this section. This is because the amount payable to X under Plan T for the 2009 limitation year and limitation years thereafter (as increased by the amendment effective January 1, 2009) is not greater than the product of the amount payable to X under Plan T for such limitation years (as determined without regard to the amendment increasing X's benefit effective January 1, 2009) and the cumulative adjustment fraction (which, in X's case, is 1.03). Thus, X's annual benefit, as increased by the amendment, is not determined pursuant to the rules of §1.415(b)–1(b)(1)(iii).

Example 5. (i) Participant P participated in Plan A, maintained by Employer M, for more than 10 years. Plan A uses a calendar year limitation year and Plan A automatically adjusts a participant's section 415(b)(1)(B) compensation limit for limitation years after the limitation year in which the participant incurs a severance from employment as described in §1.415(a)–1(d)(3)(v). Prior to separating from employment with M in 2010, P's average compensation for P's period of high-3 years while a participant in Plan A is $50,000, based on P's compensation for 2007, 2008, and 2009, which was $50,000 for each

year. P's compensation for year 2010 was $45,000. In year 2012, P is rehired by M and resumes participation in Plan A. P's compensation in year 2012 is $45,000, and is $70,000 in year 2013. Assume that the annual adjustment factor described in §1.415(d)–1(a)(2)(ii) for the limitation years 2011 through 2013 is 1.03 for each year. Thus, disregarding P's rehire by M, P's average compensation for P's period of high-3 years while a participant in Plan A for the 2013 limitation year would be equal to $54,636 (or 1.03 * 1.03 * 1.03 * $50,000). See §1.415(b)–1(a)(5)(iii).

(ii) Under §1.415(d)–1(a)(2)(iii), P's average compensation for P's period of high-3 years while a participant in Plan A for the 2013 limitation year is $54,636.

(b) *Defined contribution plans*—(1) *In general*. Under section 415(d)(1)(C), the dollar limitation described in section 415(c)(1)(A) is adjusted annually to take into account increases in the cost of living. The adjusted dollar limitation is prescribed by the Commissioner and published in the Internal Revenue Bulletin. See §601.601(d)(2) of this chapter.

(2) *Determination of adjusted limit*—(i) *Base period*. The base period taken into account for purposes of adjusting the dollar limitation pursuant to paragraph (b)(2)(ii) of this section is the calendar quarter beginning July 1, 2001.

(ii) *Method of adjustment*—(A) *In general*. The dollar limitation is adjusted with respect to a calendar year based on the increase in the applicable index for the calendar quarter ending September 30 of the preceding calendar year over such index for the base period. Adjustment procedures similar to the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act will be used.

(B) *Rounding*. Any increase in the $40,000 amount specified in section 415(c)(1)(A) which is not a multiple of $1,000 shall be rounded to the next lowest multiple of $1,000.

(iii) *Effective date of adjustment*. The adjusted dollar limitation applicable to defined contribution plans is effective as of January 1 of each calendar year and applies with respect to limitation years ending with or within that calendar year. Annual additions for a limitation year cannot exceed the currently applicable dollar limitation (as in effect before the January 1 adjustment) prior to January 1. However, after a January 1 adjustment is made, annual additions for the entire limitation year are permitted to reflect the dollar limitation as adjusted on January 1.

(c) *Application of rounding rules to other cost-of-living adjustments*. Pursuant to section 415(d)(4)(A), the $5,000 rounding methodology of paragraph (a)(1)(iii) of this section is used for purposes of any provision of chapter 1 of subtitle A of the Internal Revenue Code that provides for adjustments in accordance with section 415(d), except to the extent provided by that provision. Thus, the $5,000 rounding methodology of paragraph (a)(1)(iii) of this section is used for purposes of—

(1) Determining the level of compensation specified in section 414(q)(1)(B) that is used to determine whether an employee is a highly compensated employee;

(2) Calculating the amounts used pursuant to section 409(o)(1)(C) to determine the maximum period over which distributions from an employee stock ownership plan may be made without participant consent; and

(3) Determining the levels of compensation specified in §1.61–21(f)(5)(i) and (iii) used in determining whether an employee is a control employee of a nongovernmental employer for purposes of the commuting valuation rule of §1.61–21(f).

(d) *Implementation of cost-of-living adjustments*. A plan is permitted to be amended to reflect any of the adjustments described in this section at any time after those limitations become applicable. Alternatively, a plan is permitted to incorporate by reference any of the adjustments described in this section in accordance with the rules of §1.415(a)–1(d)(3)(v). Because the accrued benefit of a participant can reflect increases in the applicable limitations only after those increases become effective, a pattern of repeated plan amendments increasing annual benefits to reflect the increases in the section 415(b) limitations pursuant to section 415(d) does not result in any protection under section 411(d)(6) for future increases to reflect increases in the section 415(b) limitations pursuant to §1.411(d)–4, Q&A–1(c)(1). Thus, a plan does not violate the requirements of section 411(d)(6) merely because the plan has been amended annually for a

number of years to increase annual benefits to reflect the increases in the section 415(b) limitations pursuant to section 415(d) and subsequently is not amended to reflect later increases in the section 415(b) limitations.

[T.D. 9319, 72 FR 16919, Apr. 5, 2007]

§ 1.415(f)–1 Aggregating plans.

(a) *In general.* Except as provided in paragraph (g) of this section (regarding multiemployer plans), and taking into account the rules of paragraph (b)(2) (regarding the break-up of affiliated employers and affiliated service groups), paragraph (c) (regarding predecessor employers), and paragraph (d)(1) (regarding nonduplication rules) of this section, section 415(f) and this section require that for purposes of applying the limitations of sections 415(b) and (c) applicable to a participant for a particular limitation year—

(1) All defined benefit plans (without regard to whether a plan has been terminated) ever maintained by the employer (or a predecessor employer within the meaning of paragraphs (c)(1) and (c)(2) of this section) under which the participant has accrued a benefit are treated as one defined benefit plan;

(2) All defined contribution plans (without regard to whether a plan has been terminated) ever maintained by the employer (or a predecessor employer within the meaning of paragraphs (c)(1) and (c)(2) of this section) under which the participant receives annual additions are treated as one defined contribution plan; and

(3) All section 403(b) annuity contracts purchased by an employer (including plans purchased through salary reduction contributions) for the participant are treated as one section 403(b) annuity contract.

(b) *Affiliated employers, affiliated service groups, and leased employees*—(1) *General rule.* See §1.415(a)–1(f)(1) and (2) for rules regarding aggregation of employers in the case of affiliated employers and affiliated service groups. See §1.415(a)–1(f)(3) for rules regarding the treatment of leased employees.

(2) *Special rule in the case of the break-up of an affiliated employer or an affiliated service group*—(i) *In general.* A formerly affiliated plan of an employer is taken into account for purposes of applying paragraph (a) of this section to the employer, but the formerly affiliated plan is treated as if it had terminated immediately prior to the cessation of affiliation with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. See §1.415(b)–1(b)(5)(i) for rules determining annual benefits under a terminated defined benefit plan under which annuities are purchased to provide plan benefits.

(ii) *Definitions.* For purposes of this paragraph (b)(2), a *formerly affiliated plan of an employer* is a plan that, immediately prior to the cessation of affiliation, was actually maintained by one or more of the entities that constitute the employer (as determined under the employer affiliation rules described in §1.415(a)–1(f)(1) and (2)), and immediately after the cessation of affiliation, is not actually maintained by any of the entities that constitute the employer (as determined under the employer affiliation rules described in §1.415(a)–1(f)(1) and (2)). For purposes of this paragraph (b)(2), a *cessation of affiliation* means the event that causes an entity to no longer be aggregated with one or more other entities as a single employer under the employer affiliation rules described in §1.415(a)–1(f)(1) and (2) (such as the sale of a subsidiary outside a controlled group), or that causes a plan to not actually be maintained by any of the entities that constitute the employer under the employer affiliation rules of §1.415(a)–1(f)(1) and (2) (such as a transfer of plan sponsorship outside of a controlled group).

(c) *Predecessor employer*—(1) *Where plan is maintained by successor.* For purposes of section 415 and regulations promulgated under section 415, a former employer is a predecessor employer with respect to a participant in a plan maintained by an employer if the employer maintains a plan under which the participant had accrued a benefit while performing services for the former employer (for example, the employer assumed sponsorship of the former employer's plan, or the employer's plan received a transfer of benefits from the former employer's plan), but only if that benefit is provided under the plan maintained by the employer.

In such a case, in applying the limitations of section 415 to a participant in a plan maintained by the employer, paragraph (a) of this section requires the plan to take into account benefits provided to the participant under plans that are maintained by the predecessor employer and that are not maintained by the employer. For this purpose, the formerly affiliated plan rules in paragraph (b)(2) of this section apply as if the employer and predecessor employer constituted a single employer under the rules described in §1.415(a)–1(f)(1) and (2) immediately prior to the cessation of affiliation (and as if they constituted two, unrelated employers under the rules described in §1.415(a)–1(f)(1) and (2) immediately after the cessation of affiliation) and cessation of affiliation was the event that gives rise to the predecessor employer relationship, such as a transfer of benefits or plan sponsorship.

(2) *Where plan is not maintained by successor*. With respect to an employer of a participant, a former entity that antedates the employer is a predecessor employer with respect to the participant if, under the facts and circumstances, the employer constitutes a continuation of all or a portion of the trade or business of the former entity. This will occur, for example, where formation of the employer constitutes a mere formal or technical change in the employment relationship and continuity otherwise exists in the substance and administration of the business operations of the former entity and the employer.

(d) *Special rules*—(1) *Nonduplication*. In applying the limitations of section 415 to a plan maintained by an employer, if the plan is aggregated with another plan pursuant to the aggregation rules of paragraph (a) of this section, a participant's benefits are not counted more than once in determining the participant's aggregate annual benefit or annual additions. For example, if a defined benefit plan is treated as if it terminated immediately prior to a cessation of affiliation under paragraph (b)(2) of this section, the plans maintained by the employer (as determined after the cessation of affiliation) that actually maintains the plan do not double count the annual benefit provided under the plan by aggregating under paragraph (a) of this section both the participant's annual benefit provided under the plan and the participant's annual benefit under the plan as a formerly affiliated plan (which is a plan that the employers formerly affiliated with the employer must take into account as a terminated plan under the rules of paragraph (b)(2) of this section). Instead, the plans maintained by the employer include the annual benefit provided to the participant under the actual plan that the employer maintains. Similarly, if a defined benefit plan maintained by an employer (the transferee plan) receives a transfer of benefits from a defined benefit plan maintained by a predecessor employer (the transferor plan) and the transfer is described in §1.415(b)–1(b)(3)(i)(B) (which requires the transferred benefits to be treated by the transferor plan as if the benefits were provided under a plan that must be aggregated with the transferor plan that terminated immediately prior to the transfer), the transferee plan does not double count the transferred benefits under paragraph (a) of this section by taking into account both the actual benefit provided under the transferee plan and the benefit provided under the deemed terminated plan that the predecessor employer is treated as maintaining (and that otherwise would have to be taken into account by the transferee plan under the predecessor employer aggregation rules of paragraph (a) of this section). Instead, the transferee plan takes into account the transferred benefits that are actually provided under the transferee plan (see §1.415(b)–1(b)(3)(i)(C)) and, pursuant to paragraph (c)(1) of this section, any nontransferred benefits provided under plans maintained by the predecessor employer with respect to a participant whose benefits have been transferred to the transferee plan.

(2) *Determination of years of participation for multiple plans*. If two or more defined benefit plans are aggregated under section 415(f) and this section for a particular limitation year, in applying the reduction for participation of

less than ten years (as described in section 415(b)(5)(A)) to the dollar limitation under section 415(b)(1)(A), time periods that are counted as years of participation under any of the plans are counted in computing the limitation of the aggregated plans under this section.

(3) *Determination of years of service for multiple plans.* If two or more defined benefit plans are aggregated under section 415(f) and this section for a particular limitation year, in applying the reduction for service of less than ten years (as described in section 415(b)(5)(B)) to the compensation limitation under section 415(b)(1)(B), time periods that are counted as years of service under any of the plans are counted in computing the limitation of the aggregated plans under this section.

(e) *Previously unaggregated plans*—(1) *In general.* This paragraph (e) provides rules for those situations in which two or more existing plans, which previously were not required to be aggregated pursuant to section 415(f) and this section, are aggregated during a particular limitation year and, as a result, the limitations of section 415(b) or (c) are exceeded for that limitation year. Paragraph (e)(2) of this section provides rules for defined contribution plans that are first required to be aggregated pursuant to section 415(f) and this section in a plan year. Paragraph (e)(3) of this section provides rules for defined benefit plans that are first required to be aggregated pursuant to section 415(f) and this section, and for defined benefit plans under which a participant's benefit is frozen following aggregation.

(2) *Defined contribution plans.* Two or more defined contribution plans that are not required to be aggregated pursuant to section 415(f) and this section as of the first day of a limitation year do not fail to satisfy the requirements of section 415 with respect to a participant for the limitation year merely because they are aggregated later in that limitation year, provided that no annual additions are credited to the participant's account after the date on which the plans are required to be aggregated.

(3) *Defined benefit plans*—(i) *First year of aggregation.* Two or more defined benefit plans that are not required to be aggregated pursuant to section 415(f) and this section as of the first day of a limitation year do not fail to satisfy the requirements of section 415 for the limitation year merely because they are aggregated later in that limitation year, provided that no plan amendments increasing benefits with respect to the participant under either plan are made after the occurrence of the event causing the plan to be aggregated.

(ii) *All years of aggregation in which accrued benefits are frozen.* Two or more defined benefit plans that are required to be aggregated pursuant to section 415(f) and this section during a limitation year subsequent to the limitation year during which the plans were first aggregated do not fail to satisfy the requirements of section 415 with respect to a participant for the limitation year merely because they are aggregated if there have been no increases in the participant's accrued benefit derived from employer contributions (including increases as a result of increased compensation or service) under any of the plans within the period during which the plans have been aggregated.

(f) *Section 403(b) annuity contracts*—(1) *In general.* In the case of a section 403(b) annuity contract, except as provided in paragraph (f)(2) of this section, the participant on whose behalf the annuity contract is purchased is considered for purposes of section 415 to have exclusive control of the annuity contract. Accordingly, except as provided in paragraph (f)(2) of this section, the participant, and not the participant's employer who purchased the section 403(b) annuity contract, is deemed to maintain the annuity contract, and such a section 403(b) annuity contract is not aggregated with a qualified plan that is maintained by the participant's employer.

(2) *Special rules under which the employer is deemed to maintain the annuity contract*—(i) *In general.* Where a participant on whose behalf a section 403(b) annuity contract is purchased is in control of any employer for a limitation year as defined in paragraph (f)(2)(ii) of this section (regardless of whether the employer controlled by

the participant is the employer maintaining the section 403(b) annuity contract), the annuity contract for the benefit of the participant is treated as a defined contribution plan maintained by both the controlled employer and the participant for that limitation year. Accordingly, where a participant on whose behalf a section 403(b) annuity contract is purchased is in control of any employer for a limitation year, the section 403(b) annuity contract is aggregated with all other defined contribution plans maintained by that employer. In addition, in such a case, the section 403(b) annuity contract is aggregated with all other defined contribution plans maintained by the employee or any other employer that is controlled by the employee. Thus, for example, if a doctor is employed by a non-profit hospital to which section 501(c)(3) applies and which provides him with a section 403(b) annuity contract, and the doctor also maintains a private practice as a shareholder owning more than 50 percent of a professional corporation, then any qualified defined contribution plan of the professional corporation must be aggregated with the section 403(b) annuity contract for purposes of applying the limitations of section 415(c) and §1.415(c)–1. For purposes of this paragraph (f)(2), it is immaterial whether the section 403(b) annuity contract is purchased as a result of a salary reduction agreement between the employer and the participant.

(ii) *Determination of when a participant is in control of an employer.* For purposes of paragraph (f)(2)(i) of this section, a participant is in control of an employer for a limitation year if, pursuant to §1.415(a)–1(f)(1) and (2), a plan maintained by that employer would have to be aggregated with a plan maintained by an employer that is 100 percent owned by the participant. Thus, for example, if a participant owns 60 percent of the common stock of a corporation, the participant is considered to be in control of that employer for purposes of applying paragraph (f)(2)(i) of this section.

(3) *Aggregation of section 403(b) annuity with qualified plan of controlled employer.* If a section 403(b) annuity contract is aggregated with a qualified plan of a controlled employer in accordance with paragraph (f)(2) of this section, the plans must satisfy the limitations of section 415(c) both separately and on an aggregate basis. In applying separately the limitations of section 415 to the qualified plan and to the section 403(b) annuity contract, compensation from the controlled employer may not be aggregated with compensation from the employer purchasing the section 403(b) annuity contract (that is, without regard to §1.415(c)–2(g)(3)).

(g) *Multiemployer plans*—(1) *Multiemployer plan aggregated with another multiemployer plan.* Pursuant to section 415(f)(3)(B), multiemployer plans, as defined in section 414(f), are not aggregated with other multiemployer plans for purposes of applying the limits of section 415.

(2) *Multiemployer plan aggregated with other plan*—(i) *Aggregation only for benefits provided by the employer.* Notwithstanding the rule of §1.415(a)–1(e), a multiemployer plan, as defined in section 414(f), is permitted to provide that only the benefits under that multiemployer plan that are provided by an employer are aggregated with benefits under plans maintained by that employer that are not multiemployer plans. If the multiemployer plan so provides, then, where an employer maintains both a plan which is not a multiemployer plan and a multiemployer plan, only the benefits under the multiemployer plan that are provided by the employer are aggregated with benefits under the employer's plans other than multiemployer plans (in lieu of including benefits provided by all employers under the multiemployer plan pursuant to the generally applicable rule of §1.415(a)–1(e)).

(ii) *Exception from aggregation for purposes of applying section 415(b)(1)(B) compensation limit.* Pursuant to section 415(f)(3)(A), a multiemployer plan, as defined in section 414(f), is not aggregated with any other plan that is not a multiemployer plan for purposes of applying the compensation limit of section 415(b)(1)(B) and §1.415(b)–1(a)(1)(ii).

(h) *Special rules for aggregating certain plans, etc.* If a plan, annuity contract or arrangement is subject to a special limitation in addition to, or instead of,

the regular limitations described in section 415(b) or (c), and is aggregated under this section with a plan which is subject only to the regular section 415(b) or (c) limitations, the following rules apply:

(1) Each plan, annuity contract or arrangement which is subject to a special limitation must meet its own applicable limitation and each plan subject to the regular limitations of section 415 must meet its applicable limitation.

(2) The limitation for the aggregated plans is the larger of the applicable limitations for the separate plans.

(i) [Reserved]

(j) *Examples*. The following examples illustrate the rules of this section. Except to the extent otherwise stated in an example, each entity is not and has never been affiliated with another entity under the employer affiliation rules of §1.415(a)–1(f)(1) and (2), each entity has never maintained a qualified plan (other than the plans specifically mentioned in the example), and the limitation year for each qualified plan is the calendar year.

Example 1. (i) *Facts*. M was formerly an employee of ABC Corporation and is currently an employee of XYZ Corporation. ABC maintains a qualified defined benefit plan (Plan ABC) and a qualified defined contribution plan in which M participates and XYZ maintains a qualified defined benefit plan (Plan XYZ) and a qualified defined contribution plan in which M participates. ABC Corporation owns 60 percent of XYZ Corporation.

(ii) *Treatment as a single employer*. ABC Corporation and XYZ Corporation are members of a controlled group of corporations within the meaning of section 414(b) as modified by section 415(h). Because ABC Corporation and XYZ Corporation are members of a controlled group of corporations within the meaning of section 414(b) as modified by section 415(h), M is treated as being employed by a single employer under §1.415(a)–1(f)(1).

(iii) *Plan aggregation*. Under paragraph (a)(1) of this section, the sum of M's annual benefit under Plan ABC and M's annual benefit under Plan XYZ is not permitted to exceed the limitations of section 415(b) and §1.415(b)–1; and, under paragraph (a)(2) of this section, the sum of the annual additions to M's account under the defined contribution plans maintained by ABC and XYZ may not exceed the limitations of section 415(c) and §1.415(c)–1. For purposes of determining the limitations of section 415(b) and §1.415(b)–1 for the aggregated plans, a year of service for either employer is considered as a year of service for purposes of §1.415(b)–1(g)(2) (phase-in rules for the compensation limit) and a year of participation under either plan is considered as a year of participation for purposes of §1.415(b)–1(g)(1) (phase-in rules for the dollar limit).

Example 2. (i) *Facts*. The facts are the same as in *Example 1*, except that ABC Corporation and XYZ Corporation do not maintain defined contribution plans. In addition, Participant O was formerly an employee of ABC Corporation and is currently an employee of XYZ Corporation. Participant O has an accrued benefit under the ABC Plan, but Participant O has no accrued benefit under the XYZ Plan. Effective January 1, 2010, ABC Corporation sells all of its shares of stock of XYZ Corporation to an unaffiliated entity, LMN Corporation (the 2010 stock sale). After the 2010 stock sale, XYZ Corporation continues to maintain Plan XYZ. LMN Corporation maintains a qualified defined benefit plan (Plan LMN). After the 2010 stock sale, M begins to accrue benefits under Plan LMN, but O does not participate in Plan LMN.

(ii) *Affiliated employer status of the corporations*. Immediately after the 2010 stock sale, ABC Corporation and XYZ Corporation are no longer members of a controlled group of corporations under section 414(b) (as modified by section 414(h)) and accordingly are no longer treated as a single employer under the employer affiliation rules of §1.415(a)–1(f)(1). Immediately after the 2010 stock sale, LMN Corporation and XYZ Corporation are members of a controlled group of corporations under section 414(b) (as modified by section 414(h)) and accordingly are treated as a single employer under the employer affiliation rules of §1.415(a)–1(f)(1).

(iii) *Treatment of plans maintained by ABC Corporation after the 2010 stock sale*. Under §1.415(a)–1(f)(1), any plan maintained by any member of a controlled group of corporations is deemed maintained by all members of the controlled group, and paragraph (a)(1) of this section requires that, for purposes of applying the limitations of section 415(b), all defined benefit plans ever maintained by an employer (as determined under the affiliation rules of §1.415(a)–1(f)(1) and (2)) are treated as one defined benefit plan. Therefore, defined benefit plans maintained by ABC Corporation must take into account the annual benefit of a participant provided under Plan XYZ in applying the limitations of section 415(b) to the participant because Plan XYZ is a plan that had once been maintained by ABC Corporation. However, beginning with the 2010 limitation year, the aggregation of the annual benefit accrued by a participant under Plan XYZ for purposes of testing defined benefit plans maintained by ABC Corporation is limited to the annual benefit accrued by the participant under Plan XYZ immediately prior to the 2010 stock sale. This is because paragraph (b)(2)(i)

of this section provides that a formerly affiliated plan of an employer is treated as if it had terminated immediately prior to the cessation of affiliation with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. The 2010 stock sale is a cessation of affiliation under paragraph (b)(2)(ii) of this section because this event caused XYZ Corporation to no longer be affiliated with ABC Corporation under the employer affiliation rules of §1.415(a)–1(f)(1) and (2). Immediately after the 2010 stock sale, Plan XYZ is a formerly affiliated plan with respect to ABC Corporation under paragraph (b)(2)(ii) of this section because immediately prior to the cessation of affiliation, Plan XYZ was actually maintained by XYZ Corporation (which together with ABC Corporation constituted a single employer under the employer affiliation rules of §1.415(a)–1(f)(1) and (2)), and immediately after the cessation of affiliation, Plan XYZ is not actually maintained by ABC Corporation or any other entity affiliated with it.

(iv) *Application of rules to Participants M and O with respect to plans maintained by ABC Corporation after the 2010 stock sale.* In applying the limitations of section 415(b) to Participant M for the 2010 limitation year and later limitation years, Plan ABC must take into account the annual benefit provided under Plan ABC to Participant M and the annual benefit provided under Plan XYZ to Participant M, but treating Plan XYZ as if it had terminated immediately prior to the 2010 stock sale with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. The aggregation of Plan XYZ with Plan ABC is irrelevant for purposes of Participant O because Participant O does not have any accrued benefit under Plan XYZ (as determined prior to the 2010 stock sale).

(v) *Treatment of plans maintained by LMN Corporation and XYZ Corporation after the 2010 stock sale.* Under §1.415(a)–1(f)(1) and paragraph (a)(1) of this section, when applying the limitations of section 415(b) to a participant under Plans LMN and XYZ for the 2010 limitation year and later years, the annual benefit provided to the participant under Plans LMN, XYZ and ABC must be aggregated. Benefits under Plan ABC must be included in this aggregation because XYZ Corporation is deemed to have once maintained Plan ABC pursuant to §1.415(a)–1(f)(1), and since LMN Corporation and XYZ Corporation constitute a single employer under §1.415(a)–1(f)(1), paragraph (a)(1) of this section requires the aggregation of all defined benefit plans ever maintained by LMN Corporation and XYZ Corporation. However, in performing this aggregation, a participant's annual benefit under Plan ABC is limited to the annual benefit accrued by the participant immediately prior to the 2010 stock sale. This is because, pursuant to paragraph (b)(2)(i) of this section, Plan ABC is a formerly affiliated plan of LMN Corporation and XYZ Corporation.

(vi) *Application of rules to Participants M and O with respect to plans maintained by LMN Corporation and XYZ Corporation after the 2010 stock sale.* In applying the limitation of section 415(b) to Participant M for the 2010 limitation year and later limitation years, Plan LMN and Plan XYZ must take into account the annual benefit provided under Plans LMN and XYZ to Participant M and the annual benefit provided under Plan ABC to Participant M as if Plan ABC had terminated immediately prior to the 2010 stock sale with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. Participant O does not have an accrued benefit under Plan LMN or Plan XYZ, so the aggregation of Plan ABC with Plans LMN and XYZ is currently irrelevant with respect to Participant O. However, if Participant O were to ever participate in Plans LMN or XYZ after the 2010 stock sale, Participant O's annual benefit under Plan ABC (determined as if Plan ABC terminated immediately prior to the 2010 stock sale) would have to be aggregated with any annual benefit that Participant O accrues under Plan LMN or Plan XYZ.

(vii) *Application of nonduplication rule.* In applying paragraph (a)(1) of this section to plans maintained by ABC Corporation after 2010 stock sale, plans maintained by ABC Corporation do not take into account the deemed termination of Plan ABC since ABC Corporation maintains Plan ABC after the cessation of affiliation. Similarly, in applying paragraph (a)(1) of this section to plans maintained by LMN Corporation and XYZ Corporation after the 2010 stock sale, plans maintained by LMN Corporation and XYZ Corporation do not take into account the deemed termination of Plan XYZ since XYZ Corporation maintains Plan XYZ after the cessation of affiliation. See paragraph (d)(1) of this section.

Example 3. (i) *Facts.* The facts are the same as in *Example 2*, except that on January 1, 2009, Plan ABC transfers Participant M's benefit to Plan XYZ.

(ii) *Treatment of plans maintained by ABC Corporation.* Pursuant to §1.415(b)–1(b)(3)(i)(A), M's benefit that is transferred from Plan ABC to Plan XYZ is not treated as being provided under Plan ABC for the limitation year in which the transfer occurs (2009). This is because M's transferred benefit is otherwise required to be taken into account by Plan ABC for the 2009 limitation year since Plan XYZ must be aggregated with Plan ABC pursuant to paragraph (a)(1) of this section. This result does not change for the 2010 limitation year and later limitation years, where pursuant to paragraph

(b)(2)(i) of this section, Plan XYZ becomes a formerly affiliated plan with respect to ABC Corporation due to the 2010 stock sale. Under paragraph (b)(2)(i) of this section, Plan XYZ (the formerly affiliated plan) is treated from the perspective of plans maintained by ABC Corporation (Plan ABC) as if Plan XYZ terminated immediately prior to the 2010 stock sale with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. However, the pre-2010 stock sale benefits of Plan XYZ include the January 1, 2009, transfer of Participant M's benefit. Thus, in the 2010 limitation year, M's transferred benefit is still otherwise required to be taken into account by Plan ABC on account of the aggregation of Plan XYZ with Plan ABC pursuant to paragraph (a)(1) of this section, and therefore the transferred benefit is not treated as being provided by Plan ABC.

(iii) *Treatment of plans maintained by LMN Corporation and XYZ Corporation.* Pursuant to §1.415(b)–1(b)(3)(i)(C), Participant M's benefit that is transferred to Plan XYZ from Plan ABC must be treated as provided under Plan XYZ for purposes of applying the limitations of section 415 to Plan XYZ with respect to Participant M for the limitation year in which the transfer occurs and later years. This result does not change on account of the 2010 stock sale. When applying the limitation of section 415 to Plans LMN and XYZ for the 2010 limitation year and later years, Plans LMN and XYZ must aggregate the annual benefit provided to a participant under each plan along with the participant's benefit under Plan ABC pursuant to §1.415(a)–1(f)(1) and paragraph (a)(1) of this section. However, under paragraph (b)(2)(i) of this section, for the 2010 limitation year and later years, this aggregation of M's Plan ABC benefit only includes the annual benefit attributable to a participant's accrued benefit under Plan ABC immediately prior to the 2010 stock sale, which (due to the 2009 transfer) is zero.

Example 4. (i) *Facts.* The facts are the same as in *Example 2,* except that on January 1, 2011, Plan ABC transfers Participant M's benefit to Plan XYZ.

(ii) *Treatment of plans maintained by ABC Corporation for the 2011 limitation year and later years.* Pursuant to §1.415(b)–1(b)(3)(i)(B), M's benefit that is transferred from Plan ABC to Plan XYZ during the 2011 limitation year is treated by Plan ABC for the 2011 limitation year and later years as if the transferred benefit were provided under a plan that must be aggregated with Plan ABC that terminated immediately prior to the transfer with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. This is because M's transferred benefit is not otherwise required to be taken into account by Plan ABC for the 2011 limitation year and later years pursuant to paragraphs (a)(1) and (b)(2)(i) of this section. While Plan ABC must take into account Participant M's annual benefit under Plan XYZ under paragraph (a)(1) of this section, Participant M's annual benefit for this purpose is limited under paragraph (b)(2)(i) of this section to M's accrued benefit under Plan XYZ immediately prior to the 2010 stock sale, and Participant M's pre-2010 stock sale accrued benefit under Plan XYZ excludes the 2011 transfer.

(iii) *Treatment of plans maintained by LMN Corporation and XYZ Corporation for the 2011 limitation year and later years.* Pursuant to §1.415(b)–1(b)(3)(i)(C), Participant M's benefit that is transferred to Plan XYZ from Plan ABC must be treated as provided under Plan XYZ for purposes of applying the limitations of section 415 to Plan XYZ with respect to Participant M for the limitation year in which the transfer occurs and later years. In applying the limitations of section 415(b) to Plans LMN and XYZ with respect to Participant M for the 2010 limitation year and later years, the annual benefit of Participant M under Plans ABC, LMN, and XYZ must be aggregated pursuant to §1.415(a)–1(f)(1) and paragraph (a)(1) of this section, but for this purpose, Participant M's benefit under Plan ABC is treated as if it were provided under a plan that terminated immediately prior to the cessation of affiliation of ABC Corporation and XYZ Corporation with sufficient assets to pay benefit liabilities under the plan, and had purchased an annuity to provide Participant M's benefits. (See paragraph (b)(2)(i) of this section and *Example 2.*) In applying the limitations of section 415(b) to Plans LMN and XYZ with respect to Participant M for the 2011 limitation year and later years, the annual benefit of Participant M under Plans ABC, LMN, and XYZ still must be aggregated pursuant to §1.415(a)–1(f)(1) and paragraph (a)(1) of this section. However, beginning with the 2011 limitation year, ABC Corporation is a predecessor employer with respect to LMN Corporation and XYZ Corporation with respect to Participant M on account of the transfer of benefits from Plan ABC to Plan XYZ, pursuant to paragraph (c)(1) of this section. Therefore, Plans LMN and XYZ must take into account benefits that Participant M accrued under Plan ABC after the January 1, 2010, cessation of affiliation of ABC Corporation and XYZ Corporation that were not transferred to Plan XYZ on January 1, 2011, pursuant to paragraphs (c)(1) and (d)(1) of this section. Since all of Participant M's benefit in Plan ABC is transferred to Plan XYZ on January 1, 2011, Participant M's annual benefit from Plan ABC for purposes of aggregating Plan ABC with Plans LMN and XYZ is zero.

Example 5. (i) *Facts.* The facts are the same as in *Example 2,* except that instead of the 2010 stock sale, XYZ Corporation sells some of its operating assets to LMN Corporation

(and, under the facts and circumstances, the sale does not result in XYZ Corporation constituting a predecessor employer of LMN Corporation under the rules of paragraph (c)(2) of this section), and in connection with the asset sale, LMN Corporation assumes sponsorship of Plan XYZ in place of XYZ Corporation, effective January 1, 2010.

(ii) *Treatment of plans maintained by ABC Corporation and XYZ Corporation.* Pursuant to paragraph (a)(1) of this section, all defined benefit plans ever maintained by ABC Corporation and XYZ Corporation must be aggregated as a single defined benefit plan for purposes of applying the limitations of section 415(b). However, for purposes of determining the annual benefit under Plan XYZ for the 2010 limitation year and later years, the aggregation of a participant's benefit under Plan XYZ is limited to the participant's annual benefit accrued immediately prior to the January 1, 2010, transfer of sponsorship of Plan XYZ. This is because paragraph (b)(2)(i) of this section provides that a formerly affiliated plan of an employer is treated as if it were a plan that terminated immediately prior to the cessation of affiliation with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. The January 1, 2010, transfer of sponsorship of Plan XYZ is a cessation of affiliation under paragraph (b)(2)(ii) of this section because this event causes Plan XYZ to no longer actually be maintained by either ABC Corporation or XYZ Corporation. Effective immediately after the January 1, 2010, transfer of sponsorship, Plan XYZ is a formerly affiliated plan with respect to ABC Corporation and XYZ Corporation under paragraph (b)(2)(ii) of this section because immediately prior to the cessation of affiliation, Plan XYZ was actually maintained by XYZ Corporation, and immediately after the cessation of affiliation, Plan XYZ is not actually maintained by either XYZ Corporation or ABC Corporation. Therefore, in applying the limitation of section 415(b) to Participant M for the 2010 limitation year and later limitation years, Plan ABC must take into account the annual benefit provided under Plan ABC to Participant M and the annual benefit provided under Plan XYZ to Participant M as if Plan XYZ had terminated immediately prior to the 2010 stock sale with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. The aggregation of Plan XYZ with Plan ABC is irrelevant for purposes of Participant O because Participant O does not have any accrued benefit under Plan XYZ (as determined prior to the 2010 transfer of sponsorship).

(iii) *Treatment of plans maintained by LMN Corporation.* Under paragraph (a)(1) of this section, all defined benefit plans ever maintained by LMN Corporation or a predecessor employer must be aggregated as a single plan for purposes of applying the limitations of section 415(b). ABC Corporation and XYZ Corporation constitute a predecessor employer pursuant to paragraph (c)(1) of this section with respect to the participants who participate in Plan XYZ on the date of the transfer of sponsorship of Plan XYZ (the transferred participants) from XYZ Corporation to LMN Corporation, such as Participant M. This is because, effective with the January 1, 2010, transfer of sponsorship, LMN Corporation maintains a plan (Plan XYZ) under which the participants accrued a benefit while performing services for XYZ Corporation (which is in turn affiliated with ABC Corporation under §1.415(a)–1(f)(1)) and such benefits are provided under a plan maintained by LMN Corporation. Therefore, for the 2010 limitation year and later years, the annual benefit under Plan ABC of the transferred participants (such as Participant M) must be aggregated with the annual benefit provided to such participants under Plans XYZ and LMN for purposes of determining whether Plan LMN or Plan XYZ satisfies the limitations of section 415(b). However, the aggregation of the transferred participants' Plan ABC annual benefits is limited to the annual benefit accrued under Plan ABC immediately prior to January 1, 2010, transfer of sponsorship. This is because, pursuant to paragraph (c)(1) of this section, Plan ABC is treated from the perspective of plans maintained by LMN Corporation as if Plan ABC had terminated immediately prior to the transfer of sponsorship of Plan ABC to LMN Corporation with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. ABC Corporation and XYZ Corporation do not constitute a predecessor employer with respect to Participant O. Thus, if Participant O is a participant in Plan LMN or becomes a participant in Plan XYZ after the 2010 transfer of sponsorship, neither plan aggregates Participant O's Plan ABC benefits for purposes of satisfying section 415(b). In applying paragraph (a)(1) of this section to a participant, plans maintained by LMN Corporation do not double count the participant's annual benefit. See paragraph (d)(1) of this section. Thus, such plans do not aggregate the annual benefit provided under Plan XYZ with the annual benefit from the deemed termination of Plan XYZ that LMN Corporation's predecessor employer (which is ABC and XYZ Corporations) must take into account in applying paragraph (a)(1) of this section, and instead consider the annual benefit actually provided under Plan XYZ.

Example 6. (i) *Facts.* N is employed by a hospital which purchases an annuity contract described in section 403(b) on N's behalf for the current limitation year. N is in control of the hospital within the meaning of section 414(b) or (c), as modified by section

415(h). The hospital also maintains a qualified defined contribution plan during the current limitation year in which N participates.

(ii) *Conclusion*. Under section 415(k)(4), the hospital, as well as N, is considered to maintain the annuity contract. Accordingly, for N the sum of the annual additions under the qualified defined contribution plan and the annuity contract must satisfy the limitations of section 415(c) and §1.415(c)–1.

Example 7. (i) *Facts*. The facts are the same as in *Example 6*, except that instead of being in control of the hospital, N is the 100 percent owner of a professional corporation P, which maintains a qualified defined contribution plan in which N participates.

(ii) *Conclusion*. Under section 415(k)(4), the professional corporation, as well as N, is considered to maintain the annuity contract. Accordingly, the sum of the annual additions under the qualified defined contribution plan maintained by professional corporation P and the annuity contract must satisfy the limitations of section 415(c) and §1.415(c)–1. See §1.415(g)–1(b)(3)(iv)(C)(2) for an example of the treatment of a contribution to a section 403(b) annuity contract that exceeds the limits of section 415(c) by reason of the aggregation required by this section.

Example 8. (i) *Facts*. J is an employee of two corporations, N and M, each of which has employed J for more than 10 years. N and M are not required to be aggregated pursuant to section 415(f) and this section. Each corporation has a qualified defined benefit plan in which J has participated for more than 10 years. Each plan provides a benefit which is equal to 75 percent of a participant's average compensation for the period of the participant's high-3 years of service and is payable in the form of a straight life annuity beginning at age 65. J's average compensation for the period of his high-3 years of service from each corporation is $160,000. In July 2008, N Corporation becomes a wholly owned subsidiary of M Corporation.

(ii) *Plan aggregation analysis*. As a result of the acquisition of N Corporation by M Corporation, J is treated as being employed by a single employer under section 414(b). Therefore, because section 415(f)(1)(A) requires that all defined benefit plans of an employer be treated as one defined benefit plan, the two plans must be aggregated for purposes of applying the limitations of section 415. However, under paragraph (e)(3)(i) of this section, since the plans were not aggregated as of the first day of the 2008 limitation year (January 1, 2008), they will not be considered aggregated until the limitation year beginning January 1, 2009, provided that no plan amendment increasing benefits with respect to participant J is made after the acquisition of N by M.

(iii) *Application to Participant J*. J has a total benefit under the two plans of $240,000, which, as a result of the plan aggregation, is in excess of the section 415(b) limit. However, under paragraph (e)(3)(ii) of this section, the limitations of section 415(b) and §1.415(b)–1 applicable to J may be exceeded in this situation without plan disqualification so long as J's accrued benefit derived from employer contributions is not increased (that is, J's accrued benefit does not increase on account of increased compensation, service, participation, or other accruals) during the period within which the limitations are being exceeded.

Example 9. (i) *Facts*. A, age 30, owns all of the stock of X Corporation and also owns 10 percent of the stock of Z Corporation. F, A's father, directly owns 75 percent of the stock of Z Corporation. Both corporations have qualified defined contribution plans in which A participates. A's compensation (within the meaning of §1.415(c)–2) for 2008 is $20,000 from Z Corporation and $150,000 from X Corporation. During the period January 1, 2008 through June 30, 2008, annual additions of $20,000 are credited to A's account under the plan of Z Corporation, while annual additions of $40,000 are credited to A's account under the plan of X Corporation. In both instances, the amount of annual additions represent the maximum allowable under section 415(c) and §1.415(c)–1. On July 15, 2008, F dies, and A inherits all of F's stock in Z in 2008.

(ii) *Conclusion*. As of July 15, 2008, A is considered to be in control of X and Z Corporations, and the two plans must be aggregated for purposes of applying the limitations of section 415. However, even though A's total annual additions for 2008 are $60,000, the limitations of section 415(c) and §1.415(c)–1 are not violated for 2008, provided no annual additions are credited to A's accounts after July 15, 2008 (the date that A is first in control of Z) for the remainder of the 2008 limitation year.

Example 10. (i) *Facts*. P is a key employee of employer XYZ who participates in a qualified defined contribution plan (Plan X). P is also provided post-retirement medical benefits, and XYZ has taken into account a reserve for those benefits under section 419A(c)(2). In the 2008 limitation year, P's compensation is $30,000 and P's annual additions under Plan X are $5,000. Pursuant to section 419A(d), a separate account is maintained for P, and that account is credited with an allocation of $32,000 for the 2008 limitation year. It is assumed that the section 415(c)(1)(A) dollar limit for 2008 is $46,000.

(ii) *Separate testing analysis*. Under paragraph (h)(1) of this section, Plan X and the individual medical account must separately satisfy the requirements of section 415(c), taking into account any special limit applicable to that arrangement. In this case, the contributions to Plan X separately satisfy the limitations of section 415(c). While the individual medical account is treated as a

defined contribution plan subject to the rules of section 415(c), it is not subject to the 100 percent of compensation limit of section 415(c)(1)(B), so the contributions to that account satisfy the limitations of section 415(c).

(iii) *Aggregation analysis.* The sum of the annual additions under Plan X and the amounts contributed to the separate account on P's behalf must satisfy the requirements of section 415(c). Under paragraph (h)(2) of this section, the limit applicable to the aggregated plan is equal to the greater of the limits applicable to the separate plans. In this case, the limit applicable to the medical account is $46,000 (which is greater than the limit of $30,000 applicable to the qualified plan), so the limit that applies to the aggregated plan is $46,000, and the aggregated plan satisfies the requirements of section 415.

[T.D. 9319, 72 FR 16922, Apr. 5, 2007; 72 FR 28854, May 23, 2007]

§ 1.415(g)–1 Disqualification of plans and trusts.

(a) *Disqualification of plans*—(1) *In general.* Under section 415(g) and this section, with respect to a particular limitation year, a plan (and the trust forming part of the plan) is disqualified in accordance with the rules provided in paragraph (b) of this section, if the conditions described in paragraph (a)(2) or (a)(3) of this section apply. For purposes of this paragraph (a), the determination of whether a plan or a group of aggregated plans exceeds the limitations imposed by section 415 for a particular limitation year is, except as otherwise provided, made by taking into account the aggregation of plan rules provided in section 415(f) and § 1.414(f)–1.

(2) *Defined contribution plans.* A plan is disqualified in accordance with the rules provided in paragraph (b) of this section if annual additions (as defined in § 1.415(c)–1(b)) with respect to the account of any participant in a defined contribution plan maintained by the employer exceed the limitations of section 415(c) and § 1.415(c)–1.

(3) *Defined benefit plans.* A plan is disqualified in accordance with the rules provided in paragraph (b) of this section if the annual benefit (as defined in § 1.415(b)–1(b)(1)) of a participant in a defined benefit plan maintained by the employer exceeds the limitations of section 415(b) and § 1.415(b)–1.

(b) *Rules for disqualification of plans and trusts*—(1) *In general.* If any plan (including a trust which forms part of such plan) is disqualified for a particular limitation year under the rules set forth in this paragraph (b), then the disqualification is effective as of the first day of the first plan year containing any portion of the particular limitation year.

(2) *Single plan.* In the case of a single qualified defined benefit plan (determined without regard to section 415(f) and § 1.415(f)–1) maintained by the employer that provides an annual benefit (as defined in § 1.415(b)–1(b)(1)) in excess of the limitations of section 415(b) and § 1.415(b)–1 for any particular limitation year, such plan is disqualified in that limitation year. Similarly, if the employer only maintains a single defined contribution plan (determined without regard to section 415(f) and § 1.415(f)–1) under which annual additions (as defined in § 1.415(c)–1(b)) allocated to the account of any participant exceed the limitations of section 415(c) and § 1.415(c)–1 for any particular limitation year, such plan is also disqualified in that limitation year.

(3) *Multiple plans*—(i) *In general.* If the limitations of section 415(b) and § 1.415(b)–1, or section 415(c) and § 1.415(c)–1, are exceeded for a particular limitation year with respect to any participant solely because of the application of the aggregation rules of section 415(f)(1) and § 1.415(f)–1 (taking into account the rules of § 1.415(a)–1(f)), then one or more of the plans is disqualified in accordance with the ordering rules set forth in paragraph (b)(3)(ii) of this section, applied in accordance with the rules of application set forth in paragraph (b)(3)(iii) of this section, subject to the special rules set forth in paragraph (b)(3)(iv) of this section, until, without regard to annual benefits or annual additions under the disqualified plan or plans, the remaining plans satisfy the applicable limitations of section 415.

(ii) *Ordering rules*—(A) *Disqualification of ongoing plans other than multiemployer plans.* If there are two or more plans that have not been terminated at any time including the last day of the particular limitation year, and if one

or more of those plans is a multiemployer plan described in section 414(f), then one or more of the plans (as needed to satisfy the limitations of section 415) that has not been terminated and is not a multiemployer plan is disqualified in that limitation year. For purposes of the preceding sentence, the determination of whether a plan is a multiemployer plan described in section 414(f) is made as of the last day of the particular limitation year.

(B) *Disqualification of ongoing multiemployer plans.* If, after the application of paragraph (b)(3)(ii)(A) of this section, there are two or more plans and one or more of the plans has been terminated at any time including the last day of the particular limitation year, then one or more of the plans (as needed to satisfy the applicable limitations of section 415) that has not been so terminated (regardless of whether the plan is a multiemployer plan described in section 414(f)) is disqualified in that limitation year.

(iii) *Rules of application*—(A) *Employer elects which plan is disqualified.* If there are two or more plans of an employer within a group of plans one or more of which is to be disqualified pursuant to paragraph (b)(3)(ii)(A) or (B) of this section, then the employer may elect, in a manner determined by the Commissioner, which plan or plans are disqualified. If those two or more plans are involved because of the application of §1.415(a)–1(f), the employers involved may elect, in a manner determined by the Commissioner, which plan or plans are disqualified. However, the election described in the preceding sentence is not effective unless made by all of those employers.

(B) *Commissioner determines which plan is disqualified.* If the election described in paragraph (b)(3)(iii)(A) of this section is not made with respect to the two plans described in paragraph (b)(3)(iii)(A) of this section, then the Commissioner, taking into account all of the facts and circumstances, has the discretion to determine the plan that is disqualified in the particular limitation year. In making this determination, some of the factors that will be taken into account include, but are not limited to, the number of participants in each plan, the amount of benefits provided on an overall basis by each plan, and the extent to which benefits are distributed or retained in each plan.

(iv) *Special rules*—(A) *Simplified employee pensions.* If there are two or more plans one or more of which is to be disqualified pursuant to paragraph (b)(3)(ii)(A) or (B) of this section, and if one of the plans is a simplified employee pension (as defined in section 408(k)), then the simplified employee pension is not disqualified until all of the other plans have been disqualified. However, if one of the plans has been terminated, then the simplified employee pension is disqualified before the terminated plan. For purposes of this paragraph (b)(3)(iv)(A), the disqualification of a simplified employee pension means that the simplified employee pension is no longer described under section 408(k).

(B) *Aggregating medical accounts with defined contribution plans.* In the event that aggregating a medical account described in §1.415(c)–1(a)(2)(ii)(C) or (D) and a defined contribution plan other than such a medical account causes the limitations of section 415(c) and §1.415(c)–1 applicable to a participant to be exceeded for a particular limitation year, the defined contribution plan other than the medical account is disqualified for the limitation year.

(C) *Aggregating section 403(b) annuity contract and qualified defined contribution plan*—(1) *In general.* In the event that aggregating a section 403(b) annuity contract and a qualified defined contribution plan under the provisions of section 415(f)(1)(B) causes the limitations of section 415(c) and §1.415(c)–1 applicable to a participant under the aggregated defined contribution plans to be exceeded for a particular limitation year, the excess of the contributions to the annuity contract plus the annual additions to the qualified plan over such limitations is attributed to the annuity contract and therefore includable in the gross income of the participant for the taxable year with or within which that limitation year ends. See §1.415(a)–1(b)(2) for rules regarding the treatment of a contribution to a section 403(b) annuity contract that exceeds the limitations of section 415.

(*2*) *Example*. The following example illustrates the application of this paragraph (b)(3)(iv)(C). It is assumed for purposes of this example that the dollar limitation under section 415(c)(1)(A) that applies for all relevant limitation years is $45,000. The example is as follows:

Example. (i) N is employed by a hospital which purchases an annuity contract described in section 403(b) on N's behalf for the current limitation year. N is also the 100 percent owner of a professional corporation P that maintains a qualified defined contribution plan during the current limitation year in which N participates. (The facts of this example are the same as in § 1.415(f)–1(j) *Example 7*.) N's compensation (within the meaning of § 1.415(c)–2) from the hospital for the current limitation year is $150,000. For the current limitation year, the hospital contributes $30,000 for the section 403(b) annuity contract on N's behalf, which is within the limitations applicable to N under the annuity contract (specifically, the limit under the annuity contract is $45,000)). Professional corporation P also contributes $20,000 to the qualified defined contribution plan on N's behalf for the current limitation year (which represents the only annual additions allocated to N's account under the plan for such year), which is within the $45,000 limitation of section 415(c)(1) applicable to N under the plan.

(ii) Under section 415(k)(4), the professional corporation, as well as N, is considered to maintain the annuity contract. Accordingly, the sum of the annual additions under the qualified defined contribution plan maintained by professional corporation P and the annuity contract must satisfy the limitations of section 415(c) and § 1.415(c)–1.

(iii) Because the total aggregate contributions ($50,000) exceed the section 415(c) limitation applicable to N ($45,000), $5,000 of the $30,000 contributed to the section 403(b) annuity contract is considered an excess contribution and therefore currently includable in N's gross income. The contract continues to be a section 403(b) annuity contract only if, for the current limitation year and all years thereafter, the issuer of the contract maintains separate accounts for each portion attributable to such excess contributions. See §§ 1.415(a)–1(b)(2).

(c) *Plan year for certain annuity contracts and individual retirement plans*. For purposes of this section, unless the plan under which the annuity contract or individual retirement plan is provided specifies that a different twelve-month period is considered to be the plan year—

(1) An annuity contract described in section 403(b) is considered to have a plan year coinciding with the taxable year of the individual on whose behalf the contract has been purchased; and

(2) A simplified employee pension described in section 408(k) is considered to have a plan year coinciding with the year under the plan that is used pursuant to section 408(k)(7)(C).

[T.D. 9319, 72 FR 16927, Apr. 5, 2007]

§ 1.415(j)–1 Limitation year.

(a) *In general*. Unless the terms of a plan provide otherwise, the limitation year, with respect to any qualified plan maintained by the employer, is the calendar year.

(b) *Alternative limitation year election*. The terms of a plan may provide for the use of any other consecutive twelve month period as the limitation year. This includes a fiscal year with an annual period varying from 52 to 53 weeks, so long as the fiscal year satisfies the requirements of section 441(f). A plan may only provide for one limitation year regardless of the number or identity of the employers maintaining the plan.

(c) *Multiple limitation years*—(1) *In general*. Where an employer maintains more than one qualified plan, those plans may provide for different limitation years. The rule described in this paragraph (c) also applies to a controlled group of employers (within the meaning of section 414(b) or (c), as modified by section 415(h)). If the plans of an employer (or a controlled group of employers whose plans are aggregated) have different limitation years, section 415 is applied in accordance with the rule of paragraphs (c)(2) and (3) of this section.

(2) *Testing rule for defined contribution plans*. If a participant is credited with annual additions in only one defined contribution plan, in determining whether the requirements of section 415(c) are satisfied, only the limitation year applicable to that plan is considered. However, if a participant is credited with annual additions in more than one defined contribution plan, each such plan satisfies the requirements of section 415(c) only if the limitations of section 415(c) are satisfied

with respect to amounts that are annual additions for the limitation year with respect to the participant under the plan, plus amounts credited to the participant's account under all other plans required to be aggregated with the plan pursuant to section 415(f) and § 1.415(f)–1 that would have been considered annual additions for the limitation year under the plan if they had been credited under the plan rather than an aggregated plan.

(3) *Testing rule for defined benefit plans*. If a participant has participated in only one defined benefit plan, in determining whether the requirements of section 415(b) are satisfied, only the limitation year applicable to that plan is considered. However, if a participant has participated in more than one defined benefit plan, a plan satisfies the requirements of section 415(b) only if the annual benefit under all plans required to be aggregated pursuant to section 415(f) and § 1.415(f)–1 for the limitation year of that plan with respect to the participant satisfy the applicable limitations of section 415(b). Thus, for example, the dollar limitation of section 415(b)(1)(A) applicable to the limitation year for each plan must be applied to annual benefits under all aggregated plans to determine whether the plan satisfies the requirements of section 415(b).

(d) *Change of limitation year*—(1) *In general*. Once established, the limitation year may be changed only by amending the plan. Any change in the limitation year must be a change to a 12-month period commencing with any day within the current limitation year. For purposes of this section, the limitations of section 415 are to be applied in the normal manner to the new limitation year.

(2) *Application to short limitation period*. Where there is a change of limitation year, the limitations of section 415 are to be separately applied to a limitation period which begins with the first day of the current limitation year and which ends on the day before the first day of the first limitation year for which the change is effective. In the case of a defined contribution plan, the dollar limitation with respect to this limitation period is determined by multiplying the applicable dollar limitation for the calendar year in which the limitation period ends by a fraction, the numerator of which is the number of months (including any fractional parts of a month) in the limitation period, and the denominator of which is 12. In the case of a defined benefit plan, no adjustment is made to the section 415(b) limitations to reflect a short limitation period.

(3) *Deemed change of limitation year*. If a defined contribution plan is terminated effective as of a date other than the last day of the plan's limitation year, the plan is treated for purposes of this section as if the plan was amended to change its limitation year. Thus, the rules of this paragraph (d) apply to the terminating plan's final limitation year.

(e) *Limitation year for individuals on whose behalf section 403(b) annuity contracts have been purchased*. The limitation year of an individual on whose behalf a section 403(b) annuity contract has been purchased by an employer is determined in the following manner.

(1) If the individual is not in control of any employer (within the meaning of § 1.415(f)–1(f)(2)(ii)), the limitation year is the calendar year. However, the individual may elect to change the limitation year to another twelve-month period. To do this, the individual must attach a statement to his or her income tax return filed for the taxable year in which the change is made. Any change in the limitation year must comply with the rules set forth in paragraph (d) of this section.

(2) If the individual is in control of an employer (within the meaning of § 1.415(f)–1(f)(2)(ii)), the limitation year is the limitation year of that employer.

(f) *Limitation year for individuals on whose behalf individual retirement plans are maintained*. The limitation year of an individual on whose behalf an individual retirement plan (within the meaning of section 7701(a)(37)) is maintained is determined in the manner described in paragraph (e) of this section.

(g) *Examples*. The following examples illustrate the application of this section:

Example 1. (i) Participant M is employed by both Employer A and Employer B, each of which maintains a qualified defined contribution plan. M participates in both of

these plans. The limitation year for Employer A's plan is January 1 through December 31, and the limitation year for Employer B's plan is April 1 through March 31. Employer A and Employer B are both corporations, and Corporation X owns 100 percent of the stock of Employer A and Employer B.

(ii) The two plans in which M participates are required under section 415(f) to be aggregated for purposes of applying the limitations of section 415(c) to annual additions made with respect to M. Thus, for example, for the limitation year of Employer A's plan that begins January 1, 2008, annual additions with respect to M that are subject to the limitations of section 415(c) include both amounts that are annual additions with respect to M under Employer A's plan for the period beginning January 1, 2008, and ending December 31, 2008, and amounts contributed to Employer B's plan with respect to M that would have been considered annual additions for the period beginning January 1, 2008, and ending December 31, 2008, under Employer A's plan if those amounts had instead been contributed to Employer A's plan.

Example 2. In 2008, an employer with a qualified defined contribution plan using the calendar year as the limitation year elects to change the limitation year to a period beginning July 1 and ending June 30. Because of this change, the plan must satisfy the limitations of section 415(c) for the limitation period beginning January 1, 2008, and ending June 30, 2008. In applying the limitations of section 415(c) to this limitation period, the amount of compensation taken into account may only include compensation for this period. Furthermore, the dollar limitation for this period is the otherwise applicable dollar limitation for calendar year 2008, multiplied by 6/12.

[T.D. 9319, 72 FR 16928, Apr. 5, 2007]

§ 1.416–1 Questions and answers on top-heavy plans.

The following questions and answers relate to special rules for top-heavy plans under section 416 of the Internal Revenue Code of 1954, as added by section 240 of the Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. 97–248) (TEFRA), and amended by sections 524 and 713(f) of the Tax Reform Act of 1984 (Pub. L. 98–369):

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G. GENERAL PROVISIONS

G–1 Q. What requirement plans are subject to the top-heavy rules added to the Code by the Tax Equity and Fiscal Responsibility Act and amended by the Tax Reform Act of 1984?

A. All stock bonus, pension, or profit-sharing plans intended to qualify under section 401(a), annuity contracts described in section 403(a), and simplified employee pensions described in section 408(k) are subject to the new top-heavy rules added to the Code by the Tax Equity and Fiscal Responsibility Act and amended by the Tax Reform Act (''TRA'') of 1984.

G–2 Q. Is a multiple employer plan subject to the top-heavy requirements of section 416?

A. A multiple employer plan is subject to the requirements of section 416, but only with respect to each individual employer. Thus, if twelve employers contribute to a multiple employer plan and the accrued benefits for the key employees of one employer exceed 60 percent of the accrued benefits of all employees for such employer, the plan is top-heavy with respect to that employer. A failure by the multiple employer plan to satisfy section 416 with respect to the employees of such employer means that all employers are maintaining a plan that is not a qualified plan.

G–3 Q. As of what date must plan amendments to comply with top-heavy rules be effective?

A. Amendments required to comply with the top-heavy rules must be effective as of the first day of the first plan year which begins after 1983. See § 1.401(b)–1 for the date by which such amendments must be adopted.

T. TOP-HEAVINESS DETERMINATIONS

T–1 Q. What factors must be considered in determining whether a plan is top-heavy?

A. (a) In order to determine whether a plan is top-heavy for a plan year, it is necessary to determine which employers will be treated as a single employer for purposes of section 416; what the determination date is for the plan year; which employees are or formerly were key employees; which former employees have not performed any service

for the employer maintaining the plan at any time during the five-year period ending on the determination date; which plans of such employers are required or permitted to be aggregated to determine top-heavy status; and the present value of the accrued benefits (including distributions made during the plan year containing the determination date and the four preceding plan years) of key employees, former key employees, and non-key employees.

(b) All employers that are aggregated under section 414 (b), (c), and (m) must be taken into account as a single employer for the plan year in question, and those employees in all plans maintained by the employers that are aggregated must be categorized as key employees, as former key employees, or as non-key employees. See Question and Answer T–12 for the determination of which employees are or were key employees. All plans maintained by the employers in which a key employee participates, and certain other plans, must then be aggregated (the required aggregation group). See Question and Answer T–6 for rules concerning required aggregation. Other plans may in some cases be aggregated with the required aggregation group. See Question and Answer T–7 for rules concerning such permissive aggregation.

(c) Once aggregated, all plans that are required to be aggregated will either be top-heavy or not top-heavy, depending upon whether the aggregation group is top-heavy. A plan or aggregation group will be considered top-heavy if the sum of the present value of the accrued benefits for key employees is more than 60 percent of the sum of the present value of accrued benefits of all employees.

(d) Except as otherwise stated, for purposes of section 416(g), an employee is an individual currently or formerly employed by an employer. Former key employees are non-key employees and are excluded entirely from the calculation to determine top-heaviness. In all cases, the present value of accrued benefits includes distributions made during the plan year containing the determination date and the preceding four plan years. See Questions and Answers T–24 and T–25 for rules concerning the account balances and present value of accrued benefits. For plan years beginning after December 31, 1984, the accrued benefit of an employee who has not performed any sevice for the employer maintaining the plan at any time during the five-year period ending on the determination date is excluded from the calculation to determine top-heaviness. However, if an employee performs no services for five years and then performs sevices, such employee's total accrued benefit is included in the calculation for top-heaviness.

T–2 Q. To what extent are multiemployer plans and multiple employer plans to which an employer makes contributions on behalf of its employees treated as plans of that employer for top-heavy purposes?

A. Multiemployer plans described in section 414(f) and multiple employer plans described in section 413(c) to which an employer makes contributions on behalf of its employees are treated as plans of that employer to the extent that benefits under the plan are provided to employees of the employer because of service with that employer.

T–3 Q. Must a collectively-bargained plan be aggregated with other plans of the employer to determine whether some or all of the employer's plans are top-heavy?

A. A collectively-bargained plan that includes a key employee of an employer must be included in the required aggregation group for that employer. See Question and Answer T–6 for rules concerning required aggregation. A collectively-bargained plan that does not include a key employee may be included in a permissive aggregation group. See Question and Answer T–7 for rules concerning permissive aggregation. However, the special rules in section 416 (b), (c), or (d) applicable to top-heavy plans do not apply with respect to any employee included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective-bargaining agreement between employee representatives and one or more employers if there is evidence that retirement benefits were the subject of good faith bargaining between such employee representatives

and such employer or employers. In determining whether there is a collective-bargaining agreement between employee representatives and one or more employers, the additional condition of section 7701(a)(46) must be satisfied after March 31, 1984.

T–4 Q. How is a terminated plan treated for purposes of the top-heavy rules?

A. A terminated plan is treated like any other plan for purposes of the top-heavy rules. For purposes of section 416, a terminated plan is one that has been formally terminated, has ceased crediting service for benefit accruals and vesting, and has been or is distributing all plan assets to participants or their beneficiaries as soon as administratively feasible. Such a plan must be aggregated with other plans of the employer if it was maintained within the last five years ending on the determination date for the plan year in question and would, but for the fact that it terminated, be part of a required aggregation group for such plan year. Distributions which have taken place within the five years ending on the determination date must be accounted for in accordance with section 416(g)(3). No additional vesting, benefit accruals or contributions must be provided for participants in a terminated plan.

T–5 Q. How are frozen plans treated for purposes of the top-heavy rules?

A. For purposes of section 416, a frozen plan is one in which benefit accruals have ceased but all assets have not been distributed to participants or their beneficiaries. Such plans are treated, for purposes of the top-heavy rules, as any non-frozen plan. That is, such plans must provide minimum contributions or benefit accruals, limit the amount of compensation which can be taken into account in providing benefits, and provide top-heavy vesting. A frozen defined contribution plan may not be required to provide additional contributions because of the rule in section 416(c)(2)(B).

T–6 Q. What is a required aggregation group?

A. For purposes of determining whether the plans of an employer are top-heavy for a particular plan year, the required aggregation group includes each plan of the employer in which a key employee participates in the plan year containing the determination date, or any of the four preceding plan years. In addition, each other plan of the employer which, during this period, enables any plan in which a key employee participates to meet the requirements of section 401(a)(4) or 410 is part of the required aggregation group. This concept may be illustrated by the following examples:

Example 1. An employer maintains two plans. Key employees participate in one plan, but not in the other. If the plan containing key employees independently satisfies the coverage and non-discrimination rules of sections 410 and 401(a)(4), it may be tested independently to determine whether it is top-heavy. Also, the plan not covering key employees would not be part of a required aggregation group and would not need to be tested to determine whether it is top-heavy. However, if the plan containing key employees satisfies the coverage requirements of section 410(b) or the non-discrimination requirements of section 401(a)(4) only when it is considered together with the other plan in accordance with §1.410(b)–1(d)(3), the plan not covering key employees would be part of the required aggregation group.

Example 2. A sole proprietor terminated a Keogh plan in 1981. In 1982, the sole proprietor incorporated and established a corporate plan with a calendar-year plan year. For purposes of determining whether the corporate plan is top-heavy for its 1984 plan year, the terminated Keogh plan and the corporate plan would be part of a required aggregation group. The sole proprietor and the corporation would be treated as a single employer under section 414(c). Under Question and Answer T–4, the terminated plan would be aggregated with the corporate plan because it was maintained within the five-year period ending on the determination date for the 1984 plan year and because, but for the fact that it terminated, it would be aggregated with the corporate plan because it covered a key employee.

T–7 Q. What is a permissive aggregation group?

A. A permissive aggregation group consists of plans of the employer that are required to be aggregated, plus one or more plans of the employer that are not part of a required aggregation group but that satisfy the requirements of sections 401(a)(4) and 410 when considered together with the required aggregation group. This concept may

be illustrated by the following examples:

Example 1. (a) An employer maintains two plans:

1. Plan A covers key employees and independently satisfies the requirements of sections 410 and 401(a)(4).

2. Plan B covers no key employees. It also independently satisfies the requirements of sections 410 and 401(a)(4).

(b) As indicated in Question and Answer T–6, Plan B is not required to be aggregated with Plan A. Further, if Plan B provided contributions or benefits that were not at least comparable to the contributions or benefits provided under Plan A, then Plan B could not be permissively aggregated with Plan A because the contributions and benefits would discriminate if the two plans were considered as a unit. However, if the benefits or contributions under Plan B were comparable to those under Plan A, the two plans would be permitted to be aggregated to determine whether or not the group consisting of both plans is top-heavy. If Plan A and Plan B are permitted to be aggregated, and if the permissive aggregation group is not top-heavy, then neither Plan A nor Plan B would be considered top-heavy.

Example 2. (a) Employer W maintains two plans.

1. Plan C covers salaried employees and independently satisfies the requirements of sections 410 and 401(a)(4).

2. Plan D covers employees who are included in a unit of employees covered by an agreement which the Secretary of Labor has found to be a collective-bargaining agreement between employee representatives and the employer and retirement benefits were bargained for between employee representatives and the employer.

(b) The fact that Plan D is a collectively-bargained plan does not necessarily mean that it may be permissively aggregated with Plan C. In order to be permissively aggregated with Plan C, Plan D must provide contributions or benefits with respect to service with Employer W that are at least comparable to the contributions or benefits provided under Plan C.

T–8 Q. May an employer permissively aggregate multiemployer plans, multiple employer plans and simplified employee pension plans to which the employer contributes with a plan covering key employees or a required aggregated group?

A. Yes. Multiemployer plans, multiple employer plans and simplified employee pensions to which an employer makes contributions may be permissively aggregated with a plan covering key employees or with a required aggregation group if the contributions or benefits provided under the multiemployer plan, multiple employer plan or simplified employee pension by the employer are comparable to the contributions or benefits provided under the plan covering key employees or the plans in the required aggregation group. In making this determination, only the employer's contribution to the simplified employee pension may be used.

T–9 Q. What plans will be treated as top-heavy if they are part of a required aggregation group that is top-heavy?

A. In the case of plans that are required to be aggregated, each plan in the required aggregation group will be top-heavy if the group is top-heavy. No plan in the required aggregation group will be top-heavy if the group is not top-heavy.

T–10 Q. If a required aggregation group is top-heavy, and one plan of the group satisfies the requirements of sections 416 (b), (c), and (d), may other plans in the group include provisions which do not satisfy sections 416 (b), (c) and (d)?

A. No. Each plan in a required aggregation group is top-heavy if the group is top-heavy. Thus, each plan must contain provisions satisfying the requirements of sections 416 (b) and (d). If all the plans are defined contribution plans, only one plan need satisfy the requirements of section 416(c)(2) with respect to any non-key employee who participates in more than one of the plans. If all the plans are defined benefit plans, only one plan need satisfy the requirements of section 416(c)(1) with respect to any non-key employee who participates in more than one of the plans. However, in the case of non-key employees who do not participate in more than one plan, each plan must separately provide the applicable minimum contribution or benefit with respect to each such employee. See Question and Answer M–12 in the case of employees who are covered under both a defined benefit and a defined contribution plan.

T–11 Q. What plans will be treated as top-heavy if a permissive aggregation group is top-heavy?

A. If a permissive aggregation group is top-heavy, only those plans that are

part of the required aggregation group will be subject to the requirements of section 416 (b), (c) and (d). Plans that are not part of the required aggregation group will not be subject to these requirements. Thus, if an employer wishes to demonstrate that the plans maintained by the employer are not top-heavy, the employer need consider only the required aggregation group. If, after considering the required aggregation group, it is determined that the plans are not top-heavy, the requirements of section 416 (b), (c) and (d) will not apply to any of the plans. If, on the other hand, the plans required to be aggregated are top-heavy, the employer may wish to determine whether there are any plans that may be permissively aggregated to demonstrate that the plans are not top-heavy. Assuming that there are plans that are eligible for permissive aggregation, the employer may take these plans into consideration. If, after taking such plans into consideration, the net result is that the entire group is not top-heavy, the top-heavy requirements do not apply to any plan in the group.

T–12 Q. For purposes of determining whether a plan is top-heavy for a plan year, who is a key employee?

A. Under section 416(i)(1), a key employee is any employee (including any deceased employee) who at any time during the plan year containing the determination date for the plan year in question or the four preceding plan years (including plan years before 1984) is:

1. An officer of the employer having annual compensation from the employer for a plan year greater than 150 percent of the dollar limitation in effect under section 415(c)(1)(A) for the calendar year in which such plan year ends (see Questions and Answers T–13, T–14, and T–15),

2. One of the ten employees having annual compensation from the employer for a plan year greater than the dollar limitation in effect under section 415(c)(1)(A) for the calendar year in which such plan year ends and owning (or considered as owning within the meaning of section 318) both more than a ½ percent interest and the largest interests in the employer (see Question and Answer T–19),

3. A 5-percent owner of the employer, or

4. A 1-percent owner of the employer having annual compensation from the employer for a plan year more than $150,000 (see Questions and Answers T–16 and T–21).

An individual may be considered a key employee in a plan year for more than one reason. For example, an individual may be both an officer and one of the ten largest owners. However, in testing whether a plan or group is top-heavy, an individual's accrued benefit is counted only once. The terms key employee, former key employee, and non-key employee include the beneficiaries of such individuals. This Question and Answer is illustrated by the following examples:

Example 1. An employer maintains a calendar-year plan. An individual who was an employee of the employer and a 5-percent owner of the employer in 1986 was neither an employee nor an owner in 1987 or thereafter. Even though the individual is no longer an employee or owner of the employer, the individual would be treated as a key employee for purposes of determining whether the plan is top-heavy for each plan year through the 1991 plan year. However, for purposes of determining whether the plan is top-heavy for the 1992 plan year and for subsequent plan years, the individual would be treated as a former key employee.

Example 2. The facts are the same as in example (1), except that the individual died in early 1987 and his total benefit under the plan was distributed to his beneficiary in 1987. Such distribution would be treated as the accrued benefit of the individual for each year through the 1991 plan year. However, such individual would be treated as a former key employee for purposes of determining whether the plan is top-heavy for the 1992 plan year and for subsequent plan years. The conclusions are not affected by whether the beneficiary of the individual is a non-key employee or a key employee of the employer.

T–13 Q. For purposes of defining a key employee, who is an officer?

A. Whether an individual is an officer shall be determined upon the basis of all the facts, including, for example, the source of his authority, the term for which elected or appointed, and the nature and extent of his duties. Generally, the term officer means an administrative executive who is in regular and continued service. The term officer implies continuity of service

and excludes those employed for a special and single transaction. An employee who merely has the title of an officer but not the authority of an officer is not considered an officer for purposes of the key employee test. Similarly, an employee who does not have the title of an officer but has the authority of an officer is an officer for purposes of the key employee test. In the case of one or more employers treated as a single employer under sections 414(b), (c), or (m), whether or not an individual is an officer shall be determined based upon his responsibilities with respect to the employer or employers for which he is directly employed, and not with respect to the controlled group of corporations, employers under common control or affiliated service group. A partner of a partnership will not be treated as an officer for purposes of the key employee test merely because he owns a capital or profits interest in the partnership, exercises his voting rights as a partner, and may, for limited purposes, be authorized and does in fact act as an agent of the partnership.

T–14 Q. For purposes of determining whether a plan is top-heavy for a plan year, how many officers must be taken into account?

A. There is no minimum number of officers that must be taken into account. Only individuals who are in fact officers within the meaning of Question and Answer T–13 must be considered. For example, a corporation with only one officer and two employees would have only one officer for purposes of section 416(i)(1)(A)(i). After aggregating all employees (including leased employees within the meaning of section 414(n)) of employers required to be aggregated under section 414(b), (c) or (m), there is a maximum limit to the number of officers that are to be taken into account as officers for the entire group of employers that are so aggregated. The number of employees an employer (including all employers required to be aggregated under section 414(b), (c), or (m)) has for the plan year containing the determination date is the greatest number of employees it had during that plan year or any of the four preceding plan years. For purposes of this Question and Answer, employees include only those individuals who perform services for the employer during a plan year. If the number of employees (including part-time employees) of all the employers aggregated under section 414(b), (c) or (m) is less than 30 employees, no more than three individuals shall be treated as key employees for the plan year containing the determination date by reason of being officers. If the number of employees of all organizations aggregated under section 414(b), (c) or (m) is greater than 30 but less than 500, no more than 10% of the number of employees will be treated as key employees by reason of being officers. (If 10% of the number of employees is not an integer, the maximum number of individuals to be treated as key employees by reason of being officers shall be increased to the next integer). If the number of employees of employers aggregated under section 414 (b), (c) and (m) exceeds 500, no more than 50 employees are to be considered as key employees by reason of being officers. This limited number of officers is comprised of the individual officers, selected from the group of all individuals who were officers in the plan year containing the determination date or any one of the four preceding plan years, who had annual plan year compensation (in the officer year) in excess of 150 percent of the dollar limitation in effect under section 415(c)(1)(A) for the calendar year in which the plan year ends and who had the largest annual plan-year compensation in that five-year period. (The definition of compensation contained in Question and Answer T–21 is to be used for this purpose.) In determining the officers of an employer, an employee who is an officer shall be counted as an officer for key employee purposes without regard to whether the employee is a key employee for any other reason. However, in testing whether the plan(s) is top-heavy, an individual's present value of accrued benefits is counted only once.

Example. A company is testing to see if its plan is top-heavy for the 1985 plan year. In each year from 1980 through 1984 it has more than 500 employees. Assume that (1) because of rapid turnover among officers, the individuals who are officers each year are different from the individuals who are officers in any preceding year, and (2) the annual plan year

compensation of each officer exceeds 150 percent of the dollar limitation in effect under section 415(c)(1)(A) for the calendar year in which the plan year ends. Under the limitations, only a total of 50 individuals would be considered to be key employees by virtue of being officers in testing for top-heaviness for the 1985 plan year. Further, the 50 individuals considered as key employees under this test would be determined by selecting the 50 out of 250 individuals (50 different officers each year) who had the highest annual plan-year compensation during the 1980–1984 period (while officers).

T–15 Q. For purposes of section 416, do organizations other than corporations have officers?

A. Yes. For purposes of the top-heavy rules, sole proprietorships, partnerships, associations, trusts, and labor organizations may have officers. This rule is effective for purposes of determining whether a plan is top-heavy for plan years which begin after February 28, 1985.

T–16 Q. Who is a 1-percent owner of the employer?

A. (a) If the employer is a corporation, a 1-percent owner is any employee who owns (or is considered as owning within the meaning of section 318) more than 1 percent of the value of the outstanding stock of the corporation or stock possessing more than 1 percent of the total combined voting power of all stock of the corporation. If the employer is not a corporation, a 1-percent owner is any employee who owns more than 1 percent of the capital or profits interest in the employer. The rules of subsections (b), (c), and (m) of section 414 do not apply for purposes of determining who is a 1-percent owner.

(b) For purposes of determining who is a 1-percent owner, 5-percent owner, or top-ten owner, value means fair market value taking into account all facts and circumstances.

T–17 Q. Who is a 5-percent owner of the employer?

A. If the employer is a corporation, a 5-percent owner is any employee who owns (or is considered as owning within the meaning of section 318) more than 5 percent of the value of the outstanding stock of the corporation or stock possessing more than 5 percent of the total combined voting power of all stock of the corporation. If the employer is not a corporation, a 5-percent owner is any employee who owns more than 5 percent of the capital or profits interest in the employer. The rules of subsections (b), (c), and (m) of section 414 do not apply for purposes of determining who is a 5-percent owner.

T–18 Q. How do the rules of section 318 apply for purposes of determining ownership in an entity other than a corporation?

A. For purposes of determining ownership is an entity other than a corporation, the rules of section 318 apply in a manner similar to the way in which they apply for purposes of determining ownership in a corporation. For non-corporate interests, capital or profits interest must be substituted for stock.

T–19 Q. Which employees will be considered one of the top ten owners?

A. (a) For purposes of determining whether a plan is top-heavy for a plan year, the top ten owners are the ten employees who (1) own (or are considered as owning within the meaning of section 318) during the plan year containing the determination date or any of the four preceding plan years both more than a ½ percent ownership interest in value and the largest percentage ownership interests in value of any of the employers required to be aggregated under section 414(b), (c), or (m), and (2) have during the plan year of ownership annual plan year compensation from the employer more than the limitation in effect under section 415(c)(1)(A) for the calendar year in which such plan year ends. The five years for which the test is made will be referred to as the ''testing period.'' An employee whose annual plan year compensation exceeds the section 415(c)(1)(A) limit in effect for the calendar year in which a plan year in the testing period ends who has an ownership interest greater than ½ percent in that plan year is considered to be one of the top ten owners unless at least ten other employees own a greater interest in the employer during any year of the testing period and have annual plan year compensation during such plan year of ownership greater than the section 415(c)(1)(A) limit in effect for the calendar year in which such plan year ends. Ownership each plan

year is determined on the basis of percentage of ownership interest in total ownership value and not dollar amounts. Thus, an employee whose stock interest is valued at 15 percent of the total stock value of a corporation in year one that was worth $15,000 is ranked higher than an employee whose stock interest is valued at 5 percent of the total stock value of the same corporation in year three which is now worth $50,000.

(b) If an employee's ownership interest changes during a plan year, his ownership interest for the year is the largest interest owned at any time during the year. If two employees have the same ownership interest in the employer during the testing period, the employee having the largest annual compensation from the employer for the plan year during any part of which that ownership interest existed shall be treated as having a larger interest. Thus, if 25 employees each own 4 percent in value of the employer during the testing period, the 10 employees with the largest single plan year compensation during this period will be considered the top ten owners. For purposes of this Question and Answer, compensation has the meaning set forth in Question and Answer T–21. This Question and Answer is illustrated by the following examples:

Example 1. Corporation K maintains a calendar year defined contribution plan. On January 1, 1986, Corporation K has five owners who owned the following value percentages of K stock: A = 50%, B = 20%, C = 15%, D = 10%, and E = 5%. On June 30, 1987, the five owners of Corporation K sold all of their shares of stock. The new owners and their respective ownership percentages were: F = 40%, G = 30%, H = 10%, I = 10%, and J = 10%. Assume that, for 1986, A, B, C, D, and E had annual compensation from Corporation K greater than the section 415(c)(1)(A) limit and that, for 1987, F, G, H, I, and J also had compensation from Corporation K greater than the section 415(c)(1)(A) limit. For purposes of determining whether the plan is top-heavy for the 1991 plan year, the top ten owners will include A, B, C, D, E, F, G, H, I, and J because no 10 individuals during the testing period, 1986–1990, had a greater ownership interest than these individuals.

Example 2. Assume the same facts in *Example 1*, except that on June 1, 1988, F, G, H, I, and J sold their interests to new owners, K, L, M, N, and O. K, L, M, N, and O owned, respectively, 30%, 30%, 30%, 5% and 5% of the value of the shares of X. Assume also that for 1988 K, L, M, N, and O earned more than the section 415(c)(1)(A) limitation. For purposes of determining whether the plan is top-heavy for the 1991 plan year, the top ten owners will include: A, B, F, K, G, L, M, and C because these eight individuals owned the highest value percentages of the Corporation K stock. Since D, H, I, and J owned equal 10% interests in value, the two employees of this group who had the largest annual plan year compensation during the plan years of their ownership will be the last 2 top ten owners.

T–20 Q. For purposes of determining whether an employee is a key employee under section 416(i)(1)(A), what aggregation rules apply?

A. In the case of ownership percentages, each employer that would otherwise be aggregated under section 414 (b), (c) and (m) is treated as a separate employer. (See section 416(i)(1)(C).) However, for purposes of determining whether an individual has compensation of $150,000, or whether an individual is a key employee by reason of being an officer or a top ten owner, compensation from each entity required to be aggregated under sections 414 (b), (c) and (m) is taken into account. These rules may be illustrated by the following example:

Example. An individual owns two percent of the value of a professional corporation, which in turn owns a 1/10th of 1 percent interest in a partnership. The entities must be aggregated in accordance with section 414(m). The individual performs services for the professional corporation and for the partnership. The individual receives compensation of $125,000 from the professional corporation and $26,000 from the partnership. The individual is considered to be a key employee with respect to the employer that comprises both the professional corporation and the partnership because he has a two percent interest in the professional corporation and because his combined compensation from both the professional corporation and the partnership is more than $150,000.

T–21. Q. For purposes of testing whether an individual has compensation of more than $150,000, what definition of compensation must be used?

A. The definition of compensation to be used is the definition in §1.415(c)–2, however, compensation must be determined for a plan year, not a limitation year. Alternatively, compensation that would be stated on an employee's Form

W–2, ''Wage and Tax Statement,'' for the calendar year that ends with or within the plan year may be used, although amounts that would have been stated on the employee's Form W–2 but for an election under section 125, 132(f)(4), 401(k), 403(b), 408(k), 408(p)(2)(A)(i), or 457(b) must be included. A plan must use the same definition of compensation for all top-heavy plan purposes for which the definition in this Q and A must be used.

T–22 Q. In the case of an employer who maintains a single plan, when must the determination whether the plan is top-heavy be made?

A. Whether a plan is top-heavy for a particular plan year is determined as of the determination date for such plan year. The determination date with respect to a plan year is defined in section 416(g)(4)(C) as (1) the last day of the preceding plan year, or (2) in the case of the first plan year, the last day of such plan year. Distributions made and the present value of accrued benefits are generally determined as of the determination date. (See Questions and Answers T–24 and T–25 for more specific rules.)

T–23 Q. In the case of an aggregation group, when must the determination whether the group is top-heavy be made?

A. When two or more plans constitute an aggregation group in accordance with section 416(g)(2), the following procedures are used to determine whether the plans are top-heavy for a particular plan year. First, the present value of the accrued benefits (including distributions for key employees and all employees) is determined separately for each plan as of each plan's determination date. The plans are then aggregated by adding together the results for each plan as of the determination dates for such plans that fall within the same calendar year. The combined results will indicate whether or not the plans so aggregated are top-heavy. These rules may be illustrated by the following example:

Example. An employer maintains Plan A and Plan B, each containing a key employee. Plan A's plan year commences July 1 and ends June 30. Plan B's plan year is the calendar year. For Plan A's plan year commencing July 1, 1984, the determination date is June 30, 1984. For Plan B's plan year in 1985, the determination date is December 31, 1984. These plans are required to be aggregated. For each of these plans as of their respective determination dates, the present value of the accrued benefits for key employees and all employees are separately determined. The two determination dates, June 30, 1984, and December 31, 1984, fall within the same calendar year. Accordingly, the present values of accrued benefits as of each of these determination dates are combined for purposes of determining whether the group is top-heavy. If, after combining the two present values, the total results show that the group is top-heavy, Plan A will be top-heavy for the plan year commencing July 1, 1984, and Plan B will be top-heavy for the 1985 calendar year.

T–24 Q. How is the present value of an accrued benefit determined in a defined contribution plan?

A. The present value of accrued benefits as of the determination date for any individual is the sum of (a) the account balance as of the most recent valuation date occurring within a 12-month period ending on the determination date, and (b) an adjustment for contributions due as of the determination date. In the case of a plan not subject to the minimum funding requirements of section 412, the adjustment in (b) is generally the amount of any contributions actually made after the valuation date but on or before the determination date. However, in the first plan year of the plan, the adjustment in (b) should also reflect the amount of any contributions made after the determination date that are allocated as of a date in that first plan year. In the case of a plan that is subject to the minimum funding requirements, the account balance in (a) should include contributions that would be allocated as of a date not later than the determination date, even though those amounts are not yet required to be contributed. Thus, the account balance will include contributions waived in prior years as reflected in the adjusted account balance and contributions not paid that resulted in a funding deficiency. The adjusted account balance is described in Rev. Rul. 78–223, 1978–1 C.B. 125. Also, the adjustment in (b) should reflect the amount of any contribution actually made (or due to be

made) after the valuation date but before the expiration of the extended payment period in section 412(c)(10).

T–25. Q. How is the present value of an accrued benefit determined in a defined benefit plan?

A. The present value of an accrued benefit as of a determination date must be determined as of the most recent valuation date which is within a 12-month period ending on the determination date. In the first plan year of a plan, the accrued benefit for a current employee must be determined either (i) as if the individual terminated service as of the determination date or (ii) as if the individual terminated service as of the valuation date, but taking into account the estimated accrued benefit as of the determination date. For the second plan year of a plan, the accrued benefit taken into account for a current participant must not be less than the accrued benefit taken into account for the first plan year unless the difference is attributable to using an estimate of the accrued benefit as of the determination date for the first plan year and using the actual accrued benefit as of the determination date for the second plan year. For any other plan year, the accrued benefit for a current employee must be determined as if the individual terminated service as of such valuation date. For this purpose, the valuation date must be the same valuation date for computing plan costs for minimum funding, regardless of whether a valuation is performed that year.

T–26. Q. What actuarial assumptions are used for determining the present value of accrued benefits for defined benefit plans?

A. (a) There are no specific prescribed actuarial assumptions that must be used for determining the present value of accrued benefits. The assumptions used must be reasonable and need not relate to the actual plan and investment experience. The assumptions need not be the same as those used for minimum funding purposes or for purposes of determining the actuarial equivalence of optional benefits under the plan. The accrued benefit for each current employee is computed as if the employee voluntarily terminated service as of the valuation date. The present value must be computed using an interest and a post-retirement mortality assumption. Pre-retirement mortality and future increases in cost of living (but not in the maximum dollar amount permitted by section 415) may also be assumed. However, assumptions as to future withdrawals or future salary increases may not be used. In the case of a plan providing a qualified joint and survivor annuity within the meaning of section 401(a)(11) as a normal form of benefit, for purposes of determining the present value of the accrued benefit, the spouse of the participant may be assumed to be the same age as the participant.

(b) Except in the case where the plan provides for a nonproportional subsidy, the present value should reflect a benefit payable commencing at normal retirement age (or attained age, if later). Thus, benefits not relating to retirement benefits, such as pre-retirement death and disability benefits and post-retirement medical benefits, must not be taken into account. Further, subsidized early retirement benefits and subsidized benefit options must not be taken into account unless they are nonproportional subsidies. See Question and Answer

T–27.

(c) Where the plan provides for a nonproportional subsidy, the benefit should be assumed to commence at the age at which the benefit is most valuable. In the case of two or more defined benefit plans which are being tested for determining whether an aggregation group is top-heavy, the actuarial assumptions used for all plans within the group must be the same. Any assumptions which reflect a reasonable mortality experience and an interest rate not less than five percent or greater than six percent will be considered as reasonable. Plans, however, are not required to use an interest rate in this range.

T–27 Q. In determining the present value of accrued benefits in a defined benefit plan, what standards are applied toward determining whether a subsidy is nonproportional?

A. A subsidy is nonproportional unless the subsidy applies to a group of employees that would independently satisfy the requirements of section

410(b). If two or more plans are considered as a unit for comparability purposes under §1.410(b)–1(d)(3), subsidies may be necessary in both plans or else the subsidy may be nonproportional. Thus, for example, in the case of a plan which provides an early retirement benefit after age 55 and 20 years of service equal to the normal retirement benefit without actuarial reduction and if the employees who may conceivably reach age 55 with 20 years of service would, as a group, satisfy the requirements of section 410(b), that subidy is proportional. However, in contrast, consider a plan that provides an early retirement benefit that is the actuarial equivalent of the normal retirement benefit. In determining the early retirement benefit, the plan imposes the section 415 limits only on the early retirement benefit (not on the normal retirement benefit before applying the early retirement reduction factors). In such a plan, a participant with a normal retirement benefit (before limitation by section 415) in excess of the section 415 limits will receive a subsidized early retirement benefit, whereas a participant with a lower normal retirement benefit will not. Thus, such a benefit would be a nonproportional subsidy if the group of individuals who are limited by the limitations under section 415 do not, by themselves, constitute a cross section of employees that could satisfy section 410(b).

T–28 Q. For purposes of determining the present value of accrued benefits in either a defined benefit or defined contribution plan, are the accrued benefits attributable to employee contributions considered to be part of the accrued benefits?

A. The accrued benefits attributable to employee contributions are considered to be part of the accrued benefits without regard to whether such contributions are mandatory or voluntary. However, the amounts attributable to deductible employee contributions (as defined in section 72(o)(5)(A)) are not considered to be part of the accrued benefits.

T–29 Q. How are plans described in section 401(k) treated for purposes of the top-heavy rules?

A. No special top-heavy rules are provided for plans described in section 401(k), except a transitional rule. For plan years beginning after December 31, 1984, amounts which an employee elects to defer are treated as employer contributions for purposes of determining minimum required contributions under section 416(c)(2). However, for plan years beginning prior to January 1, 1985, amounts which an employee elects to have contributed to a plan described in section 401(k) are not treated as employer contributions for these purposes. A plan described in section 401(k) which is top-heavy must provide minimum contributions by the employer and limit the amount of compensation which can be taken into account in providing benefits under the plan.

T–30 Q. What distributions are added to the present value of accrued benefits in determining whether a plan is top-heavy for a particular plan year?

A. Under section 416(g)(3)(A), distributions made within the plan year that includes the determination date and within the four preceding plan years are added to the present value of accrued benefits of key employees and non-key employees in testing for top-heaviness. However, in the case of distributions made after the valuation date and prior to the determination date, such distributions are not included as distributions in section 416(g)(3)(A) to the extent that such distributions are included in the present value of the accrued benefits as of the valuation date. In the case of the distribution of an annuity contract, the amount of such distribution is deemed to be the current actuarial value of the contract, determined on the date of the distribution. Certain distributions that are rolled over by the employee are not included as distributions. See Question and Answer T–32. A distribution will not fail to be considered in determining the present value of accrued benefits merely because it was made before the effective date of section 416. For purposes of this question and answer, distributions mean all distributions made by a plan, including all distributions of employee contributions made during and before the plan year.

T–31 Q. Are benefits paid on account of death treated as distributions for purposes of section 416(g)(3)?

A. Benefits paid on account of death are treated as distributions for purposes of section 416(g)(3) to the extent such benefits do not exceed the present value of accrued benefits existing immediately prior to death; benefits paid on account of death are not treated as distributions for purposes of section 416(g)(3) to the extent such benefits exceed the present value of accrued benefits existing immediately prior to death. The distribution from a defined contribution plan (including the cash value of life insurance policies) of a participant's account balance on account of death will be treated as a distribution for purposes of section 416(g)(3).

T–32 Q. How are rollovers and plan-to-plan transfers treated in testing whether a plan is top-heavy?

A. The rules for handling rollovers and transfers depend upon whether they are unrelated (both initiated by the employee and made from a plan maintained by one employer to a plan maintained by another employer) or related (a rollover or transfer either not initiated by the employee or made to a plan maintained by the same employer). Generally, a rollover or transfer made incident to a merger or consolidation of two or more plans or the division of a single plan into two or more plans will not be treated as being initiated by the employee. The fact that the employer initiated the distribution does not mean that the rollover was not initiated by the employee. For purposes of determining whether two employers are to be treated as the same employer, all employers aggregated under section 414(b), (c) or (m) are treated as the same employer. In the case of unrelated rollovers and transfers, (1) the plan making the distribution or transfer is to count the distribution as a distribution under section 416(g)(3), and (2) the plan accepting the rollover or transfer is not to consider the rollover or transfer as part of the accrued benefit if such rollover or transfer was accepted after December 31, 1983, but is to consider it as part of the accrued benefit if such rollover or transfer was accepted prior to January 1, 1984. In the case of related rollovers and transfers, the plan making the distribution or transfer is not to count the distribution or transfer under section 416(g)(3) and the plan accepting the rollover or transfer counts the rollover or transfer in the present value of the accrued benefits. Rules for related rollovers and transfers do not depend on whether the rollover or transfer was accepted prior to January 1, 1984.

T–33 Q. How are the aggregate defined benefit and defined contribution limits under section 415(e) affected by the top-heavy rules?

A. Section 416(h) modifies the aggregate limits in section 415(e) for super top-heavy plans and for top-heavy plans that are not super top-heavy but do not provide for an additional minimum contribution or benefit. A plan is a super top-heavy plan if the present value of accrued benefits for key employees exceeds 90% of the present value of the accrued benefits for all employees. In the case of a top-heavy aggregation group, the test is applied to all plans in the group as a whole. These present values are computed using the same rules as are used for determining whether the plan is top-heavy. In the case of a super top-heavy plan, in computing the denominators of the defined benefit and defined contribution fractions under section 415(e), a factor of 1.0 is used instead of 1.25 for all employees. In the case of a top-heavy plan that is not super top-heavy, the same rule applies unless each non-key employee who is entitled to a minimum contribution or benefit receives an additional minimum contribution or benefit. In the case of a defined benefit plan, the additional minimum benefit is one percentage point (up to a maximum of ten percentage points) for each year of service described in Question and Answer M–2 of the participant's average compensation for the years described in Question and Answer M–2. In the case of a defined contribution plan, the additional minimum contribution is one percent of the participant's compensation. If a plan does not provide the applicable additional one percent minimum or if a plan is super top-heavy, the factor of 1.25 may be used for an individual only if there

are both no further accruals for that individual under any defined benefit plan and no further annual additions for that individual under any defined contribution plan until the combined fraction satisfies the rules of section 415(e) using the 1.0 factor for that individual. The rules contained in this Question and Answer apply for each limitation year that contains any portion of a plan year for which the plan is top-heavy. This Question and Answer may be illustrated by the following example:

Example. A Corporation maintains a profit-sharing plan and a defined benefit plan, and these plans constitute a required aggregation group. Both plans use the calendar year for the plan year and the limitation year under section 415. The plans were determined to be top-heavy for plan year 1986. The plans use the 1.25 factor under section 415(e), and non-key employees covered by both the profit-sharing and the defined benefit plan accrue, under the defined benefit plan, 3% of compensation for each year of service (up to a maximum of 30%). The plans become super top-heavy for the 1990 plan year. In order to satisfy section 415, no further accruals and no further annual additions may take place for any employee covered by both plans until the combined defined benefit-defined contribution fraction for such employee is less than 1.0, using the 1.0 factor in place of 1.25.

T–34 Q. May plans be permissively aggregated to avoid being super top-heavy?

A. Yes, plans may be permissively aggregated to avoid being super top-heavy.

T–35 Q. What provisions must be contained in a plan to comply with the top-heavy requirements?

A. Section 401(a)(10)(B) provides that a plan will qualify only if it contains provisions which will take effect if the plan becomes top-heavy and which meet the requirements of section 416. See Questions and Answers T–39 and T–40 for rules on what provisions must be included. Under section 401(a)(10)(B)(ii), regulations may waive this requirement for some plans. See Question and Answer T–38 for a description of plans that need not include such provisions.

T–36 Q. For an employer who has no employee who has participated or is eligible to participate in both a defined benefit and defined contribution plan (or a simplified employee pension, ''SEP'') of that employer, what provisions must be in the plan(s) to comply with the top-heavy requirements?

A. (a) If the defined benefit plan has no participants who are or could be participants in a defined contribution plan of the employer (or vice versa), the defined benefit plan (or defined contribution plan) need not include provisions describing the defined benefit or defined contribution fractions for purposes of section 415 and, thus, the plan need not contain provisions to determine whether the plan is super top-heavy or to change any plan provisions if the plan becomes super top-heavy. Furthermore, if the plan contains a single benefit structure that satisfies the requirements of section 416 (b), (c), and (d) for each plan year without regard to whether the plan is top-heavy for such year, the plan need not include separate provisions to determine whether the plan is top-heavy or that apply if the plan is top-heavy. If the plan's single benefit structure does not assure that section 416 (b), (c), and (d) will be satisfied in all cases, then the plan must include three types of provisions.

(b) First, the plan must contain provisions describing how to determine whether the plan is top-heavy. These provisions must include (1) the criteria for determining which employees are key employees (or non-key employees), (2) in the case of a defined benefit plan, the actuarial assumptions and benefits considered to determine the present value of accrued benefits, (3) a description of how the top-heavy ratio is computed, (4) a description of what plans (or types of plans) will be aggregated in testing whether the plan is top-heavy, and (5) a definition of the determination date and the valuation date applicable to the determination date. These determinations must be based on standards that are uniformly and consistently applied and that satisfy the rules set forth in section 416 and these Questions and Answers. The provisions in (1) and (3) above may be incorporated in the plan by reference to the applicable sections of the Internal Revenue Code without adversely affecting the qualification of the plan. However, the plan must state the definition of

compensation for purposes of determining who is a key employee.

(c) Second, the plan must specifically contain the following provisions that will become effective if the plan becomes top-heavy: vesting that satisfies the minimum vesting requirements of section 416(b), benefits that will not be less than the minimum benefits set forth in section 416(c), and the compensation limitation described in section 416(d). The compensation limitation described in section 416(d) may be incorporated by reference. If a plan always meets the requirements of either section 416(b), (c) or (d), the plan need not include additional provisions to meet any such requirements.

(d) Third, the plan must include provisions insuring that any change in the plan's benefit structure (including vesting schedules) resulting from a change in the plan's top-heavy status will not violate section 411(a)(10). Thus, if a plan ceases being top-heavy, certain restrictions apply with respect to the change in the applicable vesting schedule.

T–37 Q. For an employer who maintains or has maintained both a defined benefit and a defined contribution plan (or a simplified employee pension, ''SEP'') and some participants do or could participate in both types of plan, what provisions must be in the plans to comply with the top-heavy requirements?

A. If an employer maintains (or has maintained) both a defined benefit plan and a defined contribution plan (or SEP), and the plans have or could have participants who participate in both types of plans, then the plans must contain more provisions than those described in Question and Answer T-36. First, the plans may exclude rules to determine whether the plan is top-heavy (or to apply when the plan is top-heavy) only if both plans contain a single benefit structure that satisfies sections 416 (b), (c), and (d) without regard to whether the plans are top-heavy. Second, unless the plans always satisfy the requirements of section 415(e) using the 1.0 factor in the defined benefit and defined contribution fractions as described in section 416(h)(i), the plans must include provisions similar to those in Question and Answer T–36 (for top-heavy) to determine whether the plan is super top-heavy and to satisfy section 416(h) if it is.

T–38 Q. Are any plans exempted from including top-heavy provisions?

A. Section 401(a)(10)(B) exempts governmental plans (as defined in section 414(d)) from the top-heavy requirements and provides that regulations may exempt certain plans from including the top-heavy provisions. A plan need not include any top-heavy provisions if the plan: (1) is not top-heavy, and (2) covers only employees who are included in a unit of employees covered by a collective-bargaining agreement (if retirement benefits were the subject of good faith bargaining) or employees of employee representatives. The requirement set forth in section 7701(a)(46) must be met before an agreement will be considered a collective-bargaining agreement after March 31, 1984.

T–39 Q. Must ratios be computed each year to determine whether a plan is top-heavy?

A. No. In order to administer the plan, the plan administrator must know whether the plan is top-heavy. However, precise top-heavy ratios need not be computed every year. If, on examination, the Internal Revenue Service requests a demonstration as to whether the plan is top-heavy (or super top-heavy; see Question and Answer T–33) the employer must demonstrate to the Service's satisfaction that the plan is not operating in violation of section 401(a)(10)(B). For purposes of any demonstration, the employer may use computations that are not precisely in accordance with this section but which mathematically prove that the plan is not top-heavy. For example, if the employer determined the present value of accrued benefits for key employees in a simplified manner which overstated that value, determined the present value for non-key employees in a simplified manner which understated that value, and the ratio of the key employee present value divided by the sum of the present values was less than 60 percent, the plan would not be considered top-heavy. This would be a sufficient demonstration because the simplified fraction could be shown to be greater than the exact fraction and,

thus, the exact fraction must also be less than 60 percent.

Several methods that may be used to simplify the determinations are indicated below.

(1) If the top-heavy ratio, computed considering all the key employees and only some of the non-key employees, is less than 60 percent, then it is not necessary to accumulate employee data on the remaining non-key employees. Inclusion of additional non-key employees would only further decrease the ratio.

(2) If the number of key employees is known but the identity of the key employees is not known (i.e. if the only key employees are officers and the limit on officers is applicable), the numerator may be determined by using a hypothetical ''worst case'' basis. Thus, in the case of a defined benefit plan, if the numerator of the top-heavy ratio were determined assuming each key employee's present value of accrued benefits were equal to the maximum section 415 benefits at the age that would maximize such present value, that assumption would only overstate the present value of accrued benefits for key employees. Thus, if that ratio is less than 60 percent, the plan is not top-heavy and accurate data on the key employees need not be collected.

(3) If the employer has available present value of accrued benefit computations for key and non-key employees in a defined benefit plan, and these values differ from those that would be produced under Question and Answer T–25 only by inclusion of a withdrawal assumption, the present value for the key employees (but not the non-key employees) may be adjusted to a ''worst case'' value by dividing by the lowest possible probability of not withdrawing from plan participation before normal retirement age. If the top-heavy ratio based on this inflated key employee value is less than 60 percent, the present value need not be recomputed without the withdrawal assumption. The methods set forth in this answer may also be used to determine whether a plan is super top-heavy by inserting ''90%'' for ''60%'' in the appropriate places.

T–40 Q. Will a plan fail to qualify if it provides that the $200,000 maximum amount of annual compensation taken into account under section 416(d) for any plan year that the plan is top-heavy may be automatically increased in accordance with regulations under section 416?

A. No.

T–41 Q. If a plan provides benefits based on compensation in excess of $200,000 and the plan becomes top-heavy, must any accrued benefits attributable to this excess compensation be eliminated?

A. No. For any year that a plan is top-heavy, section 416(d) provides that compensation in excess of $200,000 must not be taken into account. However, a top-heavy plan may continue to provide for any benefits attributable to compensation in excess of $200,000 to the extent such benefits were accrued before the plan was top-heavy. Furthermore, section 411(d)(6) will be violated if any individual's pre-top-heavy benefit is reduced by either (1) a plan amendment adding the $200,000 restriction, or (2) an automatic change in the plan benefits structure imposing the $200,000 restriction due to the plan's becoming top-heavy.

T–42 Q. Under a top-heavy defined benefit plan, are the requirements of section 416(d) satisfied if the annual compensation of an employee taken into account to determine plan benefits is limited to the amount currently described in section 416(d) for years during which the plan is top-heavy but higher compensation is taken into account for years before the plan became top-heavy?

A. No. For the top-heavy plan to meet the requrements of section 416(d), compensation for all years, including years before the plan became top-heavy, that is taken into account to determine plan benefits must not exceed the amount currently described in section 416(d). However, if the accrued benefit as of the end of the last plan year before the plan became top-heavy (ignoring any plan amendments after that date) is greater than the accrued benefit determined by limiting compensation in accordance with section 416(d), that higher accrued benefit as of the end of the last plan year before the plan became top-heavy must not be reduced. Providing such higher accrued

benefit will not cause the plan to violate section 416(d).

T–43 Q. What happens to an individual who has ceased employment before a plan becomes top-heavy?

A. If an individual has ceased employment before a plan becomes top-heavy, such individual would not be required to receive any additional benefit accruals, contributions, or vesting, unless the individual returned to employment with the employer. See Questions and Answers V–3, M–4, and M–10. In addition, if the individual is receiving benefits based on annual compensation greater than $200,000, such benefits cannot be decreased.

V. VESTING RULES FOR TOP-HEAVY PLANS

V–1 Q. What vesting must be provided under a top-heavy plan?

A. Under section 416(b), the accrued benefits attributable to employer contributions must be nonforfeitable in accordance with one of two statutory standards. Either such accrued benefits must be nonforfeitable after 3 years of service or the nonforfeitable portion of accrued benefits must be at least 20 percent after 2 years of service, 40 percent after 3 years of service, 60 percent after 4 years of service, 80 percent after 5 years of service, and 100 percent after 6 years of service. The accrued benefits attributable to employer contributions has the same meaning as under section 411(c) of the Code. As under section 411(a), the accrued benefits attributable to employee contributions must be nonforfeitable at all times.

V–2 Q. What service must be counted in determining vesting requirements?

A. All service required to be counted under section 411(a) must be counted for these purposes. All service permitted to be disregarded under section 411(a)(4) may similarly be disregarded under the schedules of section 416(b).

V–3 Q. What benefits must be subject to the minimum vesting schedule of section 416(b)?

A. All accrued benefits within the meaning of section 411(a)(7) must be subject to the minimum vesting schedule. These accrued benefits include benefits accrued before the effective date of section 416 and benefits accrued before a plan becomes top-heavy. However, when a plan becomes top-heavy, the accrued benefits of any employee who does not have an hour of service after the plan becomes top-heavy are not required to be subject to the minimum vesting schedule. Accrued benefits which have been forfeited before a plan becomes top-heavy need not vest when a plan becomes top-heavy.

V–4 Q. May a top-heavy plan provide a minimum eligibility requirement of the later of age 21 or the completion of 3 years of service and provide that all benefits are nonforfeitable when accrued?

A. Yes. For plan years which begin after December 31, 1984, a top-heavy plan may provide a minimum eligibility requirement of the later of age 21, or the completion of 3 years of service, and provide that all benefits are nonforfeitable when accrued. For plan years which begin before January 1, 1985, ''25'' may be substituted for ''21'' in the preceding sentence.

V–5 Q. What does nonforfeitable mean?

A. In general, nonforfeitable has the same meaning as in section 411(a). However, the minimum benefits required under section 416 (to the extent required to be nonforfeitable under section 416(b)) may not be forfeited under section 411(a)(3) (B) or (D). Thus, if benefits are suspended (ceased) during a period of reemployment, the benefit payable upon the subsequent resumption of payments must be actuarially increased to reflect the nonpayment of benefits during such period of re-employment.

V–6 Q. Will a class-year plan automatically satisfy the minimum vesting requirements in section 416(b) if it provides that contributions with respect to any plan year become nonforfeitable no later than the end of the third plan year following the plan year for which the contribution was made?

A. No. Although this vesting schedule is similar to the 3-year minimum vesting schedule permitted by section 416(b)(1)(A), it does not satisfy that minimum. The 3-year vesting schedule in section 416(b)(1)(A) requires that, after completion of 3 years of service, the entire accrued benefit of a participant be nonforfeitable. Under the class-year vesting schedule described above,

a portion of a participant's accrued benefit (that portion attributable to contributions for the prior 3 years) is forfeitable regardless of the participant's years of service.

V–7 Q. When a top-heavy plan ceases to be a top-heavy, may the vesting schedule be altered to a vesting schedule permitted without regard to section 416?

A. When a top-heavy plan ceases to be top-heavy, the vesting schedule may be changed to one that would otherwise be permitted. However, in changing the vesting schedule, the rules described in section 411(a)(10) apply. Thus, the nonforfeitable percentage of the accrued benefit before the plan ceased to be top-heavy must not be reduced; also, any employee with five or more years of service must be given the option of remaining under the prior (i.e., top-heavy) vesting schedule.

M. Minimum Benefits under Top-heavy Plans

M–1 Q. Which employees must receive minimum contributions or benefits in a top-heavy plan?

A. Generally, every non-key employee who is a participant in a top-heavy plan must receive minimum contributions or benefits under such plan. However, see Questions and Answers M–4 and M–10 for certain exceptions. Different minimums apply for defined benefit and defined contribution plans.

M–2 Q. What is the defined benefit minimum?

A. (a) The defined benefit minimum requires that the accrued benefit at any point in time must equal at least the product of (i) an employee's average annual compensation for the period of consecutive years (not exceeding five) when the employee had the highest aggregate compensation from the employer and (ii) the lesser of 2% per year of service with the employer or 20%.

(b) For purposes of the defined benefit minimum, years of service with the employer are generally determined under the rules of section 411(a) (4), (5) and (6). However, a plan may disregard any year of service if the plan was not top-heavy for any plan year ending during such year of service, or if the year of service was completed in a plan year beginning before January 1, 1984.

(c) In determining the average annual compensation for a period of consecutive years during which the employee had the largest aggregate compensation, years for which the employee did not earn a year of service under the rules of section 411(a) (4), (5), and (6) are to be disregarded. Thus, if an employee has received compensation from the employer during years one two, and three, and for each of these years the employee earned a year of service, then the employee's average annual compensation is determined by dividing the employee's aggregate compensation for these three years by three. If the employee fails to earn a year of service in the next year, but does earn a year of service in the fifth year, the employee's average annual compensation is calculated by dividing the employee's aggregate compensation for years one, two, three, and five by four. The compensation required to be taken into account is the compensation described in Question and Answer T–21. In addition, compensation received for years ending in plan years beginning before January 1, 1984, and compensation received for years beginning after the close of the last plan year in which the plan is top-heavy may be disregarded.

(d) The defined benefit minimum is expressed as a life annuity (with no ancillary benefits) commencing at normal retirement age. Thus, if post-retirement death benefits are also provided, the 2% minimum annuity benefit may be adjusted. (See Question and Answer M–3.) The 2% minimum annuity benefit may not be adjusted due to the provision of pre-retirement ancillary benefits. Normal retirement age has the same meaning as under section 411(a)(8).

(e) Any accruals of employer-derived benefits, whether or not attributable to years for which the plan is top-heavy, may be used to satisfy the defined benefit minimums. Thus, if a non-key employee had already accrued a benefit of 20 percent of final average pay at the time the plan became top-heavy, no additional minimum accruals are required (although the accrued benefit

would increase as final average pay increased). Accrued benefits attributable to employee contributions must be ignored. Accrued benefits attributable to employer and employee contributions have the same meaning as under section 411(c).

M–3 Q. What defined benefit minimum must be received if an employee receives a benefit in a form other than a single life annuity or a benefit other than at normal retirement age?

A. If the form of benefit is other than a single life annuity, the employee must receive an amount that is the actuarial equivalent of the minimum single life annuity benefit. If the benefit commences at a date other than at normal retirement age, the employee must receive at least an amount that is the acturial equivalent of the minimum single life annuity benefit commencing at normal retirement age. Thus, the employee may receive a lower benefit if the benefit commences before the normal retirement age and the employee must receive a higher benefit if the benefit commences after the normal retirement age. No specific actuarial assumptions are mandated providing different actuarial equivalents. However, the assumptions must be reasonable.

M–4 Q. Which employees must accrue a minimum benefit in a top-heavy defined benefit plan?

A. Each non-key employee who is a participant in a top-heavy defined benefit plan and who has at least one thousand hours of service (or equivalent service as determined under Department of Labor regulations, 29 CFR 2530.200b–3) for an accrual computation period must accrue a minimum benefit in a top-heavy defined benefit plan for that accrual computation period. If the accrual computation period does not coincide with the plan year, a minimum benefit must be provided, if required, for both accrual periods within the top-heavy plan year. For a top-heavy plan that does not base accruals on accrual computation periods, minimum benefits must be credited for all periods of service required to be credited for benefit accrual. (See § 1.410(a)–7). A non-key employee may not fail to accrue a minimum benefit merely because the employee was not employed on a specified date. Similarly, a non-key employee may not fail to accrue a minimum benefit because either (1) an employee is excluded from participation (or accrues no benefit) merely because the employee's compensation is less than a stated amount, or (2) the employee is excluded from participation (or accrues no benefit) merely because of a failure to make mandatory employee contributions.

M–5 Q. Would the defined benefit minimum be satisfied if the plan provides a normal retirement benefit equal to the greater of the plan's projected formula or the projected minimum benefit and if benefits accrue in accordance with the fractional rule described in section 411(b)(1)(C)?

A. No. The fact that this fractional rule would not satisfy the defined benefit minimum may be illustrated by the following example. Consider a non-key employee, age 25, entering a top-heavy plan in which the projected minimum for the employee is greater than the projected benefit under the normal formula. Under the fractional rule, the employee's accrued benefit ten years later at age 35 would be 5% (20% × (10/40)). Under section 416, the employee's minimum accrued benefit after ten years of service must be at least 20%. Thus, because the 5% benefit is less than the 20% benefit required under section 416, such benefit would not satisfy the required minimum.

M–6 Q. What benefit must an employer provide in a top-heavy defined benefit employee pay-all plan?

A. The defined benefit minimum in an employee pay-all top-heavy plan is the same as that for a plan which has employer contributions. That is, the employer must provide the benefits specified in Question and Answer M–2.

M–7 Q. What is the defined contribution minimum?

A. The sum of the contributions and forfeitures allocated to the account of any non-key employee who is a participant in a top-heavy defined contribution plan must equal at least 3% of such employee's compensation (see Question and Answer T–21 for the definition of compensation) for that plan year or for the calendar year ending within the plan year. However, a lower minimum is permissible where the

largest contribution made or required to be made for key employees is less than 3%. The preceding sentence does not apply to any plan required to be included in an aggregation group if such plan enables a defined benefit plan required to be included in such group to meet the requirements of section 401(a)(4) or 410. The contribution made or required to be made on behalf of any key employee is equal to the ratio of the sum of the contributions made or required to be made and forfeitures allocated for such key employee divided by the compensation (not in excess of $200,000) for such key employee. Thus, the defined contribution minimum that must be provided for any non-key employee for a top-heavy plan year is the largest percentage of compensation (not in excess of $200,000) provided on behalf of any key employee for that plan year (if the largest percentage of compensation provided on behalf of any key employee for that plan year is less than 3%).

M–8 Q. If an employer maintains two top-heavy defined contribution plans, must both plans provide the defined contribution minimum for each non-key employee who is a participant in both plans?

A. No. If one of the plans provides the defined contribution minimum for each non-key employee who participates in both plans, the other plan need not provide an additional contribution for such employees. However, the other plan must provide the vesting required by section 416(b) and must limit compensation (based on all compensation from all aggregated employers) in providing benefits as required by section 416(d).

M–9 Q. In the case of the waiver of minimum funding standards of section 412(d), how does section 416 treat the defined contribution minimum?

A. For purposes of determining the contribution that is required to be made on behalf of a key employee, a waiver of the minimum funding requirements is disregarded. Thus, if a defined contribution plan receives a waiver of the minimum funding requirement, and if the minimum contribution required under the plan without regard to the waiver exceeds 3%, the exception described in Question and Answer M–7 does not apply even though no key employee receives a contribution in excess of 3% and even though the amount required to be contributed on behalf of the key employee has been waived. Also, a waiver of the minimum funding requirements will not alter the requirements of section 416. Thus, in the case of the top-heavy defined contribution plan in which the non-key employee must receive an allocation, a waiver of the minimum funding requirements may eliminate a funding violation and such waiver will preclude a violation under section 416 even though the required contribution is not made. However, the adjusted account balance (as described in Rev. Rul. 78–223, 1978–1 C.B. 125) of the non-key employees must reflect the required minimum contribution even though such contribution was not made.

M–10 Q. Which employees must receive the defined contribution minimum?

A. Those non-key employees who are participants in a top-heavy defined contribution plan who have not separated from service by the end of the plan year must receive the defined contribution minimum. Non-key employees who have become participants but who subsequently fail to complete 1,000 hours of service (or the equivalent) for an accrual computation period must receive the defined contribution minimum. A non-key employee may not fail to receive a defined contribution minimum because either (1) the employee is excluded from participation (or accrues no benefit) merely because the employee's compensation is less than a stated amount, or (2) the employee is excluded from participation (or accrues no benefit) merely because of a failure to make mandatory employee contributions or, in the case of a cash or deferred arrangement, elective contributions.

M–11 Q. May either the defined benefit minimum or the defined contribution minimum be integrated with social security?

A. No.

M–12 Q. What minimum contribution or benefit must be received by a non-key employee who participates in a top-heavy plan?

A. In the case of an employer maintaining only one plan, if such plan is a defined benefit plan, each non-key employee covered by that plan must receive the defined benefit minimum. If such plan is a defined contribution plan (including a target benefit plan), each non-key employee covered by the plan must receive the defined contribution minimum. In the case of an employer who maintains more than one plan, employees covered under only the defined benefit plan must receive the defined benefit minimum. Employees covered under only the defined contribution plan must receive the defined contribution minimum. In the case of employees covered under both defined benefit and defined contribution plans, the rules are more complicated. Section 416(f) precludes, in the case of employees covered under both defined benefit and defined contribution plans, either required duplication or inappropriate omission. Therefore, such employees need not receive both the defined benefit and the defined contribution minimums.

There are four safe harbor rules a plan may use in determining which minimum must be provided to a non-key employee who is covered by both defined benefit and defined contribution plans. Since the defined benefit minimums are generally more valuable, if each employee covered under both a top-heavy defined benefit plan and a top-heavy defined contribution plan receives the defined benefit minimum, the defined benefit and defined contribution minimums will be satisfied. Another approach that may be used is a floor offset approach (see Rev. Rul. 76–259, 1976–2 C.B. 111) under which the defined benefit minimum is provided in the defined benefit plan and is offset by the benefits provided under the defined contribution plan. Another approach that may be used in the case of employees covered under both defined benefit and defined contribution plans is to prove, using a comparability analysis (see Rev. Rul. 81–202, 1981–2 C.B. 93) that the plans are providing benefits at least equal to the defined benefit minimum. Finally, in order to preclude the cost of providing the defined benefit minimum alone, the complexity of a floor offset plan and the annual fluctuation of a comparability analysis, a safe haven minimum defined contribution is being provided. If the contributions and forfeitures under the defined contribution plan equal 5% of compensation for each plan year the plan is top-heavy, such minimum will be presumed to satisfy the section 416 minimums.

M–13 Q. An employer maintains a defined benefit plan and a profit-sharing plan. Both plans are top-heavy and are members of a required aggregation group. In order to meet the minimum contribution/minimum benefit requirements, the employer decides to contribute 5% of compensation to the profit-sharing plan. What happens if for a particular plan year there are no profits out of which to make contributions to the profit-sharing plan?

A. In this particular situation, in order to satisfy the requirements of section 416(c), the employer must provide the defined contribution minimum, 5% of compensation. This rule is an exception to the general rule that an employer cannot make a contribution to a profit-sharing plan if there are no profits. Alternatively, the employer may provide the defined benefit minimum for this year.

M–14 Q. What minimum contribution or benefit must be received by a non-key employee when he is covered under both a defined benefit plan and defined contribution plan (both of which are top-heavy) of an employer and the employer desires to use a factor of 1.25 in computing the denominators of the defined benefit and defined contribution fractions under section 415(e)?

A. In this particular situation, the employer may use one of the four rules set forth in Question and Answer M–12, subject to the following modifications. The defined benefit minimum must be increased by one percentage point (up to a maximum of ten percentage points) for each year of service described in Question and Answer M–2 of the participant's average compensation for the years described in Question and Answer M–2. The defined contribution minimum is increased to 7½ percent of compensation. If the floor offset or comparability analysis approach is used, the defined benefit minimum must be increased by one percentage

point (up to a maximum of ten percentage points) for each year of service described in Question and Answer M–2 of the participant's average compensation for the years described in Question and Answer M–2.

M–15 Q. May an employer use a different method each year to meet the requirements of Question and Answer M–12 or Question and Answer M–14 without amending the plans each year?

A. No. An employer must set forth in the plan document the method he will use to meet the requirements of Question and Answer M–12 or M–14, as the case may be. If an employer desires to change the method, the plan document must be amended.

M–16 Q. Will target benefit plans be treated as defined benefit or defined contribution plans for purposes of the top-heavy rules?

A. Target benefit plans will be treated as defined contribution plans for purposes of the top-heavy rules.

M–17 Q. Can a plan described in section 412(i) (funded exclusively by level premium insurance contracts) also satisfy the minimum benefit requirements of section 416?

A. The accrued benefits provided for a non-key employee under most level premium insurance contracts might not provide a benefit satisfying the defined benefit minimum because of the lower cash values in early years under most level premium insurance contracts, and because such contracts normally provide for level premiums until normal retirement age. However, a plan will not be considered to violate the requirements of section 412(i) merely because it funds certain benefits through either an auxiliary fund or deferred annuity contracts, if the following conditions are met:

(1) The targeted benefit at normal retirement age under the level premium insurance contract is determined, taking into account the defined benefit minimum that would be required assuming the current top-heavy (or non top-heavy) status of the plan continues until normal retirement age; and

(2) The benefits provided by the auxiliary fund or deferred annuity contracts do not exceed the excess of the defined benefit minimum benefits over the benefits provided by the level premium insurance contract.

If the above conditions are satisfied, then the plan is still exempt from the minimum funding requirements under section 412 and may still utilize the special accrued benefit rule in section 411(b)(1)(F) subject to the following modifications: Although the portion of the plan funded by the level premium annuity contract is exempt from the minimum funding requirements, the portion funded by an auxiliary fund is subject to those requirements. (Thus, a funding standard account must be maintained and a Schedule B must be filed with the annual report). The accrued benefit for any participant may be determined using the rule in section 411(b)(1)(F) but must not be less than the defined benefit minimum.

M–18 Q. May qualified nonelective contributions described in section 401(m)(4)(C) be treated as employer contributions for purposes of the minimum contribution or benefit requirement of section 416?

A. Yes. This is the case even if the qualified nonelective contributions are taken into account under the actual deferral percentage test of § 1.401(k)–1(b)(2) or under the actual contribution percentage test of § 1.401(m)–1(b).

M–19 Q. May matching contributions described in section 401(m)(4)(A) be treated as employer contributions for purposes of the minimum contribution or benefit requirement of section 416?

A. Matching contributions allocated to key employees are treated as employer contributions for purposes of determining the minimum contribution or benefit under section 416. However, if a plan uses contributions allocated to employees other than key employees on the basis of employee contributions or elective contributions to satisfy the minimum contribution requirement, these contributions are not treated as matching contributions for purposes of applying the requirements of sections 401(k) and 401(m) for plan years beginning after December 31, 1988. Thus these contributions must meet the nondiscrimination requirements of section 401(a)(4) without regard to section 401(m). See § 1.401(m)–1(f)(12)(iii).

M–20 Q. May elective contributions be treated as employer contributions

for purposes of satisfying the minimum contribution or benefit requirement of section 416(c)(2)?

A. Elective contributions on behalf of key employees are taken into account in determining the minimum required contribution under section 416(c)(2). However, elective contributions on behalf of employees other than key employees may not be treated as employer contributions for purposes of the minimum contribution or benefit requirement of section 416. See section 401(k)(4)(C) and the regulations thereunder. This Question and Answer is effective for plan years beginning after December 31, 1988.

[T.D. 7997, 49 FR 50646, Dec. 31, 1984, as amended by T.D. 8357, 56 FR 40550, Aug. 15, 1991; T.D. 9319, 72 FR 16929, Apr. 5, 2007]

§ 1.417(a)(3)–1 Required explanation of qualified joint and survivor annuity and qualified preretirement survivor annuity.

(a) *Written explanation requirement*—(1) *General rule.* A plan meets the survivor annuity requirements of section 401(a)(11) only if the plan meets the requirements of section 417(a)(3) and this section regarding the written explanation required to be provided a participant with respect to a QJSA or a QPSA. A written explanation required to be provided to a participant with respect to either a QJSA or a QPSA under section 417(a)(3) and this section is referred to in this section as a section 417(a)(3) explanation. See § 1.401(a)–20, Q&A–37, for exceptions to the written explanation requirement in the case of a fully subsidized QPSA or QJSA, and § 1.401(a)–20, Q&A–38, for the definition of a fully subsidized QPSA or QJSA.

(2) *Time for providing section 417(a)(3) explanation*—(i) *QJSA explanation.* See § 1.417(e)–1(b)(3)(ii) for rules governing the timing of the QJSA explanation.

(ii) *QPSA explanation.* See § 1.401(a)–20, Q&A–35, for rules governing the timing of the QPSA explanation.

(3) *Required method for providing section 417(a)(3) explanation.* A section 417(a)(3) explanation must be a written explanation. First class mail to the last known address of the participant is an acceptable delivery method for a section 417(a)(3) explanation. Likewise, hand delivery is acceptable. However, the posting of the explanation is not considered provision of the section 417(a)(3) explanation. But see § 1.401(a)–21 of this chapter for rules permitting the use of electronic media to provide applicable notices to recipients with respect to retirement plans.

(4) *Understandability.* A section 417(a)(3) explanation must be written in a manner calculated to be understood by the average participant.

(b) *Required content of section 417(a)(3) explanation*—(1) *Content of QPSA explanation.* The QPSA explanation must contain a general description of the QPSA, the circumstances under which it will be paid if elected, the availability of the election of the QPSA, and, except as provided in paragraph (d)(3) of this section, a description of the financial effect of the election of the QPSA on the participant's benefits (*i.e.*, an estimate of the reduction to the participant's estimated normal retirement benefit that would result from an election of the QPSA).

(2) *Content of QJSA explanation.* The QJSA explanation must satisfy either paragraph (c) or paragraph (d) of this section. Under paragraph (c) of this section, the QJSA explanation must contain certain specific information relating to the benefits available under the plan to the particular participant. Alternatively, under paragraph (d) of this section, the QJSA explanation can contain generally applicable information in lieu of specific participant information, provided that the participant has the right to request additional information regarding the participant's benefits under the plan.

(c) *Participant-specific information required to be provided*—(1) *In general.* A QJSA explanation satisfies this paragraph (c) if it provides the following information with respect to each of the optional forms of benefit presently available to the participant (i.e., optional forms of benefit for which the QJSA explanation applies that have an annuity starting date after the providing of the QJSA explanation and optional forms of benefit with retroactive annuity starting dates that are available with payments commencing at that same time)—

(i) A description of the optional form of benefit;

(ii) A description of the eligibility conditions for the optional form of benefit;

(iii) A description of the financial effect of electing the optional form of benefit (i.e., the amounts and timing of payments to the participant under the form of benefit during the participant's lifetime, and the amounts and timing of payments after the death of the participant);

(iv) In the case of a defined benefit plan, a description of the relative value of the optional form of benefit compared to the value of the QJSA, in the manner described in paragraph (c)(2) of this section; and

(v) A description of any other material features of the optional form of benefit.

(2) *Requirement for numerical comparison of relative values*—(i) *In general*. The description of the relative value of an optional form of benefit compared to the value of the QJSA under paragraph (c)(1)(iv) of this section must be expressed to the participant in a manner that provides a meaningful comparison of the relative economic values of the two forms of benefit without the participant having to make calculations using interest or mortality assumptions. Thus, in performing the calculations necessary to make this comparison, the benefits under one or both optional forms of benefit must be converted, taking into account the time value of money and life expectancies, so that the values of both optional forms of benefit are expressed in the same form. For example, such a comparison may be expressed to the participant using any of the following techniques—

(A) Expressing the actuarial present value of the optional form of benefit as a percentage or factor of the actuarial present value of the QJSA;

(B) Stating the amount of the annuity that is the actuarial equivalent of the optional form of benefit and that is payable at the same time and under the same conditions as the QJSA; or

(C) Stating the actuarial present value of both the optional form of benefit and the QJSA.

(ii) *Use of one form for both married and unmarried individuals*—(A) *In general*. Under the rules of this paragraph (c)(2)(ii), in lieu of providing different QJSA explanations for married and unmarried individuals, the plan may provide a QJSA explanation to an individual that does not vary based on the participant's marital status. Except as specifically provided in this section, any reference in this section to comparing the relative value of an optional form of benefit to the value of the QJSA may be satisfied using the substitution permitted under paragraph (c)(2)(ii)(B) or (C) of this section.

(B) *Substitution of single life annuity for married individual*. For a married participant, in lieu of comparing the value of each optional form of benefit presently available to the participant to the value of the QJSA, the plan can compare the value of each optional form of benefit (including the QJSA) to the value of a QJSA for an unmarried participant (*i.e.*, a single life annuity), but only if that same single life annuity is available to that married participant.

(C) *Substitution of joint and survivor annuity for unmarried individual*. For an unmarried participant, in lieu of comparing the value of each optional form of benefit presently available to the participant to the value of the QJSA for that individual (which is a single life annuity), the plan can compare the value of each optional form of benefit (including the single life annuity) to the value of the joint and survivor annuity that is the QJSA for a married participant, but only if that same joint and survivor annuity is available to that unmarried participant.

(iii) *Simplified presentations permitted*—(A) *Grouping of certain optional forms*. Two or more optional forms of benefit that have approximately the same value may be grouped for purposes of a required numerical comparison described in this paragraph (c)(2). For this purpose, two or more optional forms of benefit have approximately the same value if none of those optional forms of benefit vary in relative value in comparison to the value of the QJSA by more than 5 percentage points when the relative value comparison is made by expressing the actuarial

present value of each of those optional forms of benefit as a percentage of the actuarial present value of the QJSA. For such a group of optional forms of benefit, the requirement relating to disclosing the relative value of each optional form of benefit compared to the value of the QJSA can be satisfied by disclosing the relative value of any one of the optional forms in the group compared to the value of the QJSA, and disclosing that the other optional forms of benefit in the group are of approximately the same value. If a single-sum distribution is included in such a group of optional forms of benefit, the single-sum distribution must be the distribution form that is used for purposes of this comparison.

(B) *Representative relative value for grouped optional forms.* If, in accordance with paragraph (c)(2)(iii)(A) of this section, two or more optional forms of benefits are grouped, the relative values for all of the optional forms of benefit in the group can be stated using a representative relative value as the approximate relative value for the entire group. For this purpose, a representative relative value is any relative value that is not less than the relative value of the member of the group of optional forms of benefit with the lowest relative value and is not greater than the relative value of the member of that group with the highest relative value when measured on a consistent basis. For example, if three grouped optional forms have relative values of 87.5 percent, 89 percent, and 91 percent of the value of the QJSA, all three optional forms can be treated as having a relative value of approximately 90 percent of the value of the QJSA. As required under paragraph (c)(2)(iii)(A) of this section, if a single-sum distribution is included in the group of optional forms of benefit, the 90 percent relative factor of the value of the QJSA must be disclosed as the approximate relative value of the single sum, and the other forms can be described as having the same approximate value as the single sum.

(C) *Special rule for optional forms of benefit that are close in value to the QJSA.* The relative value of all optional forms of benefit that have an actuarial present value that is at least 95% of the actuarial present value of the QJSA and no greater than 105% of the actuarial present value of the QJSA is permitted to be described by stating that those optional forms of benefit are approximately equal in value to the QJSA, or that all of those forms of benefit and the QJSA are approximately equal in value.

(iv) *Actuarial assumptions used to determine relative values.* For the purpose of providing a numerical comparison of the value of an optional form of benefit to the value of the immediately commencing QJSA under this paragraph (c)(2), the following rules apply—

(A) If an optional form of benefit is subject to the requirements of section 417(e)(3) and §1.417(e)–1(d), any comparison of the value of the optional form of benefit to the value of the QJSA must be made using the applicable mortality table and the applicable interest rate as defined in §1.417(e)–1(d)(2) and (3) (or, at the option of the plan, another reasonable interest rate and reasonable mortality table used under the plan to calculate the amount payable under the optional form of benefit); and

(B) All other optional forms of benefit payable to the participant must be compared with the QJSA using a single set of interest and mortality assumptions that are reasonable and that are applied uniformly with respect to all such optional forms payable to the participant (regardless of whether those assumptions are actually used under the plan for purposes of determining benefit payments). For this purpose, the reasonableness of interest and mortality assumptions is determined without regard to the circumstances of the individual participant. In addition, the applicable mortality table and the applicable interest rate as defined in §1.417(e)–1(d)(2) and (3) are considered reasonable actuarial assumptions for this purpose and thus are permitted (but not required) to be used.

(v) *Required disclosure of assumptions*—(A) *Explanation of concept of relative value.* The notice must provide an explanation of the concept of relative value, communicating that the relative value comparison is intended to allow the participant to compare the total value of distributions paid in different

forms, that the relative value comparison is made by converting the value of the optional forms of benefit presently available to a common form (such as the QJSA or a single-sum distribution), and that this conversion uses interest and life expectancy assumptions. The explanation of relative value must include a general statement that all comparisons provided are based on average life expectancies, and that the relative value of payments ultimately made under an annuity optional form of benefit will depend on actual longevity.

(B) *Disclosure of assumptions.* A required numerical comparison of the value of the optional form of benefit to the value of the QJSA under this paragraph (c)(2) is required to include a disclosure of the interest rate that is used to develop the comparison. If all optional forms of benefit are permitted to be grouped under paragraph (c)(2)(iii)(A) of this section, then the requirement of this paragraph (c)(2)(v)(B) does not apply for any optional form of benefit not subject to the requirements of section 417(e)(3) and §1.417(e)–1(d)(3).

(C) *Offer to provide actuarial assumptions.* If the plan does not disclose the actuarial assumptions used to calculate the numerical comparison required under paragraph (c)(2) of this section, then, the notice must be accompanied by a statement that includes an offer to provide, upon the participant's request, the actuarial assumptions used to calculate the relative value of optional forms of benefit under the plan.

(3) *Permitted estimates of financial effect and relative value*—(i) *General rule.* For purposes of providing a description of the financial effect of the distribution forms available to a participant as required under paragraph (c)(1)(iii) of this section, and for purposes of providing a description of the relative value of an optional form of benefit compared to the value of the QJSA for a participant as required under paragraph (c)(1)(iv) of this section, the plan is permitted to provide reasonable estimates (e.g., estimates based on data as of an earlier date than the annuity starting date, a reasonable assumption for the age of the participant's spouse, or, in the case of a defined contribution plan, reasonable estimates of amounts that would be payable under a purchased annuity contract), including reasonable estimates of the applicable interest rate under section 417(e)(3).

(ii) *Right to more precise calculation.* If a QJSA notice uses a reasonable estimate under paragraph (c)(3)(i) of this section, the QJSA explanation must identify the estimate and explain that the plan will, upon the request of the participant, provide a more precise calculation and the plan must provide the participant with a more precise calculation if so requested. Thus, for example, if a plan provides an estimate of the amount of the QJSA that is based on a reasonable assumption concerning the age of the participant's spouse, the participant can request a calculation that takes into account the actual age of the spouse, as provided by the participant.

(iii) *Revision of prior information.* If a more precise calculation described in paragraph (c)(3)(ii) of this section materially changes the relative value of an optional form compared to the value of the QJSA, the revised relative value of that optional form must be disclosed, regardless of whether the financial effect of selecting the optional form is affected by the more precise calculation. For example, if a participant provides a plan with the age of the participant's spouse and that information materially changes the relative value of an optional form of benefit (such as a single sum) compared to the value of the QJSA, then the revised relative value of the optional form of benefit and the value of the QJSA must be disclosed, regardless of whether the amount of the payment under that optional form of benefit is affected by the more precise calculation.

(4) *Special rules for disclosure of financial effect for defined contribution plans.* For a written explanation provided by a defined contribution plan, a description of financial effect required by paragraph (c)(1)(iii) of this section with respect to an annuity form of benefit must include a statement that the annuity will be provided by purchasing an annuity contract from an insurance company with the participant's account balance under the plan. If the description of the financial effect of the

optional form of benefit is provided using estimates rather than by assuring that an insurer is able to provide the amount disclosed to the participant, the written explanation must also disclose this fact.

(5) *Simplified presentations of financial effect and relative value to enhance clarity for participants*—(i) *In general.* This paragraph (c)(5) permits certain simplified presentations of financial effect and relative value of optional forms of benefit to permit more useful presentations of information to be provided to participants in certain cases in which a plan offers a range of optional forms of benefit. Paragraph (c)(5)(ii) of this section permits simplified presentations of financial effect and relative value for a plan that offers a significant number of substantially similar optional forms of benefit. Paragraph (c)(5)(iii) of this section permits simplified presentations of financial effect and relative value for a plan that permits the participant to make separate benefit elections with respect to parts of a benefit.

(ii) *Disclosure for plans offering a significant number of substantially similar optional forms of benefit*—(A) *In general.* If a plan offers a significant number of substantially similar optional forms of benefit within the meaning of paragraph (c)(5)(ii)(B) of this section and disclosing the financial effect and relative value of each such optional form of benefit would provide a level of detail that could be overwhelming rather than helpful to participants, then the financial effect and relative value of those optional forms of benefit can be disclosed by disclosing the relative value and financial effect of a representative range of examples of those optional forms of benefit as described in paragraph (c)(5)(ii)(C) of this section if the requirements of paragraph (c)(5)(ii)(D) of this section (relating to additional information available upon request) are satisfied.

(B) *Substantially similar optional forms of benefit.* For purposes of this paragraph (c)(5)(ii), optional forms of benefit are substantially similar if those optional forms of benefit are identical except for a particular feature or features (with associated adjustment factors) and the feature or features vary linearly. For example, if a plan offers joint and survivor annuity options with survivor payments available in every whole number percentage between 50% and 100%, those joint and survivor annuity options are substantially similar optional forms of benefit. Similarly, if a participant is entitled under the plan to receive a particular form of benefit with an annuity starting date that is the first day of any month beginning three years before commencement of a distribution and ending on the date of commencement of the distribution, those forms of benefit are substantially similar optional forms of benefit.

(C) *Representative range of examples.* A range of examples with respect to substantially similar optional forms of benefit as permitted under this paragraph (c)(5) is representative only if it includes examples illustrating the financial effect and relative value of the optional forms of benefit that reflect each varying feature at both extremes of its linear range, plus at least one example illustrating the financial effect and relative value of the optional forms of benefit that reflects each varying feature at an intermediate point. However, if one intermediate example is insufficient to illustrate the pattern of variation in relative value with respect to a varying feature, examples sufficient to illustrate such pattern must be provided. Thus, for example, if a plan offers joint and survivor annuity options with survivor payments available in every whole number percentage between 50% and 100%, and if all such optional forms of benefit would be permitted to be disclosed as approximately equal in value as described in paragraph (c)(5)(ii)(B) of this section, the plan could satisfy the requirement to disclose the financial effect and relative value of a representative range of examples of those optional forms of benefit by disclosing the financial effect and relative value with respect to the joint and 50% survivor annuity, the joint and 75% survivor annuity, and the joint and 100% survivor annuity.

(D) *Requirement to provide information with respect to other optional forms of benefit upon request.* If a QJSA explanation discloses the financial effect

and relative value of substantially similar optional forms of benefit by disclosing the financial effect and relative value of a representative range of examples in accordance with this paragraph (c)(5)(ii), the QJSA explanation must explain that the plan will, upon the request of the participant, disclose the financial effect and relative value of any particular optional form of benefit from among the substantially similar optional forms of benefit and the plan must provide the participant with the financial effect and relative value of any such optional form of benefit if the participant so requests.

(iii) *Separate presentations permitted for elections that apply to parts of a benefit.* If the plan permits the participant to make separate benefit elections with respect to two or more portions of the participant's benefit, the description of the financial effect and relative values of optional forms of benefit can be made separately for each such portion of the benefit, rather than for each optional form of benefit (i.e., each combination of possible elections).

(d) *Substitution of generally applicable information for participant information in the section 417(a)(3) explanation*—(1) *Forms of benefit available.* In lieu of providing the information required under paragraphs (c)(1)(i) through (v) of this section for each optional form of benefit presently available to the participant as described in paragraph (c) of this section, the QJSA explanation may contain the information required under paragraphs (c)(1)(i) through (v) of this section for the QJSA and each other optional form of benefit generally available under the plan, along with a reference to where a participant may readily obtain the information required under paragraphs (c)(1)(i) through (v) of this section for any other optional forms of benefit that are presently available to the participant.

(2) *Financial effect and comparison of relative values*—(i) *General rule.* In lieu of providing a statement of the financial effect of electing an optional form of benefit as required under paragraph (c)(1)(iii) of this section, or a comparison of relative values as required under paragraph (c)(1)(iv) of this section, based on the actual age and benefit of the participant, the QJSA explanation is permitted to include a chart (or other comparable device) showing the financial effect and relative value of optional forms of benefit in a series of examples specifying the amount of the optional form of benefit payable to a hypothetical participant at a representative range of ages and the comparison of relative values at those same representative ages. Each example in this chart must show the financial effect of electing the optional form of benefit pursuant to the rules of paragraph (c)(1)(iii) of this section, and a comparison of the relative value of the optional form of benefit to the value of the QJSA pursuant to the rules of paragraph (c)(2) of this section, using reasonable assumptions for the age of the hypothetical participant's spouse and any other variables that affect the financial effect, or relative value, of the optional form of benefit. The requirement to show the financial effect of electing an optional form can be satisfied through the use of other methods (e.g., expressing the amount of the optional form as a percentage or a factor of the amount payable under the normal form of benefit), provided that the method provides sufficient information so that a participant can determine the amount of benefits payable in the optional form. The chart (or other comparable device) must be accompanied by the disclosures described in paragraph (c)(2)(v) of this section explaining the concept of relative value and disclosing certain interest assumptions. In addition, the chart (or other comparable device) must be accompanied by a general statement describing the effect of significant variations between the assumed ages or other variables on the financial effect of electing the optional form of benefit and the comparison of the relative value of the optional form of benefit to the value of the QJSA.

(ii) *Actual benefit must be disclosed.* The generalized notice described in this paragraph (d)(2) will satisfy the requirements of paragraph (b)(2) of this section only if the notice includes either the amount payable to the participant under the normal form of benefit or the amount payable to the participant under the normal form of benefit

adjusted for immediate commencement. For this purpose, the normal form of benefit is the form under which payments due to the participant under the plan are expressed under the plan, prior to adjustments for form of benefit. For example, assuming that a plan's benefit accrual formula is expressed as a straight life annuity, the generalized notice must provide the amount of either the straight life annuity commencing at normal retirement age or the straight life annuity commencing immediately. Reasonable estimates of the type described in paragraph (c)(3)(i) of this section may be used to determine the amount payable to the participant under the normal form of benefit for purposes of this paragraph (d)(2)(ii) if the requirements of paragraphs (c)(3)(ii) and (iii) of this section are satisfied with respect to those estimates.

(iii) *Ability to request additional information*. The generalized notice described in this paragraph (d)(2) must be accompanied by a statement that includes an offer to provide, upon the participant's request, a statement of financial effect and a comparison of relative values that is specific to the participant for any presently available optional form of benefit, and a description of how a participant may obtain this additional information.

(3) *Financial effect of QPSA election*. In lieu of providing a specific description of the financial effect of the QPSA election, the QPSA explanation may provide a general description of the financial effect of the election. Thus, for example, the description can be in the form of a chart showing the reduction to a hypothetical participant's normal retirement benefit at a representative range of participant ages as a result of the QPSA election (using a reasonable assumption for the age of the hypothetical participant's spouse relative to the age of the hypothetical participant). In addition, this chart must be accompanied by a statement that includes an offer to provide, upon the participant's request, an estimate of the reduction to the participant's estimated normal retirement benefit, and a description of how a participant may obtain this additional information.

(4) *Additional information required to be furnished at the participant's request*—The generalized notice described in paragraph (d)(2) of this section must be accompanied by a statement that includes an offer to provide, upon the participant's request, information described in this paragraph (d)(4)(i) and (ii), and a description of how a participant may obtain this additional information.

(i) *Explanation of QJSA*. If, as permitted under paragraphs (d)(1) and (2) of this section, the content of a QJSA explanation does not include all the items described in paragraph (c) of this section, then, upon a participant's request for any of the information required under paragraphs (c)(1)(i) through (v) of this section for one or more presently available optional forms (including a request for all optional forms presently available to the participant), the plan must furnish the information required under paragraphs (c)(1)(i) through (v) of this section with respect to those optional forms. Thus, with respect to those optional forms of benefit, the participant must receive a QJSA explanation specific to the participant that is based on the participant's actual age and benefit. In addition, the plan must comply with paragraph (c)(3)(iii) of this section. Further, if as permitted under paragraph (c)(2)(v)(B) of this section, the plan does not disclose the actuarial assumptions used to calculate the numerical comparison required under paragraph (c)(2) of this section, then, upon request, the plan must provide the actuarial assumptions used to calculate the relative value of optional forms of benefit under the plan.

(ii) *Explanation of QPSA*. If, as permitted under paragraph (d)(3) of this section, the content of a QPSA explanation does not include all the items described in paragraph (b)(1) of this section, then, upon a participant's request, the plan must furnish an estimate of the reduction to the participant's estimated normal retirement benefit that would result from a QPSA election.

(5) *Use of participant-specific information in generalized notice.* A QJSA explanation does not fail to satisfy the requirements of this paragraph (d) merely because it contains an item of participant-specific information in place of the corresponding generally applicable information.

(e) *Examples.* The following examples illustrate the application of this section. Solely for purposes of these examples, the applicable interest rate that applies to any distribution that is subject to the rules of section 417(e)(3) is assumed to be 52½ percent, and the applicable mortality table under section 417(e)(3) and §1.417(e)–1(d)(2) is assumed to be the table that applies as of January 1, 2003. In addition, solely for purposes of these examples, assume that a plan which determines actuarial equivalence using 6 percent interest and the applicable mortality table under section 417(e)(3) and §1.417(e)–1(d)(2) that applies as of January 1, 1995, is using reasonable actuarial assumptions. The examples are as follows:

Example 1. (i) Participant M participates in Plan A, a qualified defined benefit plan. Under Plan A, the QJSA is a joint and 100 percent survivor annuity, which is actuarially equivalent to the single life annuity determined using 6 percent interest and the section 417(e)(3) applicable mortality table that applies as of January 1, 1995. On October 1, 2004, M will terminate employment at age 55. When M terminates employment, M will be eligible to elect an unreduced early retirement benefit, payable as either a single life annuity or the QJSA. M will also be eligible to elect a single-sum distribution equal to the actuarial present value of the single life annuity payable at normal retirement age (age 65), determined using the applicable mortality table and the applicable interest rate under section 417(e)(3).

(ii) Consistent with paragraph (c) of this section, Participant M is provided with a QJSA explanation that describes the single life annuity, the QJSA, and single-sum distribution options under the plan, and any eligibility conditions associated with these options. Participant M is married when the explanation is provided. The explanation indicates that, if Participant M commenced benefits at age 55 and had a spouse age 55, the monthly benefit under an immediately commencing single life annuity is $3,000, the monthly benefit under the QJSA is estimated to be 89.96 percent of the monthly benefit under the immediately commencing single life annuity or $2,699, and the single sum is estimated to be 74.7645 times the monthly benefit under the immediately commencing single life annuity or $224,293.

(iii) The QJSA explanation indicates that the single life annuity and the QJSA are of approximately the same value, but that the single-sum option is equivalent in value to a monthly benefit under the QJSA of $1,215. (This amount is 45 percent of the value of the QJSA at age 55 ($1,215 divided by 89.96 percent of $3,000 equals 45 percent).) The explanation states that the relative value comparison converts the value of the single life annuity and the single-sum options to the value of each if paid in the form of the QJSA and that this conversion uses interest and life expectancy assumptions. The explanation specifies that the calculations relating to the single-sum distribution were prepared using 5.5 percent interest and average life expectancy, that the other calculations were prepared using a 6 percent interest rate and that the relative value of actual annuity payments for an individual can vary depending on how long the individual and spouse live. The explanation notes that the calculation of the QJSA assumed that the spouse was age 55, that the amount of the QJSA will depend on the actual age of the spouse (for example, annuity payments will be significantly lower if the spouse is significantly younger than the participant), and that the amount of the single-sum payment will depend on the interest rates that apply when the participant actually takes a distribution. The explanation also includes an offer to provide a more precise calculation to the participant taking into account the spouse's actual age.

(iv) In accordance with paragraph (c)(3)(ii) of this section, Participant M requests a more precise calculation of the financial effect of choosing a QJSA taking into account that Participant M's spouse is 50 years of age. Using the actual age of Participant M's spouse, Plan A determines that the monthly payments under the QJSA are 87.62 percent of the monthly payments under the single life annuity, or $2,628.60 per month, and provides this information to M. Plan A is not required to provide an updated calculation of the relative value of the single sum because the value of single sum continues to be 45 percent of the value of the QJSA.

Example 2. (i) The facts are the same as in *Example 1,* except that the comparison of the relative values of optional forms of benefit to the value of the QJSA is not expressed as a percentage of the actuarial present value of the QJSA, but instead is expressed by disclosing the actuarial present values of the optional forms and the QJSA. In addition, the Plan uses the applicable interest rate and the applicable mortality table under section 417(e)(3) for all comparison purposes.

(ii) Accordingly, the QJSA explanation indicates that the QJSA has an actuarial

present value of $498,089, while the single-sum payment has an actuarial present value of $224,293 (*i.e.* the amount of the single sum is $224,293) and that the single life annuity is approximately equal in value to the QJSA. The explanation states that the relative value comparison converts the value of single life annuity and the QJSA into an amount payable in the form of the single-sum option (even though a single-sum distribution in that amount is not available under the plan) and that this conversion uses interest and life expectancy assumptions. The explanation specifies that the calculations were prepared using 5.5 percent interest and average life expectancy, and that the relative value of actual annuity payments for an individual can vary depending on how long the individual and spouse live. The explanation notes that the calculation of the QJSA assumed that the spouse was age 55, that the amount of the QJSA will depend on the actual age of the spouse (for example, annuity payments will be significantly lower if the spouse is significantly younger than the participant), and that the amount of the single-sum payment will depend on the interest rates that apply when the participant actually takes a distribution. The explanation also includes an offer to provide a more precise calculation to the participant taking into account the spouse's actual age.

Example 3. (i) The facts are the same as in *Example 1*, except that, in lieu of providing information specific to Participant M in the QJSA notice as set forth in paragraph (c) of this section, Plan A satisfies the QJSA explanation requirement in accordance with paragraph (d)(2) of this section by providing M with a statement that M's monthly benefit under an immediately commencing single life annuity (which is the normal form of benefit under Plan A, adjusted for immediate commencement) is $3,000, along with the following chart. The chart shows the financial effect of electing each optional form of benefit for a hypothetical participant with a $1,000 benefit and a spouse who is the same age as the participant. Instead of showing the relative value of these optional forms of benefit compared to the value of the QJSA, the chart shows the relative value of these optional forms of benefit compared to the value of the single life annuity. Separate charts are provided for ages 55, 60, and 65 as follows:

AGE 55 COMMENCEMENT

Optional form	Amount of distribution per $1,000 of immediate single life annuity	Relative value
Life Annuity	$1,000 per month	n/a.
QJSA (Joint and 100 percent survivor annuity).	$900 per month ($900 per month for survivor annuity).	Approximately the same value as the Life Annuity.
Lump sum	$74,764	Approximately 45 percent of the value of the Life Annuity.

AGE 60 COMMENCEMENT

Optional form	Amount of distribution per $1,000 of immediate single life annuity	Relative value
Life Annuity	$1,000 per month	n/a.
QJSA (Joint and 100 percent survivor annuity).	$878 per month ($878 per month for survivor annuity).	Approximately the same value as the Life Annuity.
Lump sum	$99,792	Approximately 66 percent of the value of the Life Annuity.

AGE 65 COMMENCEMENT

Optional form	Amount of distribution per $1,000 of immediate single life annuity	Relative value
Life Annuity	$1,000 per month	n/a.
QJSA (Joint and 100 percent survivor annuity).	$852 per month ($852 per month for survivor annuity).	Approximately the same value as the Life Annuity.
Lump sum	$135,759	Approximately the same value as the Life Annuity.

(ii) In accordance with paragraph (d)(4)(i) of this section, when Participant M requests specific information regarding the amounts payable under the QJSA, the joint and 100 percent survivor annuity, and the single-sum distribution and provides the age of M's spouse, Plan A determines that M's QJSA is $2,628.60 per month and the single-sum distribution is $224,293. The actuarial present value of the QJSA (determined using the 5.5

percent interest and the section 417(e)(3) applicable mortality table) is $498,896 and the actuarial present value of the single life annuity is $497,876. Accordingly, the specific information discloses that the single-sum distribution has a value that is 45 percent of the value of the single life annuity available to M on October 1, 2004. In accordance with paragraph (c)(2)(iii)(C) of this section, the QJSA notice provides that the QJSA is of approximately the same value as the single life annuity.

Example 4. (i) The facts are the same as in *Example 1*, except that under Plan A, the single-sum distribution is determined as the actuarial present value of the immediately commencing single life annuity. In addition, Plan A provides a joint and 75 percent survivor annuity that is reduced from the single life annuity and that is the QJSA under Plan A. For purposes of determining the amount of the QJSA, if the participant is married the reduction is only half of the reduction that would normally apply under the actuarial assumptions specified in Plan A for determining actuarial equivalence of optional forms.

(ii) In lieu of providing information specific to Participant M in the QJSA notice as set forth in paragraph (c) of this section, Plan A satisfies the QJSA explanation requirement in accordance with paragraph (d)(2) of this section by providing M with a statement that M's monthly benefit under an immediately commencing single life annuity (which is the normal form of benefit under Plan A, adjusted for immediate commencement) is $3,000, along with the following chart showing the financial effect and the relative value of the optional forms of benefit compared to the QJSA for a hypothetical participant with a $1,000 benefit and a spouse who is three years younger than the participant. For each optional form generally available under the plan, the chart shows the financial effect and the relative value, using the grouping rules of paragraph (c)(2)(iii) of this section. Separate charts are provided for ages 55, 60, and 65, as follows:

AGE 55 COMMENCEMENT

Optional form	Amount of distribution per $1,000 of immediate single life annuity	Relative value
Life Annuity	$1,000 per month	Approximately the same value as the QJSA.
QJSA (joint and 75 percent survivor annuity for a participant who is married).	$956 per month ($717 per month for survivor annuity).	n/a.
Joint and 100 percent survivor annuity	$886 per month ($886 per month for survivor annuity).	Approximately the same value as the QJSA.
Lump sum	$165,959	Approximately the same value as the QJSA.

AGE 60 COMMENCEMENT

Optional form	Amount of distribution per $1,000 of immediate single life annuity	Relative value
Life Annuity	$1,000 per month	Approximately 94 percent of the value of the QJSA.
QJSA (joint and 75 percent survivor annuity for a participant who is married).	$945 per month ($709 per month for survivor annuity).	n/a.
Joint and 100 percent survivor annuity	$859 per month ($859 per month for survivor annuity).	Approximately 94 percent of the value of the QJSA.
Lump sum	$151,691	Approximately the same value as the QJSA.

AGE 65 COMMENCEMENT

Optional form	Amount of distribution per $1,000 of immediate single life annuity	Relative value
Life Annuity	$1,000 per month	Approximately 93 percent of the value of the QJSA.
QJSA (joint and 75 percent survivor annuity for a participant who is married).	$932 per month ($699 per month for survivor annuity).	n/a.
Joint and 100 percent survivor annuity	$828 per month ($828 per month for survivor annuity).	Approximately 93 percent of the value of the QJSA.
Lump sum	$135,759	Approximately 93 percent of the value of the QJSA.

(iii) The chart disclosing the financial effect and relative value of the optional forms specifies that the calculations were prepared assuming that the spouse is three years younger than the participant, that the calculations relating to the single-sum distribution were prepared using 5.5 percent interest and average life expectancy, that the other calculations were prepared using a 6 percent interest rate, and that the relative value of actual payments for an individual can vary depending on how long the individual and spouse live. The explanation states that the relative value comparison converts the single life annuity, the joint and 100 percent survivor annuity, and the single-sum options to value of each if paid in the form of the QJSA and that this conversion uses interest and life expectancy assumptions. The explanation notes that the calculation of the QJSA depends on the actual age of the spouse (for example, annuity payments will be significantly lower if the spouse is significantly younger than the participant), and that the amount of the single-sum payment will depend on the interest rates that apply when the participant actually takes a distribution. The explanation also includes an offer to provide a calculation specific to the participant upon request, and an offer to provide mortality tables used in preparing calculations upon request.

(iv) In accordance with paragraph (d)(4)(i) of this section, Participant M requests specific information regarding the amounts payable under the QJSA, the joint and 100 percent survivor annuity, and the single sum.

(v) Based on the information about the age of Participant M's spouse, Plan A determines that M's QJSA is $2,856.30 per month, the joint and 100 percent survivor annuity is $2,628.60 per month, and the single sum is $497,876. The actuarial present value of the QJSA (determined using the 5.5 percent interest and the section 417(e)(3) applicable mortality table, the actuarial assumptions required under section 417) is $525,091. Accordingly, the value of the single-sum distribution available to M on October 1, 2004, is 94.8 percent of the actuarial present value of the QJSA. In addition, the actuarial present value of the life annuity and the 100 percent joint and survivor annuity are 95.0 percent of the actuarial present value of the QJSA.

(vi) Plan A provides M with a QJSA explanation that incorporates these more precise calculations of the financial effect and relative value of the optional forms for which M requested information.

(f) *Effective date*—(1) *General effective date for QJSA explanations*—(i) *In general*. Except as otherwise provided in this paragraph (f), this section applies to a QJSA explanation with respect to any distribution with an annuity starting date that is on or after February 1, 2006.

(ii) *Reasonable, good faith transition rule*. Except with respect to any portion of a QJSA explanation that is subject to the earlier effective date rule of paragraph (f)(2) of this section, a reasonable, good faith effort to comply with these regulations will be deemed to satisfy the requirements of these regulations for QJSA explanations provided before January 1, 2007, with respect to distributions with annuity starting dates that are on or after February 1, 2006. For this purpose, a reasonable, good faith effort to comply with these regulations includes substantial compliance with §1.417(a)(3)–1 as it appeared in 26 CFR part 1 revised April 1, 2004.

(2) *Special effective date for certain QJSA explanations*—(i) *Application to QJSA explanations with respect to certain optional forms that are less valuable than the QJSA*. This section also applies to a QJSA explanation with respect to any distribution with an annuity starting date that is on or after October 1, 2004, and before February 1, 2006, if the actuarial present value of any optional form of benefit that is subject to the requirements of section 417(e)(3) is less than the actuarial present value (as determined under §1.417(e)–1(d)) of the QJSA. For purposes of this paragraph (f)(2)(i), the actuarial present value of an optional form is treated as not less than the actuarial present value of the QJSA if—

(A) Using the applicable interest rate and applicable mortality table under §1.417(e)–1(d)(2) and (3), the actuarial present value of that optional form is not less than the actuarial present value of the QJSA for an unmarried participant; and

(B) Using reasonable actuarial assumptions, the actuarial present value of the QJSA for an unmarried participant is not less than the actuarial present value of the QJSA for a married participant.

(ii) *Requirement to disclose differences in value for certain optional forms*. A QJSA explanation with respect to any distribution with an annuity starting date that is on or after October 1, 2004,

and before February 1, 2006, is only required to be provided under this section with respect to—

(A) An optional form of benefit that is subject to the requirements of section 417(e)(3) and that has an actuarial present value that is less than the actuarial present value of the QJSA (as described in paragraph (f)(2)(i) of this section); and

(B) The QJSA (determined without application of paragraph (c)(2)(ii) of this section).

(iii) *Application to QJSA explanations with respect to optional forms that are approximately equal in value to the QJSA.* Paragraph (c)(2)(iii)(C) of this section, relating to disclosures of optional forms of benefit that are permitted to be described as approximately equal in value to the QJSA, is not applicable to a QJSA explanation provided before January 1, 2007. However, §1.417(a)(3)–1(c)(2)(iii)(C), as it appeared in 26 CFR part 1 revised April 1, 2004, applies to a QJSA explanation with respect to any distribution with an annuity starting date that is on or after October 1, 2004, and that is provided before January 1, 2007.

(3) *Annuity starting date.* For purposes of paragraphs (f)(1) and (2) of this section, in the case of a retroactive annuity starting date under section 417(a)(7), as described in §1.417(e)–1(b)(3)(vi), the date of commencement of the actual payments based on the retroactive annuity starting date is substituted for the annuity starting date.

(4) *Effective date for QPSA explanations.* This section applies to any QPSA explanation provided on or after July 1, 2004.

[T.D. 9099, 68 FR 70144, Dec. 17, 2003, as amended by T.D. 9256, 71 FR 14802, Mar. 24, 2006; 71 FR 26688, May 8, 2006; T.D. 9294, 71 FR 61888, Oct. 20, 2006]

§1.417(e)–1 Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417.

(a) *Scope*—(1) *In general.* A plan does not satisfy the requirements of sections 401(a)(11) and 417 unless it satisfies the consent requirements, the determination of present value requirements and the other requirements set forth in this section. See section 401(a)(11) and §1.401(a)–20 for other rules regarding the survivor annuity requirements.

(2) *Additional requirements.* See §1.411(a)–11 for other rules applicable to the consent requirements.

(3) *Accrued benefit.* The definition of ''accrued benefit'' in §1.411(a)–11 applies when that term is used in this section.

(b) *Consent, etc. requirements*—(1) *General rule.* Generally plans may not commence the distribution of any portion of a participant's accrued benefit in any form unless the applicable consent requirements are satisfied. No consent of the participant or spouse is needed for distribution of a QJSA or QPSA after the benefit is no longer immediately distributable (after the participant attains (or would have attained if not dead) the later of normal retirement age (as defined in section 411(a)(8)) or age 62). No consent of the spouse is needed for distribution of a QJSA at any time. After the participant's death, a benefit may be paid to a nonspouse beneficiary without the beneficiary's consent. A distribution cannot be made at any time in a form other than a QJSA unless such QJSA has been waived by the participant and such waiver has been consented to by the spouse. A QJSA is an annuity that commences immediately. Thus, for example, a plan may not offer a participant separating from service at age 45 a choice only between a single sum distribution at separation of service and a joint and survivor annuity that satisfies all the requirements of a QJSA except that it commences at normal retirement age rather than immediately. To satisfy this section, the plan must also offer a QJSA (*i.e.*, an annuity that satisfies all the requirements for a QJSA including the requirement that it commences immediately).

(2) *Consent.* (i) Written consent of the participant and, if the participant is married at the annuity starting date and the benefit is to be paid in a form other than a QJSA, the participant's spouse (or, if either the participant or the spouse has died, the survivor) is required before the commencement of the distribution of any part of an accrued benefit if the present value of the

nonforfeitable benefit is greater than the cash-out limit in effect under §1.411(a)–11(c)(3)(ii). No consent is valid unless the participant has received a general description of the material features, and an explanation of the relative values of, the optional forms of benefit available under the plan in a manner which would satisfy the notice requirements of section 417(a)(3). *See* §1.417(a)(3)–1. No consent is required before the annuity starting date if the present value of the nonforfeitable benefit is not more than the cash-out limit in effect under §1.411(a)–11(c)(3)(ii). After the annuity starting date, consent is required for the immediate distribution of the present value of the accrued benefit being distributed in any form, including a qualified joint and survivor annuity or a qualified preretirement survivor annuity, regardless of the amount of such present value.

(ii) In determining the present value of any nonforfeitable accrued benefit, a defined benefit plan is limited by the interest rate restriction as set forth in paragraph (d) of this section.

(iii) Paragraph (b)(2)(i) of this section applies to distributions made on or after October 17, 2000. For distributions prior to October 17, 2000, §1.417(e)–1(b)(2)(i) in effect prior to October 17, 2000 (as contained in 26 CFR part 1 revised as of April 1, 2000) applies.

(3) *Time of consent.* (i) Written consent of the participant and the participant's spouse to the distribution must be made not more than 90 days before the annuity starting date, and, except as otherwise provided in paragraphs (b)(3)(iii) and (b)(3)(iv) of this section, no later than the annuity starting date.

(ii) A plan must provide participants with the written explanation of the QJSA required by section 417(a)(3) no less than 30 days and no more than 90 days before the annuity starting date, except as provided in paragraph (b)(3)(iv) of this section regarding retroactive annuity starting dates. However, if the participant, after having received the written explanation of the QJSA, affirmatively elects a form of distribution and the spouse consents to that form of distribution (if necessary), a plan will not fail to satisfy the requirements of section 417(a) merely because the written explanation was provided to the participant less than 30 days before the annuity starting date, provided that the following conditions are met:

(A) The plan administrator provides information to the participant clearly indicating that (in accordance with the first sentence of this paragraph (b)(3)(ii)) the participant has a right to at least 30 days to consider whether to waive the QJSA and consent to a form of distribution other than a QJSA.

(B) The participant is permitted to revoke an affirmative distribution election at least until the annuity starting date, or, if later, at any time prior to the expiration of the 7-day period that begins the day after the explanation of the QJSA is provided to the participant.

(C) The annuity starting date is after the date that the explanation of the QJSA is provided to the participant.

(D) Distribution in accordance with the affirmative election does not commence before the expiration of the 7-day period that begins the day after the explanation of the QJSA is provided to the participant.

(iii) The plan may permit the annuity starting date to be before the date that any affirmative distribution election is made by the participant (and before the date that distribution is permitted to commence under paragraph (b)(3)(ii)(D) of this section), provided that, except as otherwise provided in paragraph (b)(3)(vii) of this section regarding administrative delay, distributions commence not more than 90 days after the explanation of the QJSA is provided.

(iv) *Retroactive annuity starting dates.* (A) Notwithstanding the requirements of paragraphs (b)(3)(i) and (ii) of this section, pursuant to section 417(a)(7), a defined benefit plan is permitted to provide benefits based on a retroactive annuity starting date if the requirements described in paragraph (b)(3)(v) of this section are satisfied. A defined benefit plan is not required to provide for retroactive annuity starting dates. If a plan does provide for a retroactive annuity starting date, it may impose

conditions on the availability of a retroactive annuity starting date in addition to those imposed by paragraph (b)(3)(v) of this section, provided that imposition of those additional conditions does not violate any of the rules applicable to qualified plans. For example, a plan that includes a single sum payment as a benefit option may limit the election of a retroactive annuity starting date to those participants who do not elect the single sum payment. A defined contribution plan is not permitted to have a retroactive annuity starting date.

(B) For purposes of this section, a ''retroactive annuity starting date'' is an annuity starting date affirmatively elected by a participant that occurs on or before the date the written explanation required by section 417(a)(3) is provided to the participant. In order for a plan to treat a participant as having elected a retroactive annuity starting date, future periodic payments with respect to a participant who elects a retroactive annuity starting date must be the same as the future periodic payments, if any, that would have been paid with respect to the participant had payments actually commenced on the retroactive annuity starting date. The participant must receive a make-up payment to reflect any missed payment or payments for the period from the retroactive annuity starting date to the date of the actual make-up payment (with an appropriate adjustment for interest from the date the missed payment or payments would have been made to the date of the actual make-up payment). Thus, the benefit determined as of the retroactive annuity starting date must satisfy the requirements of sections 417(e)(3), if applicable, and section 415 with the applicable interest rate and applicable mortality table determined as of that date. Similarly, a participant is not permitted to elect a retroactive annuity starting date that precedes the date upon which the participant could have otherwise started receiving benefits (e.g., in the case of an ongoing plan, the earlier of the participant's termination of employment or the participant's normal retirement age) under the terms of the plan in effect as of the retroactive annuity starting date. A plan does not fail to treat a participant as having elected a retroactive annuity starting date as described in this paragraph (b)(3)(iv)(B) merely because the distributions are adjusted to the extent necessary to satisfy the requirements of paragraph (b)(3)(v)(B) and (C) of this section relating to sections 415 and 417(e)(3).

(C) If the participant's spouse as of the retroactive annuity starting date would not be the participant's spouse determined as if the date distributions commence was the participant's annuity starting date, consent of that former spouse is not needed to waive the QJSA with respect to the retroactive annuity starting date, unless otherwise provided under a qualified domestic relations order (as defined in section 414(p)).

(D) A distribution payable pursuant to a retroactive annuity starting date election is treated as excepted from the present value requirements of paragraph (d) of this section under paragraph (d)(6) of this section if the distribution form would have been described in paragraph (d)(6) of this section had the distribution actually commenced on the retroactive annuity starting date. Similarly, annuity payments that otherwise satisfy the requirements of a QJSA under section 417(b) will not fail to be treated as a QJSA for purposes of section 415(b)(2)(B) merely because a retroactive annuity starting date is elected and a make-up payment is made. Also, for purposes of section 72(t)(2)(A)(iv), a distribution that would otherwise be one of a series of substantially equal periodic payments will be treated as one of a series of substantially equal periodic payments notwithstanding the distribution of a make-up payment provided for in paragraph (b)(3)(iv)(B) of this section.

(E) The following example illustrates the application of paragraph (b)(3)(iv)(D) of this section:

Example. Under the terms of a defined benefit plan, participant A is entitled to a QJSA with a monthly payment of $1,500 beginning as of his annuity starting date. Due to administrative error, the QJSA explanation is provided to A after the annuity starting date. After receiving the QJSA explanation A elects a retroactive annuity starting date.

Pursuant to this election, A begins to receive a monthly payment of $1,500 and also receives a make-up payment of $10,000. Under these circumstances the monthly payments may be treated as a QJSA for purposes of section 415(b)(2)(B). In addition, the monthly payments of $1,500 and the make-up payment of $10,000 may be treated as part of as series of substantially equal periodic payments for purpose of section 72(t)(2)(A)(iv).

(v) *Requirements applicable to retroactive annuity starting dates.* A distribution is permitted to have a retroactive annuity starting date with respect to a participant's benefit only if the following requirements are met:

(A) The participant's spouse (including an alternate payee who is treated as the spouse under a qualified domestic relations order (QDRO), as defined in section 414(p)), determined as if the date distributions commence were the participant's annuity starting date, consents to the distribution in a manner that would satisfy the requirements of section 417(a)(2). The spousal consent requirement of this paragraph (b)(3)(v)(A) is satisfied if such spouse consents to the distribution under paragraph (b)(2)(i) of this section. The spousal consent requirement of this paragraph (b)(3)(v)(A) does not apply if the amount of such spouse's survivor annuity payments under the retroactive annuity starting date election is no less than the amount that the survivor payments to such spouse would have been under an optional form of benefit that would satisfy the requirements to be a QJSA under section 417(b) and that has an annuity starting date after the date that the explanation was provided.

(B) The distribution (including appropriate interest adjustments) provided based on the retroactive annuity starting date would satisfy the requirements of section 415 if the date the distribution commences is substituted for the annuity starting date for all purposes, including for purposes of determining the applicable interest rate and the applicable mortality table. However, in the case of a form of benefit that would have been excepted from the present value requirements of paragraph (d) of this section under paragraph (d)(6) of this section if the distribution had actually commenced on the retroactive annuity starting date, the requirement to apply section 415 as of the date distribution commences set forth in this paragraph (b)(3)(v)(B) does not apply if the date distribution commences is twelve months or less from the retroactive annuity starting date.

(C) In the case of a form of benefit that would have been subject to section 417(e)(3) and paragraph (d) of this section if distributions had commenced as of the retroactive annuity starting date, the distribution is no less than the benefit produced by applying the applicable interest rate and the applicable mortality table determined as of the date the distribution commences to the annuity form that corresponds to the annuity form that was used to determine the benefit amount as of the retroactive annuity starting date. Thus, for example, if a distribution paid pursuant to an election of a retroactive annuity starting date is a single-sum distribution that is based on the present value of the straight life annuity payable at normal retirement age, then the amount of the distribution must be no less than the present value of the annuity payable at normal retirement age, determined as of the distribution date using the applicable mortality table and applicable interest rate that apply as of the distribution date. Likewise, if a distribution paid pursuant to an election of a retroactive annuity starting date is a single-sum distribution that is based on the present value of the early retirement annuity payable as of the retroactive annuity starting date, then the amount of the distribution must be no less than the present value of the early retirement annuity payable as of the distribution date, determined as of the distribution date using the applicable mortality table and applicable interest rate that apply as of the distribution date.

(vi) *Timing of notice and consent requirements in the case of retroactive annuity starting dates.* In the case of a retroactive annuity starting date, the date of the first actual payment of benefits based on the retroactive annuity starting date is substituted for the annuity starting date for purposes of satisfying the timing requirements for

giving consent and providing an explanation of the QJSA provided in paragraphs (b)(3)(i) and (ii) of this section, except that the substitution does not apply for purposes of paragraph (b)(3)(iii) of this section. Thus, the written explanation required by section 417(a)(3)(A) must generally be provided no less than 30 days and no more than 90 days before the date of the first payment of benefits and the election to receive the distribution must be made after the written explanation is provided and on or before the date of the first payment. Similarly, the written explanation may also be provided less than 30 days prior to the first payment of benefits if the requirements of paragraph (b)(3)(ii) of this section would be satisfied if the date of the first payment is substituted for the annuity starting date.

(vii) *Administrative delay*. A plan will not fail to satisfy the 90-day timing requirements of paragraphs (b)(3)(iii) and (vi) of this section merely because, due solely to administrative delay, a distribution commences more than 90 days after the written explanation of the QJSA is provided to the participant.

(viii) The following example illustrates the provisions of this paragraph (b)(3):

Example. Employee E, a married participant in a defined benefit plan who has terminated employment, is provided with the explanation of the QJSA on November 28.

Employee E elects (with spousal consent) on December 2 to waive the QJSA and receive an immediate distribution in the form of a single life annuity. The plan may permit Employee E to receive payments with an annuity starting date of December 1, provided that the first payment is made no earlier than December 6 and the participant does not revoke the election before that date. The plan can make the remaining monthly payments on the first day of each month thereafter in accordance with its regular payment schedule.

(ix) The additional rules of this paragraph (b)(3) concerning the notice and consent requirements of section 417 apply to distributions on or after September 22, 1995. For distributions before September 22, 1995, the additional rules concerning the notice and consent requirements of section 417 in § 1.417(e)–1(b)(3) in effect prior to September 22, 1995 (see § 1.417(e)–1 (b)(3) in 26 CFR Part 1 revised as of April 1, 1995) apply.

(4) *Delegation to Commissioner*. The Commissioner, in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin, may modify, or provide additional guidance with respect to, the notice and consent requirements of this section. See § 601.601(d)(2)(ii)(*b*) of this chapter.

(c) *Permitted distributions*. A plan may not require that a participant or surviving spouse begin to receive benefits without satisfying paragraph (b) of this section while such benefits are immediately distributable, (see paragraph (b)(1) of this section). Once benefits are no longer immediately distributable, all benefits that the plan requires to begin must be provided in the form of a QJSA and QPSA unless the applicable written explanation, election and consent requirements of section 417 are satisfied.

(d) *Present value requirement*—(1) *General rule*. A defined benefit plan must provide that the present value of any accrued benefit and the amount (subject to sections 411(c)(3) and 415) of any distribution, including a single sum, must not be less than the amount calculated using the applicable interest rate described in paragraph (d)(3) of this section (determined for the month described in paragraph (d)(4) of this section) and the applicable mortality table described in paragraph (d)(2) of this section. The present value of any optional form of benefit cannot be less than the present value of the normal retirement benefit determined in accordance with the preceding sentence. The same rules used for the plan under this paragraph (d) must also be used to compute the present value of the benefit for purposes of determining whether consent for a distribution is required under paragraph (b) of this section.

(2) *Applicable mortality table*. The applicable mortality table is the mortality table based on the prevailing commissioners' standard table (described in section 807(d)(5)(A)) used to determine reserves for group annuity contracts issued on the date as of which present value is being determined (without regard to any other subparagraph of section 807(d)(5)), that

is prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter). The Commissioner may prescribe rules that apply in the case of a change to the prevailing commissioners' standard table (described in section 807(d)(5)(A)) used to determine reserves for group annuity contracts, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter).

(3) *Applicable interest rate*—(i) *General rule*. The applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter).

(ii) *Example*. This example illustrates the rules of this paragraph (d)(3):

Example. Plan A is a calendar year plan. For its 1995 plan year, Plan A provides that the applicable mortality table is the table described in Rev. Rul. 95–6 (1995–1 C.B. 80), and that the applicable interest rate is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for the first full calendar month preceding the calendar month that contains the annuity starting date. Participant P is age 65 in January 1995, which is the month that contains P's annuity starting date. P has an accrued benefit payable monthly of $1,000 and has elected to receive a distribution in the form of a single sum in January 1995. The annual interest rate on 30-year Treasury securities as published by the Commissioner for December 1994 is 7.87 percent. To satisfy the requirements of section 417(e)(3) and this paragraph (d), the single sum received by P may not be less than $111,351.

(4) *Time for determining interest rate*—(i) *General rule*. Except as provided in paragraph (d)(4)(iv) or (v) of this section, the applicable interest rate to be used for a distribution is the rate determined under paragraph (d)(3) of this section for the applicable lookback month. The applicable lookback month for a distribution is the lookback month (as described in paragraph (d)(4)(iii) of this section) for the month (or other longer stability period described in paragraph (d)(4)(ii) of this section) that contains the annuity starting date for the distribution. The time and method for determining the applicable interest rate for each participant's distribution must be determined in a consistent manner that is applied uniformly to all participants in the plan.

(ii) *Stability period*. A plan must specify the period for which the applicable interest rate remains constant. This stability period may be one calendar month, one plan quarter, one calendar quarter, one plan year, or one calendar year.

(iii) *Lookback month*. A plan must specify the lookback month that is used to determine the applicable interest rate. The lookback month may be the first, second, third, fourth, or fifth full calendar month preceding the first day of the stability period.

(iv) *Permitted average interest rate*. A plan may apply the rules of paragraph (d)(4)(i) of this section by substituting a permitted average interest rate with respect to the plan's stability period for the rate determined under paragraph (d)(3) of this section for the applicable lookback month for the stability period. For this purpose, a permitted average interest rate with respect to a stability period is an interest rate that is computed by averaging the applicable interest rates determined under paragraph (d)(3) of this section for two or more consecutive months from among the first, second, third, fourth, and fifth calendar months preceding the first day of the stability period. For this paragraph (d)(4)(iv) to apply, a plan must specify the manner in which the permitted average interest rate is computed.

(v) *Additional determination dates*. The Commissioner may prescribe, in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*)), other times that a plan may provide for determining the applicable interest rate.

(vi) *Example*. This example illustrates the rules of this paragraph (d)(4):

Example. Employer X maintains Plan A, a calendar year plan. Employer X wishes to amend Plan A so that the applicable interest rate will remain fixed for each plan quarter, and so that the applicable interest rate for distributions made during each plan quarter can be determined approximately 80 days before the beginning of the plan quarter. To comply with the provisions of this paragraph

(d)(4), Plan A is amended to provide that the applicable interest rate is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for the fourth calendar month preceding the first day of the plan quarter during which the annuity starting date occurs.

(5) *Use of alternative interest rate and mortality table.* If a plan provides for use of an interest rate or mortality table other than the applicable interest rate or the applicable mortality table, the plan must provide that a participant's benefit must be at least as great as the benefit produced by using the applicable interest rate and the applicable mortality table. For example, if a plan provides for use of an interest rate of 7% and the UP–1984 Mortality Table (see §1.401(a)(4)–12, *Standard mortality table*) in calculating single-sum distributions, the plan must provide that any single-sum distribution is calculated as the greater of the single-sum benefit calculated using 7% and the UP–1984 Mortality Table and the single-sum benefit calculated using the applicable interest rate and the applicable mortality table.

(6) *Exceptions.* This paragraph (d) (other than the provisions relating to section 411(d)(6) requirements in paragraph (d)(10) of this section) does not apply to the amount of a distribution paid in the form of an annual benefit that—

(i) Does not decrease during the life of the participant, or, in the case of a QPSA, the life of the participant's spouse; or

(ii) Decreases during the life of the participant merely because of—

(A) The death of the survivor annuitant (but only if the reduction is to a level not below 50% of the annual benefit payable before the death of the survivor annuitant); or

(B) The cessation or reduction of Social Security supplements or qualified disability benefits (as defined in section 411(a)(9)).

(7) *Defined contribution plans.* Because the accrued benefit under a defined contribution plan equals the account balance, a defined contribution plan is not subject to the requirements of this paragraph (d), even though it is subject to section 401(a)(11).

(8) *Effective date*—(i) *In general.* This paragraph (d) is effective for distributions with annuity starting dates in plan years beginning after December 31, 1994.

(ii) *Optional delayed effective date of Retirement Protection Act of 1994 (RPA '94)(108 Stat. 5012) rules for plans adopted and in effect before December 8, 1994.* For a plan adopted and in effect before December 8, 1994, the application of the rules relating to the applicable mortality table and applicable interest rate under paragraphs (d)(2) through (4) of this section is delayed to the extent provided in this paragraph (d)(8)(ii), if the plan provisions in effect on December 7, 1994, met the requirements of section 417(e)(3) and §1.417(e)–1(d) as in effect on December 7, 1994 (as contained in 26 CFR part 1 revised April 1, 1995). In the case of a distribution from such a plan with an annuity starting date that precedes the optional delayed effective date described in paragraph (d)(8)(iv) of this section, and that precedes the first day of the first plan year beginning after December 31, 1999, the rules of paragraph (d)(9) of this section (which generally apply to distributions with annuity starting dates in plan years beginning before January 1, 1995) apply in lieu of the rules of paragraphs (d)(2) through (4) of this section. The interest rate under the rules of paragraph (d)(9) of this section is determined under the provisions of the plan as in effect on December 7, 1994, reflecting the interest rate or rates published by the Pension Benefit Guaranty Corporation (PBGC) and the provisions of the plan for determining the date on which the interest rate is fixed. The above described interest rate or rates published by the PBGC are those determined by the PBGC (for the date determined under those plan provisions) pursuant to the methodology under the regulations of the PBGC for determining the present value of a lump sum distribution on plan termination under 29 CFR part 2619 that were in effect on September 1, 1993 (as contained in 29 CFR part 2619 revised July 1, 1994).

(iii) *Optional accelerated effective date of RPA '94 rules.* This paragraph (d) is also effective for a distribution with an annuity starting date after December 7, 1994, during a plan year beginning before January 1, 1995, if the employer

elects, on or before the annuity starting date, to make the rules of this paragraph (d) effective with respect to the plan as of the optional accelerated effective date described in paragraph (d)(8)(iv) of this section. An employer is treated as making this election by making the plan amendments described in paragraph (d)(8)(iv) of this section.

(iv) *Determination of delayed or accelerated effective date by plan amendment adopting RPA '94 rules.* The optional delayed effective date of paragraph (d)(8)(ii) of this section, or the optional accelerated effective date of paragraph (d)(8)(iii) of this section, whichever is applicable, is the date plan amendments applying both the applicable mortality table of paragraph (d)(2) of this section and the applicable interest rate of paragraph (d)(3) of this section are adopted or, if later, are made effective.

(9) *Plan years beginning before January 1, 1995*—(i) *Interest rate.* (A) For distributions made in plan years beginning after December 31, 1986, and before January 1, 1995, the following interest rate described in paragraph (d)(9)(i)(A)(*1*) or (*2*) of this section, whichever applies, is substituted for the applicable interest rate for purposes of this section—

(*1*) The rate or rates that would be used by the PBGC for a trusteed single-employer plan to value the participant's (or beneficiary's) vested benefit (PBGC interest rate) if the present value of such benefit does not exceed $25,000; or

(*2*) 120 percent of the PBGC interest rate, as determined in accordance with paragraph (d)(9)(i)(A)(*1*) of this section, if such present value exceeds $25,000. In no event shall the present value determined by use of 120 percent of the PBGC interest rate result in a present value less than $25,000.

(B) The PBGC interest rate may be a series of interest rates for any given date. For example, the PBGC interest rate for immediate annuities for November 1994 is 6%, and the PBGC interest rates for the deferral period for that month are as follows: 5.25% for the first 7 years of the deferral period, 4% for the following 8 years of the deferral period, and 4% for the remainder of the deferral period. For November 1994, 120 percent of the PBGC interest rate is 7.2% (1.2 times 6%) for an immediate annuity, 6.3% (1.2 times 5.25%) for the first 7 years of the deferral period, 4.8% (1.2 times 4%) for the following 8 years of the deferral period, and 4.8% (1.2 times 4%) for the remainder of the deferral period. The PBGC interest rates are the interest rates that would be used (as of the date of the distribution) by the PBGC for purposes of determining the present value of that benefit upon termination of an insufficient trusteed single employer plan. Except as otherwise provided by the Commissioner, the PBGC interest rates are determined by PBGC regulations. See subpart B of 29 CFR part 4044 for the applicable PBGC rates.

(ii) *Time for determining interest rate.* (A) Except as provided in paragraph (d)(9)(ii)(B) of this section, the PBGC interest rate or rates are determined on either the annuity starting date or the first day of the plan year that contains the annuity starting date. The plan must provide which date is applicable.

(B) The plan may provide for the use of any other time for determining the PBGC interest rate or rates provided that such time is not more than 120 days before the annuity starting date if such time is determined in a consistent manner and is applied uniformly to all participants.

(C) The Commissioner may, in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*), prescribe other times for determining the PBGC interest rate or rates.

(iii) *No applicable mortality table.* In the case of a distribution to which this paragraph (d)(9) applies, the rules of this paragraph (d) are applied without regard to the applicable mortality table described in paragraph (d)(2) of this section.

(10) *Relationship with section 411(d)(6)*—(i) *In general.* A plan amendment that changes the interest rate, the time for determining the interest rate, or the mortality assumptions used for the purposes described in paragraph (d)(1) of this section is subject to section 411(d)(6). But see §1.411(d)–4,

Q&A–2(b)(2)(v) (regarding plan amendments relating to involuntary distributions). In addition, a plan amendment that changes the interest rate or the mortality assumptions used for the purposes described in paragraph (d)(1) of this section merely to eliminate use of the interest rate described in paragraph (d)(3) or paragraph (d)(9) of this section, or the applicable mortality table, with respect to a distribution form described in paragraph (d)(6) of this section, for distributions with annuity starting dates occurring after a specified date that is after the amendment is adopted, does not violate the requirements of section 411(d)(6) if the amendment is adopted on or before the last day of the last plan year ending before January 1, 2000.

(ii) *Section 411(d)(6) relief for change in time for determining interest rate.* Notwithstanding the general rule of paragraph (d)(10)(i) of this section, if a plan amendment changes the time for determining the applicable interest rate (including an indirect change as a result of a change in plan year), the amendment will not be treated as reducing accrued benefits in violation of section 411(d)(6) merely on account of this change if the conditions of this paragraph (d)(10)(ii) are satisfied. If the plan amendment is effective on or after the adoption date, any distribution for which the annuity starting date occurs in the one-year period commencing at the time the amendment is effective must be determined using the interest rate provided under the plan determined at either the date for determining the interest rate before the amendment or the date for determining the interest rate after the amendment, whichever results in the larger distribution. If the plan amendment is adopted retroactively (that is, the amendment is effective prior to the adoption date), the plan must use the interest rate determination date resulting in the larger distribution for the period beginning with the effective date and ending one year after the adoption date.

(iii) *Section 411(d)(6) relief for plan amendments pursuant to changes to section 417 made by RPA '94 providing for statutory interest rate determination date.* Notwithstanding the general rule of paragraph (d)(10)(i) of this section, except as provided in paragraph (d)(10)(vi)(B) of this section, a participant's accrued benefit is not considered to be reduced in violation of section 411(d)(6) merely because of a plan amendment that changes any interest rate or mortality assumption used to calculate the present value of a participant's benefit under the plan, if the following conditions are satisfied—

(A) The amendment replaces the PBGC interest rate (or an interest rate or rates based on the PBGC interest rate) as the interest rate used under the plan in determining the present value of a participant's benefit under this paragraph (d); and

(B) After the amendment is effective, the present value of a participant's benefit under the plan cannot be less than the amount calculated using the applicable mortality table and the applicable interest rate for the first full calendar month preceding the calendar month that contains the annuity starting date.

(iv) *Section 411(d)(6) relief for plan amendments pursuant to changes to section 417 made by RPA '94 providing for prior determination date or up to two months earlier.* Notwithstanding the general rule of paragraph (d)(10)(i) of this section, except as provided in paragraph (d)(10)(vi)(B) of this section, a participant's accrued benefit is not considered to be reduced in violation of section 411(d)(6) merely because of a plan amendment that changes any interest rate or mortality assumption used to calculate the present value of a participant's benefit under the plan, if the following conditions are satisfied—

(A) The amendment replaces the PBGC interest rate (or an interest rate or rates based on the PBGC interest rate) as the interest rate used under the plan in determining the present value of a participant's benefit under this paragraph (d); and

(B) After the amendment is effective, the present value of a participant's benefit under the plan cannot be less than the amount calculated using the applicable mortality table and the applicable interest rate, but only if the applicable interest rate is the annual

interest rate on 30-year Treasury securities for the calendar month that contains the date as of which the PBGC interest rate (or an interest rate or rates based on the PBGC interest rate) was determined immediately before the amendment, or for one of the two calendar months immediately preceding such month.

(v) *Section 411(d)(6) relief for plan amendments pursuant to changes to section 417 made by RPA '94 providing for other interest rate determination date.* Notwithstanding the general rule of paragraph (d)(10)(i) of this section, except as provided in paragraph (d)(10)(vi)(B) of this section, a participant's accrued benefit is not considered to be reduced in violation of section 411(d)(6) merely because of a plan amendment that changes any interest rate or mortality assumption used to calculate the present value of a participant's benefit under the plan, if the following conditions are satisfied—

(A) The amendment replaces the PBGC interest rate (or an interest rate or rates based on the PBGC interest rate) as the interest rate used under the plan in determining the present value of a participant's benefit under this paragraph (d);

(B) After the amendment is effective, the present value of a participant's benefit under the plan cannot be less than the amount calculated using the applicable mortality table and the applicable interest rate; and

(C) The plan amendment satisfies either the condition of paragraph (d)(10)(ii) of this section (determined using the interest rate provided under the terms of the plan after the effective date of the amendment) or the special early transition interest rate rule of paragraph (d)(10)(vi)(C) of this section.

(vi) *Special rules*—(A) *Provision of temporary additional benefits.* A plan amendment described in paragraph (d)(10)(iii), (iv), or (v) of this section is not considered to reduce a participant's accrued benefit in violation of section 411(d)(6) even if the plan amendment provides for temporary additional benefits to accommodate a more gradual transition from the plan's old interest rate to the new rules.

(B) *Replacement of non-PBGC interest rate.* The section 411(d)(6) relief provided in paragraphs (d)(10)(iii) through (v) of this section does not apply to a plan amendment that replaces an interest rate other than the PBGC interest rate (or an interest rate or rates based on the PBGC interest rate) as an interest rate used under the plan in determining the present value of a participant's benefit under this paragraph (d). Thus, the accrued benefit determined using that interest rate and the associated mortality table is protected under section 411(d)(6). For purposes of this paragraph (d), an interest rate is based on the PBGC interest rate if the interest rate is defined as a specified percentage of the PBGC interest rate, the PBGC interest rate minus a specified number of basis points, or an average of such interest rates over a specified period.

(C) *Special early transition interest rate rule for paragraph (d)(10)(v).* A plan amendment satisfies the special rule of this paragraph (d)(10)(vi)(C) if any distribution for which the annuity starting date occurs in the one-year period commencing at the time the plan amendment is effective is determined using whichever of the following two interest rates results in the larger distribution—

(*1*) The interest rate as provided under the terms of the plan after the effective date of the amendment, but determined at a date that is either one month or two months (as specified in the plan) before the date for determining the interest rate used under the terms of the plan before the amendment; or

(*2*) The interest rate as provided under the terms of the plan after the effective date of the amendment, determined at the date for determining the interest rate after the amendment.

(vii) *Examples.* The provisions of this paragraph (d)(10) are illustrated by the following examples:

Example 1. On December 31, 1994, Plan A provided that all single-sum distributions were to be calculated using the UP–1984 Mortality Table and 100% of the PBGC interest rate for the date of distribution. On January 4, 1995, and effective on February 1, 1995, Plan A was amended to provide that all single-sum distributions are calculated using

the applicable mortality table and the annual interest rate on 30-year Treasury securities for the first full calendar month preceding the calendar month that contains the annuity starting date. Pursuant to paragraph (d)(10)(iii) of this section, this amendment of Plan A is not considered to reduce the accrued benefit of any participant in violation of section 411(d)(6).

Example 2. On December 31, 1994, Plan B provided that all single-sum distributions were to be calculated using the UP–1984 Mortality Table and an interest rate equal to the lesser of 100% of the PBGC interest rate for the date of distribution, or 6%. On January 4, 1995, and effective on February 1, 1995, Plan B was amended to provide that all single-sum distributions are calculated using the applicable mortality table and the annual interest rate on 30-year Treasury securities for the second full calendar month preceding the calendar month that contains the annuity starting date. Pursuant to paragraph (d)(10)(iv) of this section, this amendment of Plan B is not considered to reduce the accrued benefit of any participant in violation of section 411(d)(6) merely because of the replacement of the PBGC interest rate. However, under paragraph (d)(10)(vi)(B) of this section, the section 411(d)(6) relief provided in paragraphs (d)(10)(iii) through (v) of this section does not apply to a plan amendment that replaces an interest rate other than the PBGC interest rate (or a rate based on the PBGC interest rate). Therefore, pursuant to paragraph (d)(10)(vi)(B) of this section, to satisfy the requirements of section 411(d)(6), the plan must provide that the single-sum distribution payable to any participant must be no less than the single-sum distribution calculated using the UP–1984 Mortality Table and an interest rate of 6%, based on the participant's benefits under the plan accrued through January 31, 1995, and based on the participant's age at the annuity starting date.

Example 3. On December 31, 1994, Plan C, a calendar year plan, provided that all single sum distributions were to be calculated using the UP–1984 Mortality Table and an interest rate equal to the PBGC interest rate for January 1 of the plan year. On March 1, 1995, and effective on July 1, 1995, Plan C was amended to provide that all single-sum distributions are calculated using the applicable mortality table and the annual interest rate on 30-year Treasury securities for August of the year before the plan year that contains the annuity starting date. The plan amendment provides that each distribution with an annuity starting date after June 30, 1995, and before July 1, 1996, is calculated using the 30-year Treasury rate for August of the year before the plan year that contains the annuity starting date, or the 30-year Treasury rate for January of the plan year that contains the annuity starting date, whichever produces the larger benefit. Pursuant to paragraph (d)(10)(v) of this section, the amendment of Plan C is not considered to have reduced the accrued benefit of any participant in violation of section 411(d)(6).

Example 4. (a) Employer X maintains Plan D, a calendar year plan. As of December 7, 1994, Plan D provided for single-sum distributions to be calculated using the PBGC interest rate as of the annuity starting date for distributions not greater than $25,000, and 120% of that interest rate (but not an interest rate producing a present value less than $25,000) for distributions over $25,000. Employer X wishes to delay the effective date of the RPA '94 rules for a year, and to provide for an extended transition from the use of the PBGC interest rate to the new applicable interest rate under section 417(e)(3). On December 1, 1995, and effective on January 1, 1996, Employer X amends Plan D to provide that single-sum distributions are determined as the sum of—

(i) The single-sum distribution calculated based on the applicable mortality table and the annual interest rate on 30-year Treasury securities for the first full calendar month preceding the calendar month that contains the annuity starting date; and

(ii) A transition amount.

(b) The amendment provides that the transition amount for distributions in the years 1996–99 is a transition percentage of the excess, if any, of the amount that the single-sum distribution would have been under the plan provisions in effect prior to this amendment over the amount of the single sum described in paragraph (a)(i) of this *Example 4*. The transition percentages are 80% for 1996, decreasing to 60% for 1997, 40% for 1998 and 20% for 1999. The amendment also provides that the transition amount is zero for plan years beginning on or after the year 2000. Pursuant to paragraphs (d)(10)(iii) and (vi)(A) of this section, the amendment of Plan D is not considered to have reduced the accrued benefit of any participant in violation of section 411(d)(6).

Example 5. On December 31, 1994, Plan E, a calendar year plan, provided that all single-sum distributions were to be calculated using the UP–1984 Mortality Table and an interest rate equal to the PBGC interest rate for January 1 of the plan year. On March 1, 1995, and effective on July 1, 1995, Plan E was amended to provide that all single-sum distributions are calculated using the applicable mortality table and the annual interest rate on 30-year Treasury securities for August of the year before the plan year that contains the annuity starting date. The plan amendment provides that each distribution with an annuity starting date after June 30, 1995, and before July 1, 1996, is calculated using the 30-year Treasury rate for August of the year before the plan year that contains the annuity starting date, or the 30-year

Treasury rate for November of the plan year preceding the plan year that contains the annuity starting date, whichever produces the larger benefit. Pursuant to paragraphs (d)(10)(v) and (vi)(C) of this section, the amendment of Plan E is not considered to have reduced the accrued benefit of any participant in violation of section 411(d)(6).

(e) *Special rules for annuity contracts*—(1) *General rule*. Any annuity contract purchased by a plan subject to section 401(a)(11) and distributed to or owned by a participant must provide that benefits under the contract are provided in accordance with the applicable consent, present value, and other requirements of sections 401(a)(11) and 417 applicable to the plan.

(2) [Reserved]

(f) *Effective dates*—(1) *Annuity contracts*. (i) Paragraph (e) of this section does not apply to contracts distributed to or owned by a participant prior to September 17, 1985, unless additional contributions are made under the plan by the employer with respect to such contracts.

(ii) In the case of a contract owned by the employer or distributed to or owned by a participant prior to the first plan year beginning after December 31, 1988, paragraph (e) of this section shall be satisfied if the annuity contracts described therein satisfy the requirements in §§1.401(a)–11T and 1.417(e)–1T. The preceding sentence shall not apply if additional contributions are made under the plan by the employer with respect to such contracts on or after the beginning of the first plan year beginning after December 31, 1988.

(2) *Interest rates*. (i) A plan that uses the PBGC immediate interest rate as required by §1.417(e)–1T(e) for distributions commencing in plan years beginning before January 1, 1987, shall be deemed to satisfy paragraph (d) of this section for such years.

(ii) For a special exception to the requirements of section 411(d)(6) for certain plan amendments that incorporate applicable interest rates, see section 1139(d)(2) of the Tax Reform Act of 1986.

(3) *Other effective dates and transitional rules*. (i) Except as otherwise provided, a plan will be treated as satisfying sections 401(a)(11) and 417 for plan years beginning before the first plan year that the requirements of section 410(b) as amended by TRA 86 apply to such plan, if the plan satisfied the requirements in §§1.401(a)–11T and 1.417(e)–1T.

(ii) See §1.401(a)–20 for other effective dates and transitional rules that apply to plans subject to sections 401(a)(11) and 417.

[T.D. 8219, 53 FR 31854, Aug. 22, 1988; 53 FR 48534, Dec. 1, 1988, as amended by T.D. 8591, 60 FR 17219, Apr. 5, 1995; T.D. 8620, 60 FR 49221, Sept. 22, 1995; T.D. 8768, 63 FR 16898, Apr. 7, 1998; T.D. 8796, 63 FR 70011, Dec. 18, 1998; T.D. 8794, 63 FR 70338, Dec. 21, 1998; T.D. 8891, 65 FR 44681, 44682, July 19, 2000; T.D. 9076, 68 FR 41909, July 16, 2003; T.D. 9099, 68 FR 70149, Dec. 17, 2003]

§1.417(e)–1T Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417. (Temporary)

(a) [Reserved]

(b) *Consent, etc. requirements*—(1) *General rule*. [Reserved]

(2) *Consent*. [Reserved]

(c) [Reserved]

(d) For rules regarding the present value of a participant's accrued benefit and related matters, see §1.417(e)–1(d).

[T.D. 8591, 60 FR 17219, Apr. 5, 1995, as amended by T.D. 8620, 60 FR 49221, Sept. 22, 1995; T.D. 8768, 63 FR 16902, Apr. 7, 1998; T.D. 8796, 63 FR 70012, Dec. 18, 1998]

§1.419–1T Treatment of welfare benefit funds. (Temporary)

Q–1: What does section 419 of the Internal Revenue Code provide?

A–1: Section 419 prescribes limitations upon deductions for contributions paid or accrued with respect to a welfare benefit fund. Under section 419 (a) and (b), an employer's contributions to a welfare benefit fund are not deductible under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for production of income) but, if the requirements of section 162 or 212 are otherwise met, are deductible under section 419 for the taxable year of the employer in which paid to the extent of the welfare benefit fund's qualified cost (within the meaning of section 419(c)(1)) for the taxable year of the fund that relates to such taxable year of the employer. Under section 419(g), section 419 and this section shall also apply to the deduction by a taxpayer of contributions

with respect to a fund that would be a welfare benefit fund but for the fact that there is no employer-employee relationship between the person providing the services and the person for whom the services are provided. Contributions paid to a welfare benefit fund after section 419 becomes effective with respect to such contributions are deemed to relate, first, to amounts accrued and deducted (but not paid) by the employer with respect to such fund before section 419 becomes effective with respect to such contributions and thus shall not be treated as satisfying the payment requirement of section 419. See paragraph (b) of Q&A–5 for special deduction limits applicable to employer contributions to welfare benefit funds with excess reserves.

Q–2: When do the deduction rules of section 419, as enacted by the Tax Reform Act of 1984, become effective?

A–2: (a) Section 419 generally applies to contributions paid or accrued with respect to a welfare benefit fund after December 31, 1985, in taxable years of employers ending after that date. See Q&A–9 of this regulation for special rules relating to the deduction limit for the first taxable year of a fiscal year employer ending after December 31, 1985.

(b) In the case of a welfare benefit fund which is part of a plan maintained pursuant to one or more collective bargaining agreements (1) between employee representatives and one or more employers, and (2) that are in effect on July 1, 1985 (or ratified on or before such date), sections 419 shall not apply to contributions paid or accrued in taxable years beginning before the termination of the last of the collective bargaining agreements pursuant to which the plan is maintained (determined without regard to any extension thereof agreed to after July 1, 1985). For purposes of the preceding sentence, any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement added under section 511 of the Tax Reform Act of 1984 (i.e., requirements under sections 419, 419A, 512(a)(3)(E), and 4976) shall not be treated as a termination of such collective bargaining agreement. See §1.419A–2T for special rules relating to the application of section 419 to collectively bargained welfare benefit funds.

(c) Notwithstanding paragraphs (a) and (b), section 419 applies to any contribution of a facility to a welfare benefit fund (or other contribution, such as cash, which is used to acquire, construct, or improve such a facility) after June 22, 1984, unless such facility is placed in service by the fund before January 1, 1987, and either (1) is acquired or improved by the fund (or contributed to the fund) pursuant to a binding contract in effect on June 22, 1984, and at all times thereafter, or (2) the construction of which was begun by or for the welfare benefit fund before June 22, 1984. See Q&A–11 of this regulation for special rules relating to the application of section 419 to the contribution of a facility to a welfare benefit fund (and to the contribution of other amounts, such as cash, used to acquire, construct, or improve such a facility) before section 419 generally becomes effective with respect to contributions to the fund.

Q–3. What is a ''welfare benefit fund'' under section 419?

A–3. (a) A ''welfare benefit fund'' is any fund which is part of a plan, or method or arrangement, of an employer and through which the employer provides welfare benefits to employees or their beneficiaries. For purposes of this section, the term ''welfare benefit'' includes any benefit other than a benefit with respect to which the employer's deduction is governed by section 83(h), section 404 (determined without regard to section 404(b)(2)), section 404A, or section 463.

(b) Under section 419(e)(3) (A) and (B), the term ''fund'' includes any organization described in section 501(c) (7), (9), (17) or (20), and any trust, corporation, or other organization not exempt from tax imposed by chapter 1, subtitle A, of the Internal Revenue Code. Thus, a taxable trust or taxable corporation that is maintained for the purpose of providing welfare benefits to an employer's employees is a ''welfare benefit fund.''

(c) Section 419(e)(3)(C) also provides that the term ''fund'' includes, to the

extent provided in regulations, any account held for an employer by any person. Pending the issuance of further guidance, only the following accounts, and arrangements that effectively constitute accounts, as described below, are ''funds'' within section 419(e)(3)(C).

A retired lives reserve or a premium stabilization reserve maintained by an insurance company is a ''fund,'' or part of a ''fund,'' if it is maintained for a particular employer and the employer has the right to have any amount in the reserve applied against its future years' benefit costs or insurance premiums. Also, if an employer makes a payment to an insurance company under an ''administrative services only'' arrangement with respect to which the life insurance company maintains a separate account to provide benefits, then the arrangement would be considered to be a ''fund.'' Finally, an insurance or premium arrangement between an employer and an insurance company is a ''fund'' if, under the arrangement, the employer has a right to a refund, credit, or additional benefits (including upon termination of the arrangement) based on the benefit or claims experience, administrative cost experience, or investment experience attributable to such employer. However, an arrangement with an insurance company is not a ''fund'' under the previous sentence merely because the employer's premium for a renewal year reflects the employer's own experience for an earlier year if the arrangement is both cancellable by the insurance company and cancellable by the employer as of the end of any policy year and, upon cancellation by either of the parties, neither of the parties can receive a refund or additional amounts or benefits and neither of the parties can incur a residual liability beyond the end of the policy year (other than, in the case of the insurer, to provide benefits with respect to claims incurred before cancellation). The determination whether either of the parties can receive a refund or additional amounts or benefits or can incur a residual liability upon cancellation of an arrangement will be made by examining both the contractual rights and obligations of the parties under the arrangement and the actual practice of the insurance company (and other insurance companies) with respect to other employers upon cancellation of similar arrangements. Similarly, a disability income policy does not constitute a ''fund'' under the preceding provisions merely because, under the policy, an employer pays an annual premium so that employees who became disabled in such year may receive benefit payments for the duration of the disability.

Q–4: For purposes of determining the section 419 limit on the employer's deduction for contributions to the fund for a taxable year of the employer, which taxable year of the welfare benefit fund is related to the taxable year of the employer?

A–4: The amount of an employer's deduction for contributions to a welfare benefit fund for a taxable year of the employer is limited to the ''qualified cost'' of the welfare benefit fund for the taxable year of the fund that is related to such taxable year of the employer. The taxable year of the welfare benefit fund that ends with or within the taxable year of the employer is the taxable year of the fund that is related to the taxable year of the employer. Thus, for example, if an employer has a calendar taxable year and it makes contributions to a fund having a taxable year ending June 30, the ''qualified cost'' of the fund for the taxable year of the fund ending on June 30, 1986, applies to limit the employer's deduction for contributions to the fund in the employer's 1986 taxable year. In the case of employer contributions paid directly to an account or arrangement with an insurance company that is treated as a welfare benefit fund for the purposes of section 419, the policy year will be treated as the taxable year of the fund. See Q&A–7 of this regulation for special section 419 rules relating to the coordination of taxable years for the taxable year of the employer in which a welfare benefit fund is established and for the next following taxable year of the employer.

Q–5: What is the ''qualified cost'' of a welfare benefit fund for a taxable year under section 419?

A–5: (a) Under section 419(c), the ''qualified cost'' of a welfare benefit fund for a taxable year of the fund is

the sum of: (1) The ''qualified direct cost'' of such fund for such taxable year of the fund, and (2) the amount that may be added to the qualified asset account for such taxable year of the fund to the extent that such addition does not result in a total amount of such account as of the end of such taxable year of the fund that exceeds the applicable account limit under section 419A(c). However, in calculating the qualified cost of a welfare benefit fund for a taxable year of the fund, this sum is reduced by the fund's ''after-tax income'' (as defined in section 419(c)(4)) for such taxable year of the fund. Also, the qualified cost of a welfare benefit fund is reduced further under the provisions of paragraph (b) of this Q&A.

(b)(1) Pursuant to section 419A(i), notwithstanding section 419 and § 1.419–1T, contributions to a welfare benefit fund during any taxable year of the employer beginning after December 31, 1985, shall not be deductible for such taxable year to the extent that such contributions result in the total amount in the fund as of the end of the last taxable year of the fund ending with or within such taxable year of the employer exceeding the account limit applicable to such taxable year of the fund (as adjusted under section 419A(f)(7)). Solely for purposes of this subparagraph, (i) contributions paid to a welfare benefit fund during the taxable year of the employer but after the end of the last taxable year of the fund that relates to such taxable year of the employer, and (ii) contributions accrued with respect to a welfare benefit fund during the taxable year of the employer or during any prior taxable year of the employer (but not actually paid to such fund on or before the end of a taxable year of the employer) and deducted by the employer for such or any prior taxable year of the employer, shall be treated as an amount in the fund as of the end of the last taxable year of the fund that relates to the taxable year of the employer. Contributions that are not deductible under this subparagraph are in excess of the qualified cost of the welfare benefit fund for the taxable year of the fund that relates to the taxable year of the employer and thus are treated as contributed to the fund on the first day of the employer's next taxable year.

(2) Paragraph (b)(1) of this section shall not apply to contributions with respect to a collectively bargained welfare benefit fund within the meaning of § 1.419A–2T. In addition, paragraph (b)(1) of this section shall not apply to any taxable year of an employer beginning after the end of the earlier of the following taxable years: (i) the first taxable year of the employer beginning after December 31, 1985, for which the employer's deduction limit under section 419 (after the application of paragraph (b)(1) of this section) is at least equal to the qualified direct cost of the fund for the taxable year (or years) of the fund that relates to such first taxable year of the employer, or (ii) the first taxable year of the employer beginning after December 31, 1985, with or within which ends the first taxable year of the fund with respect to which the total amount in the fund as of the end of such taxable year of the fund does not exceed the account limit for such taxable year of the fund (as adjusted under section 419A(f)(7)).

(3) For example, assume an employer with a taxable year ending June 30 and a welfare benefit fund with a taxable year ending January 31. During its taxable year ending June 30, 1987, and on or before January 31, 1987, the employer contributes $250,000 to the fund, and during the remaining portion of its taxable year ending June 30, 1987, the employer contributes $200,000. The qualified direct cost of the fund for its taxable year ending January 31, 1987, is $500,000, the account limit applicable to such taxable year (after the adjustment under section 419A(f)(7)) is $750,000, and the total amount in the fund as of January 31, 1987, is $800,000. Before the application of this paragraph, the employer may deduct the entire $450,000 contribution for its taxable year ending June 30, 1987. However, under this paragraph, the excess of (i) the sum of the total amount in the fund as of January 31, 1987 ($800,000), and employer contributions to the fund after January 31, 1987, and on or before June 30, 1987 ($200,000), over (ii) the account limit applicable to the fund for its taxable year ending January 31, 1987 ($750,000), is $250,000.

Thus, under this paragraph, only $200,000 of the $450,000 contribution the employer made during its taxable year ending June 30, 1987, is deductible for such taxable year. If the excess were $450,000 or greater, no portion of the $450,000 contribution would be deductible by the employer for its taxable year ending June 30, 1987. Such nondeductible contributions are in excess of the fund's qualified cost for the taxable year related to the employer's taxable year and thus are deemed to be contributed on the first day of the employer's next taxable year.

(c) See Q&A–7 of this regulation for special rules relating to the calculation of the qualified cost of a welfare benefit fund for an Initial Fund Year and an Overlap Fund Year (as defined in Q&A–7). See Q&A–11 of this regulation for special rules relating to the application of section 419 to the contribution to a welfare benefit fund of a facility (and to the contribution of other amounts, such as cash, used to acquire, construct, or improve a facility) before section 419 generally becomes effective with respect to contributions to the fund. See §1.419A–2T for special rules relating to certain collectively bargained welfare benefit funds.

Q–6: What is the ''qualified direct cost'' of a welfare benefit fund under section 419(c)(3)?

A–6: (a) Under section 419(c)(3), the ''qualified direct cost'' of a welfare benefit fund for any taxable year of the fund is the aggregate amount which would have been allowable as a deduction to the employer for benefits provided by such fund during such year (including insurance coverage for such year) if (1) such benefits were provided directly by the employer and (2) the employer used the cash receipts and disbursements method of accounting and had the same taxable year as the fund. In this regard, a benefit is treated as provided when such benefit would be includible in the gross income of the employee if provided directly by the employer (or would be so includible but for a provision of chapter 1, subtitle A, of the Internal Revenue Code excluding it from gross income). Thus, for example, if a calendar year welfare benefit fund pays an insurance company in July 1986 the full premium for coverage of its current employees under a term health insurance policy for the twelve month period ending June 30, 1987, the insurance coverage will be treated as provided by the fund over such twelve month period. Accordingly, only the portion of the premium for coverage during 1986 will be treated as a ''qualified direct cost'' of the fund for 1986; the remaining portion of the premium will be treated as a ''qualified direct cost'' of the fund for 1987. The ''qualified direct cost'' for a taxable year of the fund includes the administrative expenses incurred by the welfare benefit fund in delivering the benefits for such year.

(b) If, in a taxable year of a welfare benefit fund, the fund holds an asset with a useful life extending substantially beyond the end of the taxable year (e.g., buildings, vehicles, tangible assets, and licenses) and, for such taxable year of the fund, the asset is used in the provision of welfare benefits to employees, the ''qualified direct cost'' of the fund for such taxable year of the fund includes the amount that would have been allowable to the employer as a deduction under the applicable Code provisions (e.g., sections 168 and 179) with respect to the portion of the asset used in the provision of welfare benefits for such year if the employer had acquired and placed in service the asset at the same time the fund received and placed in service the asset, and the employer had the same taxable year as the fund. This rule applies regardless of whether the fund received the asset through a contribution of the asset by the employer or through an acquisition or the construction by the fund of the asset. For example, assume that in 1986 a calendar year employer contributes recovery property under section 168(c) to a welfare benefit fund with a calendar taxable year to be used in the provision of welfare benefits. The employer will be treated as having sold the property in such year and thus will recognize gain to the extent that the fair market value of the property exceeds the employer's adjusted basis in the property. In this regard, see section 1239(d). Also, the employer will be treated as having made a contribution to the fund in such year equal to the

fair market value of the property. Finally, the qualified direct cost of the welfare benefit fund for 1986 will include the amount that the employer could have deducted in 1986 with respect to the portion of the property used in the provision of welfare benefits if the employer had acquired the property in 1986 and had placed the property in service when the fund actually placed the property in service. Similarly, for example, assume that in 1986 a welfare bendfit fund purchases and places in service a facility to be used in the provision of welfare benefits. The qualified direct cost of the fund for 1986 will include the amount that the employer could have deducted with respect to such facility if the employer had purchased and placed in service the facility at the same time that the fund purchased and placed in service the facility.

(c) The qualified direct cost of a welfare benefit fund does not include expenditures by the fund that would not have been deductible if they had been made directly by the employer. For example, a fund's purchase of land in a year for an employee recreational facility will not be treated as a qualified direct cost because, if made directly by the employer, the purchase would not have been deductible under section 263. See also sections 264 and 274.

(d) Notwithstanding the preceding paragraphs, the qualified direct cost of a welfare benefit fund with respect to that portion of a child care facility used in the provision of welfare benefits for a year will include the amount that would have been allowable to the employer as a deduction for the year under a straight-line depreciation schedule for a period of 60 months beginning with the month in which the facility is placed in service under rules similar to those provided for section 188 property under § 1.188–1(a). For purposes of this section, a ''child care facility'' is tangible property of a character subject to depreciation that is located in the United States and specifically used as an integral part of a ''qualified child care center facility'' within the meaning of § 1.188–1(d)(4).

(e) See Q&A–7 of this regulation for special section 419 rules relating to the calculation of the qualified direct cost of a welfare benefit fund for an Initial Fund Year and an Overlap Fund Year (as defined in Q&A–7). See Q&A–11 of this regulation for special rules relating to the contribution to a welfare benefit fund of a facility (and to the contribution of other amounts, such as cash, used to acquire, construct, or improve a facility) before section 419 generally becomes effective with respect to contributions to the fund.

Q–7: What special rules apply for purposes of determining the section 419 limit on the employer's deduction for contributions to a welfare benefit fund for the taxable year of the employer in which the fund is established and for the next following taxable year of the employer?

A–7: (a) If the taxable year of a welfare benefit fund is the same as the taxable year of the employer, there are no special rules that apply for purposes of determining the section 419 limit on an employer's deduction for contributions to the fund for either the taxable year of the employer in which the fund is established or the next following taxable year of the employer. However, if the taxable year of a welfare benefit fund is different from the taxable year of the employer, the general section 419 rules are modified by the special rules set forth below for purposes of determining the section 419 deduction limit for the taxable year of the employer in which a fund is established and for the next following taxable year of the employer.

(b) If a welfare benefit fund is established after December 31, 1985, during a taxable year of an employer and either (i) the first taxable year of the fund ends after the close of such taxable year of the employer, or (ii) the first taxable year of the fund is six months or less and ends before the close of such taxable year of the employer and the second taxable year of the fund begins before and ends after the close of such taxable year of the employer, the taxable year of the fund that contains the closing day of such taxable year of the employer will be treated as an ''Overlap Fund Year.'' For purposes of determining the limit on the employer's deduction for contributions to a welfare benefit fund for the taxable year of the

employer in which the fund was established, the period between the beginning of the fund's Overlap Fund Year and the end of the employer's taxable year in which the Overlap Fund Year began will be treated as a taxable year of the fund (''Initial Fund Year'').

(c) The qualified cost of a welfare benefit fund for its Initial Fund Year will be equal to the qualified direct cost of the fund for such Initial Fund Year. The qualified cost of a fund for its Overlap Fund Year will be determined under the general rules of Q&A–5 of this regulation and section 419(c), with the exception that such qualfied cost will be reduced by the employer contributions made during the Initial Fund Year and deductible by the employer for the taxable year of the employer in which the Overlap Fund Year of the fund begins.

(d) Assume that an employer with a calendar taxable year establishes on July 1, 1986, a welfare benefit fund with a taxable year ending on June 30. The fund's first taxable year from July 1, 1986, to June 30, 1987, is an Overlap Fund Year. The employer contributes $1,000 to the fund during its taxable year ending December 31, 1986 (i.e., during the period between July 1, 1986, and December 31, 1986, which is also the Initial Fund Year) and another $1,500 to the fund during its taxable year ending December 31, 1987. Assume further that the qualified direct cost of the fund for the Initial Fund Year is $900 and that the qualified cost for the Overlap Fund Year is $2,500 (prior to the reduction required by paragraph (c) of this Q&A). Under the special rules of paragraphs (b) and (c), the employer may deduct $900 for its taxable year ending on December 31, 1986, and $1,600 for its taxable year ending on December 31, 1987. If the qualified direct cost of the fund for the Initial Fund Year had been $1,050 and the qualified cost for the Overlap Fund Year had been $2,500 (prior to the reduction required by paragraph (c) of this Q&A), the employer's deduction for its taxable year ending December 31, 1986, would have been $1,000 and its deduction for its taxable year ending December 31, 1987, would have been $1,500.

(e) Assume that an employer with a calendar taxable year establishes on March 1, 1986, a welfare benefit fund with a taxable year ending June 30. Thus, the fund has a short first taxable year ending June 30, 1986, an Overlap Fund Year from July 1, 1986, until June 30, 1987, and an ongoing June 30 taxable year. The employer contributes $1,750 to the fund during the employer's taxable year ending December 31, 1986—$750 during the short first taxable year of the fund and $1,000 during the Initial Fund Year (i.e., the period between July 1, 1986, and December 31, 1986)—and $1,500 to the fund during its taxable year ending December 31, 1987. Assume that the qualified cost of the fund for the short first taxable year of the fund is $800, the qualified direct cost for the Initial Fund Year is $900, and the qualified cost for the Overlap Fund Year is $2,500 (prior to the reduction required by paragraph (c) of this Q&A). Under the special rules of paragraphs (b) and (c), the employer may deduct $1,700 for its taxable year ending December 31, 1986, and $1,550 for its taxable year ending December 31, 1987.

Q–8: How does section 419 treat an employer's contribution with respect to a welfare benefit fund in excess of the applicable deduction limit for a taxable year of the employer?

A–8: (a) If an employer makes contributions to a welfare benefit fund in a taxable year of the employer and such contributions (when combined with prior contributions that are deemed under the rule of this Q&A and section 419(d) to have been made in such taxable year) exceed the section 419 deduction limit for such taxable year of the employer, the excess amounts are deemed to be contributed to the fund on the first day of the next taxable year of the employer. Such deemed contributions are combined with amounts actually contributed by the employer to the fund during the next taxable year and may be deductible for such year, subject to the otherwise applicable section 419 deduction limit for such year.

(b) Contributions to a welfare benefit fund on or before December 31, 1985, that were not deductible by the employer for any taxable year of the employer ending on or before December 31, 1985, or for the first taxable year of the employer ending after December 31,

1985, as pre-1986 contributions (see Q&A–9 of this regulation) are deemed to be contributed to the fund on January 1, 1986, However, see Q&A–11 of this regulation for special rules relating to the contribution to a welfare benefit fund of amounts (such as cash) used to acquire, construct, or improve a facility before section 419 generally becomes effective with respect to contributions to the fund. Generally, such contributions (to the extent that they were made after June 22, 1984 and on or before December 31, 1985) are treated as nondeductible pre-1986 contributions and are deemed to be contributed in the form of a facility at the same time as when the facility is placed in service by the fund.

Q–9: How does an employer with a fiscal taxable year calculate its deduction limit for contributions with respect to a welfare benefit fund for the first taxable year of the employer ending after December 31, 1985?

A–9: (a) If the first taxable year of an employer ending after December 31, 1985 (or, if applicable under paragraph (b) of Q&A–2 of this section, the first taxable year of an employer beginning after termination of the last of the collective bargaining agreements pursuant to which the fund is maintained) is a fiscal year, the employer's deduction for such taxable year for contributions to a welfare benefit fund that is not a collectively bargained welfare benefit fund under §1.419A–2T is limited to the greater of the following two amounts: (1) The contributions paid to the fund during such first taxable year up to the qualified cost of the welfare benefit fund for the taxable year of the fund that relates to such taxable year of the employer, and (2) the contributions paid to the fund during the 1985 portion of such first taxable year of the employer (''the pre-1986 contributions'') to the extent that such pre-1986 contributions are deductible under the rules governing the deduction of such contributions before section 419 generally becomes effective (including the rules set forth in Q&A–10 of this regulation, modified for purposes of this Q&A–9 by substituting ''December 31, 1986'' for ''December 31, 1985'' in paragraph (c)). See Q&A–11 of this regulation for special rules relating to the contribution to a welfare benefit fund of a facility (and to the contribution of other amounts, such as cash, used to acquire, construct, or improve such a facility) before section 419 generally becomes effective with respect to contributions to such fund.

(b) For example, assume that an employer with a taxable year ending June 30, contributes to a welfare benefit fund with a taxable year ending January 31. This employer contributes $1,000 to the fund between July 1, 1985, and December 31, 1985, and an additional $500 to the fund between January 1, 1986, and June 30, 1986. Assume further that the qualified direct cost of the fund for the taxable year of the fund ending January 31, 1986, is $500 and that the qualified cost for such taxable year is $800. Under the deduction rule set forth above, the employer's deduction for its taxable year ending June 30, 1986, is the greater of two amounts: (1) The contributions made during such full taxable year ($1,500) up to the qualifed cost of the fund with respect to such taxable year ($800), and (2) the pre-1986 contributions ($1,000) to the extent that such pre-1986 contributions are deductible under the pre-section 419 rules. In determining the extent to which the pre-1986 contributions are deductible under the pre-section 419 rules, the rules contained in Q&A–10 apply as though December 31, 1985, in paragraph (c) were December 31, 1986. Assuming that only $875 is deductible under the pre-section 419 rules, because $875 is greater than $800, this employer may deduct $875 for its first taxable year ending after December 31, 1985. This full $875 deduction for 1985 is deemed to consist entirely of pre-1986 contributions.

Q–10: How do the rules of sections 263, 446(b), 461(a), and 461(h) apply in determining whether contributions with respect to a welfare benefit fund are deductible for a taxable year?

A–10: (a) Both before and after the effective date of section 419 (see Q&A–2 of this regulation), an employer is allowed a deduction for taxable year for contributions paid or accrued with respect to a ''welfare benefit fund'' (as defined in Q&A–3 of this regulation and section 419(e)) only to the extent that

such contributions satisfy the requirements of section 162 or 212. These requirements must be satisfied after the effective date of section 419 because 419 requires that (among other requirements) contributions to a welfare benefit fund satisfy the requirements of section 162 or 212.

(b) Except as provided in paragraphs (c) and (d), in determinig the extent to which contributions paid or accrued with respect to welfare benefit fund satisfy the requirements of section 162 or 212 for a taxable year (both before and after section 419 generally becomes effective with respect to such contributions), the rules of sections 263, 446(b), 461(a) (including the rules that relate to the creation of an asset with a useful life extending substantially beyond the close of the taxable year), and 461(h) (to the extent that such section is effective with respect to such contributions) are are generally applicable.

(c) Notwithstanding paragraph (b), under the authority of section 7805(b), the rules of sections 263, 446(b), and 461(a) shall not be applied in determining the extent to which an employer's contribution with respect to a welfare benefit fund is deductible under section 162 or 212 with respect to any taxable year of the employer ending on or before December 31, 1985, to the extent that, for such taxable year, (1) the contribution was made pursuant to a bona fide collective bargaining agreement requiring fixed and determinable contributions to a collectively bargained welfare benefit fund (as defined in §1.419A–2T), or (2) the contribution was not in excess of the amount deductible under the principles of Revenue Rulings 69–382, 1969–2 C.B. 28; 69–478, 1969–2 C.B. 29; and 73–599, 1973–2 C.B. 40, modified as appropriate for benefits for active employees.

(d) Notwithstanding paragraph (b), in determining the extent to which contributions paid or accrued with respect to a welfare benefit fund are deductible under section 419, the rules of sections 263, 446(b), and 461(a) will be treated as having been satisfied to the extent that such contributions satisfy the otherwise applicable rules of section 419. Thus, for example, contributions to a welfare benefit fund will not fail to be deductible under section 419 merely because they create an asset with a useful life extending substantially beyoud the close of the taxable year if such contributions satisfy the otherwise applicable requirements of section 419.

(e) In determining the extent to which contributions with respect to a welfare benefit fund satisfy the requirements of section 461(h) for any taxable year for which section 461(h) is effective, pursuant to the authority under section 461(h)(2), economic performance occurs as contributions to the welfare benefit fund are made. Solely for purposes of section 461(h), in the case of an employer's taxable year ending on or after July 18, 1984, and on or before March 21, 1986, contributions made to the welfare benefit fund after the end of such taxable year and on or before March 21, 1986 shall be deemed to have been made on the last day of such taxable year.

Q–11: What special section 419 rules apply to the payment or accrual with respect to a welfare benefit fund of a facility (and the payment or accrual of other amounts, such as cash, used to acquire, construct, or improve such a facility)?

A–11: (a)(1) In the case of an employer's payment or accrual with respect to a welfare benefit fund after June 22, 1984, and on or before December 31, 1985 (or, if applicable under paragraph (b) of Q&A–2 of this regulation, before section 419 generally becomes effective with respect to contributions to such fund), of a facility, the rules of section 419, §1.419–1T, and §1.419A–2T generally apply to determine the extent to which such contribution is deductible by the employer for its taxable year of contribution. For this purpose, however, the facility is to be treated as the only contribution made to the fund and the qualified cost of the fund for the taxable year of the fund in which the facility was contributed is to be equal to the qualified direct cost directly attributable to the facility (as determined under Q&A–6 of this regulation). Also, for this purpose, the welfare benefit fund to which the facility was contributed may not be aggregated with any other fund. For purposes of this Q&A, ''facility'' means any tangible

asset with a useful life extending substantially beyond the end of the taxable year (e.g., vehicles, buildings) and any intangible asset (e.g., licenses) related to a tangible asset, whether or not such asset is used in the provision of welfare benefits. See, however, paragraph (c) of Q&A–2 of this regulation for a binding contract exception.

(2) For example, assume that an employer and a welfare benefit fund each has a calendar taxable year and that, during 1985, the employer contributes to the fund $200,000 in cash and a facility with a fair market value of $100,000. Such facility is used in the provision of welfare benefits under the fund. The employer is treated as having sold the facility in such year and thus will recognize gain to the extent that the fair market value of the facility exceeds the employer's adjusted basis in the facility. In this regard, see section 1239(d). The extent to which the facility contribution is deductible by the employer for its 1985 taxable year is determined as though it were the only contribution made by the employer to the fund during such year and the qualified cost of the fund for the taxable year of the fund in which the contribution was made (i.e., the 1985 taxable year) were equal to the amount that would have been allowable to the employer as a deduction for such year under the applicable Code provisions with respect to the portion of the facility used in the provision of welfare benefits for such year if the employer had placed in service the facility at the time the fund placed in service the facility and if the employer had the same taxable year as the fund. If, under these assumptions, the employer would have been allowed a $10,000 deduction with respect to the facility for the 1985 taxable year, the fund's qualified cost for its 1985 taxable year would be only $10,000. Thus, only $10,000 of the $100,000 facility contribution would be deductible by the employer for its 1985 taxable year (i.e., the taxable year of the employer with or within which the applicable taxable year of the fund ends). However, in determining the extent to which the $200,000 in cash is deductible by the employer for its 1985 taxable year, the $100,000 facility is not to be disregarded. Thus, if under the applicable pre-section 419 rules the employer is allowed for 1985 a total deduction of only $175,000, the employer would be permitted a deduction for 1985 of $175,000 ($10,000 with respect to the facility and $165,000 of the cash contribution). The nondeductible portion of the cash contribution is to be treated as contributed to the fund on the first day of the next taxable year of the employer. If under the applicable pre-section 419 rules the employer were allowed a total deduction of $300,000 for 1985, the employer would be permitted a deduction for 1985 of only $210,000 ($10,000 with respect to the facility and the full $200,000 cash contribution).

(3) For example, assume that an employer has a June 30 taxable year and maintains a welfare benefit fund with a taxable year ending January 31. During the 1985 portion of its taxable year ending June 30, 1986, the employer contributes $50,000 in cash and a facility with a fair market value of $100,000; and during the 1986 portion of such taxable year, the employer contributes another $75,000 in cash to the fund. The facility is used in the provision of welfare benefits under the fund. Under the rules of Q&A–9 of this regulation, the employer's deduction for its June 30, 1986, taxable year is limited to the greater of the following two amounts: (i) The contributions paid to the fund during such taxable year ($225,000) up to the qualified cost of the fund for the taxable year of the fund ending January 31, 1986, and (ii) the contributions paid to the fund during the 1985 portion of the employer's taxable year ending June 30, 1986 (''the pre-1986 contributions'') ($150,000) to the extent that such pre-1986 contributions are deductible under the rules governing the deduction of such contributions before section 419 is generally effective with respect to the fund. For purposes of this rule, the contribution of the facility on or before December 31, 1985, is to be treated as a pre-1986 contribution and the rules of section 419 and this Q&A are to be treated as rules governing the deduction of such contribution before section 419 generally becomes effective with respect to the fund. Thus, in determining the extent to which the facility is deductible as a pre-1986 contribution

under the rules before section 419 generally becomes effective, the facility is treated as the only contribution to the welfare benefit fund and the qualified cost of such fund for the taxable year of the fund in which the facility was contributed is the amount that would have been allowable to the employer as a deduction with respect to the portion of the facility used in the provision of welfare benefits if the employer had placed in service the facility at the same time that the fund placed in service the facility and the employer's taxable year ended on January 31, 1986.

(b)(1) The preceding rules shall also apply for purposes of determining when and the extent to which an employer may deduct contributions or other items and amounts after June 22, 1984 and on or before December 31, 1985 (or, if applicable under paragraph (b) of Q&A–2 of this regulation, before section 419 generally becomes effective with respect to contributions to the fund) that are not facilities (e.g., cash contributions) to a welfare benefit fund that are used by the fund to acquire, construct, or improve a facility. The most recent non-facility contributions made to a welfare benefit fund before the facility in question is placed in service by the fund (up to the fair market value of the facility at such time) are to be treated as used by the fund for the acquisition, construction, or improvement (as the case may be) of such facility. To the extent that contributions before such a facility is placed in service are not at least equal to the value of the facility at such time, contributions after such date (up to the value of the facility at the time it is placed in service) are treated as used for acquisition, construction, or improvement of the facility. Such non-facility contributions, to the extent that they were made after June 22, 1984, and on or before December 31, 1985 (or, if applicable under paragraph (b) of Q&A–2 of this regulation, before section 419 generally becomes effective with respect to contributions to the fund), are not deductible by the employer as non-facility contributions for any year. Instead, the employer is permitted a deduction with respect to such contributions only under the rules of this Q&A as though the employer had contributed a facility to the fund at the same time that the fund placed in service the facility in question and, at such time, the facility had a fair market value equal to the total of such non-facility contributions.

(2) For example, assume that an employer and a welfare benefit fund each has a calendar taxable year and during 1985 the fund acquired and placed in service a facility with a fair market value of $100,000 to be used in the provision of welfare benefits. Further, during July 1984 the employer contributed $150,000 in cash to the fund and, during the portion of 1985, before the facility was placed in service by the fund, the employer contributed another $75,000 in cash to the fund; during the remaining portion of 1985, the employer contributed $125,000 in cash. The facility is used in the provision of welfare benefits under the fund. Because $25,000 of the employer's 1984 contribution is treated under this rule as used for the acquisition of a facility, such $25,000 is not deductible by the employer for 1984. For purposes of determining the employer's deduction for 1985, the employer will be treated as having contributed $125,000 in cash and a facility with a fair market value of $100,000. The employer's deduction for its 1985 taxable year will be determined under the rules relating to the contribution of a facility after June 22, 1984, and on or before December 31, 1985.

(3) For example, assume that an employer and a welfare benefit fund each has a calendar taxable year and during 1986 the fund placed in service a facility with a fair market value of $100,000 to be used in the provision of welfare benefits. During 1985, the employer contributed $125,000 in cash to the fund. During the portion of 1986 before the facility was placed in service, the employer contributed $60,000 in cash, and during the remaining portion of 1986, the employer contributed another $75,000 in cash. The facility is used in the provision of welfare benefits under the fund. Because $40,000 of its 1985 cash contribution is treated under this rule as used for the acquisition of the facility, such $40,000 is not deductible by the employer for 1985. For purposes of determining the employer's deduction for 1986, the employer will be

treated as though it had contributed a $40,000 facility to the fund at the time the fund placed the facility in service.

(c) For purposes of calculating the ''existing excess reserve amount'' under Q&A–1 of §1.419A–1T and the ''existing reserves for post-retirement medical or life insurance benefits'' under Q&A–4 of §1.512(a)–5T (but not the exempt function income under Q&A–3 of §1.512(a)–5T), the amount set aside as of any applicable date is to be reduced to the extent that contributions originally included in such amount are subsequently treated under this Q&A as used for the acquisition, construction, or improvement of an asset excluded from the calculation of the total amount set aside under paragraph (b) of §1.512(a)–5T (or would be so treated under this Q&A if it applied to such asset). The reduction required under this paragraph applies for purposes of calculating the ''existing excess reserve amount'' and the ''existing reserves for post-retirement medical or life insurance benefits'' for all taxable years of the welfare benefit fund.

[T.D. 8073, 51 FR 4323, Feb. 4, 1986; 51 FR 7262, Mar. 3, 1986; 51 FR 11303, Apr. 2, 1986]

§ 1.419A–1T Qualified asset account limitation of additions to account. (Temporary)

Q–1: What does the transition rule under section 419A(f)(7) provide?

A–1: Section 419A(f)(7) provides that, in the case of a welfare benefit fund that was in existence on July 18, 1984, the account limit (as determined under section 419A(c)) for each of the first four taxable years of the fund that relate to taxable years of the employer ending after December 31, 1985 (or, if applicable under paragraph (b) of Q&A–2 of §1.419–1T, taxable years of the employer beginning after the termination of the last of the collective bargaining agreements pursuant to which the plan is maintained) shall be increased by the following percentages of the ''existing excess reserve amount'':

	Percent
First taxable year	80
Second taxable year	60
Third taxable year	40
Fourth taxable year	20

For purposes of this section, the ''existing excess reserve amount'' for any taxable year of a fund is the excess of (a) the assets actually set aside for purposes described in section 419A(a) at the close of the first taxable year of the fund ending after July 18, 1984 (calculated in the manner set forth in Q&A–3 of §1.512(a)–3T, and adjusted under paragraph (c) of Q&A–11 of §1.419–1T), reduced by employer contributions to the fund before the close of such first taxable year to the extent that such contributions are not deductible for the taxable year of the employer with or within which such taxable year of the fund ends and for any prior taxable year of the employer, over (b) the account limit which would have applied to the taxable year of the fund for which the excess is being computed (without regard to this transition rule). A welfare benefit fund is treated as in existence on July 18, 1984, for purposes of this transition rule only if amounts were actually set aside in such fund on such date to provide welfare benefits enumerated under section 419A.

[T.D. 8073, 51 FR 4329, Feb. 4, 1986, as amended at 51 FR 11303, Apr. 2, 1986]

§ 1.419A–2T Qualified asset account limitation for collectively bargained funds. (Temporary)

Q–1: What account limits apply to welfare benefit funds that are maintained pursuant to a collective bargaining agreement?

A–1: Contributions to a welfare benefit fund maintained pursuant to one or more collective bargaining agreements and the reserves of such a fund generally are subject to the rules of sections 419, 419A, and 512. However, neither contributions to nor reserves of such a collectively bargained welfare benefit fund shall be treated as exceeding the otherwise applicable limits of section 419(b), 419A(b), or 512(a)(3)(E) until the earlier of: (i) The date on which the last of the collective bargaining agreements relating to the fund in effect on, or ratified on or before, the date of issuance of final regulations concerning such limits for collectively bargained welfare benefit funds terminates (determined without regard to any extension thereof agreed

to after the date of issuance of such final regulations), or (ii) the date 3 years after the issuance of such final regulations.

Q–2: What is a welfare benefit fund maintained pursuant to a collective bargaining agreement for purposes of Q&A–1?

A–2: (1) For purposes of Q&A–1, a collectively bargained welfare benefit fund is a welfare benefit fund that is maintained pursuant to an agreement which the Secretary of Labor determines to be a collective bargaining agreement and which meets the requirements of the Secretary of the Treasury as set forth in paragraph 2 below.

(2) Notwithstanding a determination by the Secretary of Labor that an agreement is a collective bargaining agreement, a welfare benefit fund is considered to be maintained pursuant to a collective bargaining agreement only if the benefits provided through the fund were the subject of arms-length negotiations between employee representatives and one or more employers, and if such agreement between employee representatives and one or more employers satisfies section 7701(a)(46) of the Code. Moreover, the circumstances surrounding a collective bargaining agreement must evidence good faith bargaining between adverse parties over the welfare benefits to be provided through the fund. Finally, a welfare benefit fund is not considered to be maintained pursuant to a collective bargaining agreement unless at least 50 percent of the employees eligible to receive benefits under the fund are covered by the collective bargaining agreement.

(3) In the case of a collectively bargained welfare benefit fund, only the portion of the fund (as determined under allocation rules to be provided by the Commissioner) attributable to employees covered by a collective bargaining agreement, and from which benefits for such employees are provided, is considered to be maintained pursuant to a collective bargaining agreement.

(4) Notwithstanding the preceding paragraphs and pending the issuance of regulations setting account limits for collectively bargained welfare benefit funds, a welfare benefit fund will not be treated as a collectively bargained welfare benefit fund for purposes of Q&A–1 if and when, after July 1, 1985, the number of employees who are not covered by a collective bargaining agreement and are eligible to receive benefits under the fund increases by reason of an amendment, merger, or other action of the employer or the fund. In addition, pending the issuance of such regulations, for purposes of applying the 50 percent test of paragraph (2) to a welfare benefit fund that is not in existence on July 1, 1985, ''90 percent'' shall be substituted for ''50 percent''.

[T.D. 8034, 50 FR 27428, July 3, 1985]

§ 1.419A(f)(6)–1 Exception for 10 or more employer plan.

(a) *Requirements*—(1) *In general.* Sections 419 and 419A do not apply in the case of a welfare benefit fund that is part of a 10 or more employer plan described in section 419A(f)(6). A plan is a 10 or more employer plan described in section 419A(f)(6) only if it is a single plan—

(i) To which more than one employer contributes;

(ii) To which no employer normally contributes more than 10 percent of the total contributions contributed under the plan by all employers;

(iii) That does not maintain an experience-rating arrangement with respect to any individual employer; and

(iv) That satisfies the requirements of paragraph (a)(2) of this section.

(2) *Compliance information.* A plan satisfies the requirements of this paragraph (a)(2) if the plan is maintained pursuant to a written document that requires the plan administrator to maintain records sufficient for the Commissioner or any participating employer to readily verify that the plan satisfies the requirements of section 419A(f)(6) and this section and that provides the Commissioner and each participating employer (or a person acting on the participating employer's behalf) with the right, upon written request to the plan administrator, to inspect and copy all such records. See § 1.414(g)–1 for the definition of plan administrator.

(3) *Application of rules*—(i) *In general.* The requirements described in paragraph (a)(1) and (2) of this section must be satisfied both in form and in operation.

(ii) *Arrangement is considered in its entirety*. The determination of whether a plan is a 10 or more employer plan described in section 419A(f)(6) is based on the totality of the arrangement and all related facts and circumstances, including any related insurance contracts. Accordingly, all agreements and understandings (including promotional materials and policy illustrations) and the terms of any insurance contract will be taken into account in determining whether the requirements are satisfied in form and in operation.

(b) *Experience-rating arrangements*—(1) *General rule.* A plan maintains an experience-rating arrangement with respect to an individual employer and thus does not satisfy the requirement of paragraph (a)(1)(iii) of this section if, with respect to that employer, there is any period for which the relationship of contributions under the plan to the benefits or other amounts payable under the plan (the *cost of coverage*) is or can be expected to be based, in whole or in part, on the benefits experience or overall experience (or a proxy for either type of experience) of that employer or one or more employees of that employer. For purposes of this paragraph (b)(1), an employer's contributions include all contributions made by or on behalf of the employer or the employer's employees. *See* paragraph (d) of this section for the definitions of *benefits experience, overall experience, and benefits or other amounts payable.* The rules of this paragraph (b) apply under all circumstances, including employer withdrawals and plan terminations.

(2) *Adjustment of contributions.* An example of a plan that maintains an experience-rating arrangement with respect to an individual employer is a plan that entitles an employer to (or for which the employer can expect) a reduction in future contributions if that employer's overall experience is positive. Similarly, a plan maintains an experience-rating arrangement with respect to an individual employer where an employer can expect its future contributions to be increased if the employer's overall experience is negative. A plan also maintains an experience-rating arrangement with respect to an individual employer where an employer is entitled to receive (or can expect to receive) a rebate of all or a portion of its contributions if that employer's overall experience is positive or, conversely, where an employer is liable to make additional contributions if its overall experience is negative.

(3) *Adjustment of benefits.* An example of a plan that maintains an experience-rating arrangement with respect to an individual employer is a plan under which benefits for an employer's employees are (or can be expected to be) increased if that employer's overall experience is positive or, conversely, under which benefits are (or can be expected to be) decreased if that employer's overall experience is negative. A plan also maintains an experience-rating arrangement with respect to an individual employer if benefits for an employer's employees are limited by reference, directly or indirectly, to the overall experience of the employer (rather than having all the plan assets available to provide the benefits).

(4) *Special rules*—(i) *Treatment of insurance contracts*—(A) *In general.* For purposes of this section, insurance contracts under the arrangement will be treated as assets of the fund. Accordingly, the value of the insurance contracts (including non-guaranteed elements) is included in the value of the fund, and amounts paid between the fund and the insurance company are disregarded, except to the extent they generate gains or losses as described in paragraph (b)(4)(i)(C) of this section.

(B) *Payments to and from an insurance company*. Payments from a participating employer or its employees to an insurance company pursuant to insurance contracts under the arrangement will be treated as contributions made to the fund, and amounts paid under the arrangement from an insurance company will be treated as payments from the fund.

(C) *Gains and losses from insurance contracts.* As of any date, if the sum of the benefits paid by the insurer and the

value of the insurance contract (including non-guaranteed elements) is greater than the cumulative premiums paid to the insurer, the excess is treated as a gain to the fund. As of any date, if the cumulative premiums paid to the insurer are greater than the sum of the benefits paid by the insurer and the value of the insurance contract (including non-guaranteed elements), the excess is treated as a loss to the fund.

(ii) *Treatment of flexible contribution arrangements.* Solely for purposes of determining the cost of coverage under a plan, if contributions for any period can vary with respect to a benefit package, the Commissioner may treat the employer as contributing the minimum amount that would maintain the coverage for that period.

(iii) *Experience rating by group of employers or group of employees.* A plan will not be treated as maintaining an experience-rating arrangement with respect to an individual employer merely because the cost of coverage under the plan with respect to the employer is based, in whole or in part, on the benefits experience or the overall experience (or a proxy for either type of experience) of a rating group, provided that no employer normally contributes more than 10 percent of all contributions with respect to that rating group. For this purpose, a rating group means a group of participating employers that includes the employer or a group of employees covered under the plan that includes one or more employees of the employer.

(iv) *Family members, etc.* For purposes of this section, contributions with respect to an employee include contributions with respect to any other person (e.g., a family member) who may be covered by reason of the employee's coverage under the plan and amounts provided with respect to an employee include amounts provided with respect to such a person.

(v) *Leased employees.* In the case of an employer that is the recipient of services performed by a leased employee described in section 414(n)(2) who participates in the plan, the leased employee is treated as an employee of the recipient and contributions made by the leasing organization attributable to service performed with the recipient are treated as made by the recipient.

(c) *Characteristics indicating a plan is not a 10 or more employer plan*—(1) *In general.* The presence of any of the characteristics described in paragraphs (c)(2) through (c)(6) of this section generally indicates that the plan is not a 10 or more employer plan described in section 419A(f)(6). Accordingly, unless established to the satisfaction of the Commissioner that the plan satisfies the requirements of section 419A(f)(6) and this section, a plan having any of the following characteristics is not a 10 or more employer plan described in section 419A(f)(6). A plan's lack of all the following characteristics does not create any inference that the plan is a 10 or more employer plan described in section 419A(f)(6).

(2) *Allocation of plan assets.* Assets of the plan or fund are allocated to a specific employer or employers through separate accounting of contributions and expenditures for individual employers, or otherwise.

(3) *Differential pricing.* The amount charged under the plan is not the same for all the participating employers, and those differences are not merely reflective of differences in current risk or rating factors that are commonly taken into account in manual rates used by insurers (such as current age, gender, geographic locale, number of covered dependents, and benefit terms) for the particular benefit or benefits being provided.

(4) *No fixed welfare benefit package.* The plan does not provide for fixed welfare benefits for a fixed coverage period for a fixed cost, within the meaning of paragraph (d)(5) of this section.

(5) *Unreasonably high cost.* The plan provides for fixed welfare benefits for a fixed coverage period for a fixed cost, but that cost is unreasonably high for the covered risk for the plan as a whole.

(6) *Nonstandard benefit triggers.* Benefits or other amounts payable can be paid, distributed, transferred, or otherwise provided from a fund that is part of the plan by reason of any event other than the illness, personal injury, or death of an employee or family member, or the employee's involuntary separation from employment. Thus, for

example, a plan exhibits this characteristic if the plan provides for the payment of benefits or the distribution of an insurance contract to an employer's employees on the occasion of the employer's withdrawal from the plan. A plan will not be treated as having the characteristic described in this paragraph merely because, upon cessation of participation in the plan, an employee is provided with the right to convert coverage under a group life insurance contract to coverage under an individual life insurance contract without demonstrating evidence of insurability, but only if there is no additional economic value associated with the conversion right.

(d) *Definitions.* For purposes of this section:

(1) *Benefits or other amounts payable.* The term *benefits or other amounts payable* includes all amounts that are payable or distributable (or that will be otherwise provided) directly or indirectly to employers, to employees or their beneficiaries, or to another fund as a result of a spinoff or transfer, and without regard to whether payable or distributable as welfare benefits, cash, dividends, rebates of contributions, property, promises to pay, or otherwise.

(2) *Benefits experience.* The *benefits experience* of an employer (or of an employee or a group of employers or employees) means the benefits and other amounts incurred, paid, or distributed (or otherwise provided) directly or indirectly, including to another fund as a result of a spinoff or transfer, with respect to the employer (or employee or group of employers or employees), and without regard to whether provided as welfare benefits, cash, dividends, credits, rebates of contributions, property, promises to pay, or otherwise.

(3) *Overall experience*—(i) *Employer's overall experience.* The term *overall experience* means, with respect to an employer (or group of employers), the balance that would have accumulated in a welfare benefit fund if that employer (or those employers) were the only employer (or employers) providing welfare benefits under the plan. Thus, the overall experience is credited with the sum of the contributions under the plan with respect to that employer (or group of employers), less the benefits and other amounts paid or distributed (or otherwise provided) with respect to that employer (or group of employers) or the employees of that employer (or group of employers), and adjusted for gain or loss from insurance contracts (as described in paragraph (b)(4)(i) of this section), investment return, and expenses. Overall experience as of any date may be either a positive or a negative number.

(ii) *Employee's overall experience.* The term *overall experience* means, with respect to an employee (or group of employees, whether or not employed by the same employer), the balance that would have accumulated in a welfare benefit fund if the employee (or group of employees) were the only employee (or employees) being provided welfare benefits under the plan. Thus, the overall experience is credited with the sum of the contributions under the plan with respect to that employee (or group of employees), less the benefits and other amounts paid or distributed (or otherwise provided) with respect to that employee (or group of employees), and adjusted for gain or loss from insurance contracts (as described in paragraph (b)(4)(i) of this section), investment return, and expenses. Overall experience as of any date may be either a positive or a negative number.

(4) *Employer.* The term *employer* means the employer whose employees are participating in the plan and those employers required to be aggregated with the employer under section 414(b), (c), or (m).

(5) *Fixed welfare benefit package*—(i) *In general.* A plan provides for fixed welfare benefits for a fixed coverage period for a fixed cost, if it—

(A) Defines one or more welfare benefits, each of which has a fixed amount that does not depend on the amount or type of assets held by the fund;

(B) Specifies fixed contributions to provide for those welfare benefits; and

(C) Specifies a coverage period during which the plan agrees to provide specified welfare benefits, subject to the payment of the specified contributions by the employer.

(ii) *Treatment of actuarial gains or losses.* A plan will not be treated as failing to provide for fixed welfare benefits

for a fixed coverage period for a fixed cost merely because the plan does not pay the promised benefits (or requires all participating employers to make proportionate additional contributions based on the fund's shortfall) when there are insufficient assets under the plan to pay the promised benefits. Similarly, a plan will not be treated as failing to provide for fixed welfare benefits for a fixed coverage period for a fixed cost merely because the plan provides a period of extended coverage after the end of the coverage period with respect to employees of all participating employers at no cost to the employers (or provides a proportionate refund of contributions to all participating employers) because of the plan-wide favorable actuarial experience during the coverage period.

(e) *Maintenance of records.* The plan administrator of a plan that is intended to be a 10 or more employer plan described in section 419A(f)(6) shall maintain permanent records and other documentary evidence sufficient to substantiate that the plan satisfies the requirements of section 419A(f)(6) and this section. (*See* § 1.414(g)–1 for the definition of plan administrator.)

(f) *Examples.* The provisions of paragraph (c) of this section and the provisions of section 419A(f)(6) and this section relating to experience-rating arrangements may be illustrated by the following examples. Unless stated otherwise, it should be assumed that any life insurance contract described in an example is non-participating and has no value other than the value of the policy's current life insurance protection plus its cash value, and that no employer normally contributes more than 10 percent of the total contributions contributed under the plan by all employers. Paragraph (ii) of each example applies the characteristics listed in paragraph (c) of this section to the facts described in that example. Paragraphs (iii) and (iv) of each example analyze the facts described in the example to determine whether the plan maintains experience-rating arrangements with respect to individual employers. Paragraphs (iii) and (iv) of each example illustrate only the meaning of *experience-rating arrangements.* No inference should be drawn from these examples about whether these plans are otherwise described in section 419A(f)(6) or about the applicability or nonapplicability of any other Internal Revenue Code provision that may limit or deny the deduction of contributions to the arrangements. Further, no inference should be drawn from the examples concerning the tax treatment of employees as a result of the employer contributions or the provision of the benefits. The examples are as follows:

Example 1. (i) An arrangement provides welfare benefits to employees of participating employers. Each year a participating employer is required to contribute an amount equal to the claims and other expenses expected with respect to that employer for the year (based on current age, gender, geographic locale, number of participating employees, benefit terms, and other risk or rating factors commonly taken into account in manual rates used by insurers for the benefits being provided), multiplied by the ratio of actual claims with respect to that employer for the previous year over the expected claims with respect to that employer for the previous year.

(ii) This arrangement exhibits at least one of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). Differential pricing exists under this arrangement because the amount charged under the plan is not the same for all the participating employers, and those differences are not merely reflective of differences in current risk or rating factors that are commonly taken into account in manual rates used by insurers for the particular benefit or benefits being provided.

(iii) This arrangement does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Under the arrangement, an employer's cost of coverage for each year is based, in part, on that employer's benefits experience (*i.e.,* the benefits and other amounts provided in the past with respect to one or more employees of that employer). Accordingly, pursuant to paragraph (b)(1) of this section, the arrangement maintains experience-rating arrangements with respect to individual employers.

Example 2. (i) The facts are the same as in *Example* 1, except that the amount charged to an employer each year is equal to claims and other expenses expected with respect to that employer for the year (determined the same as in *Example 1*), multiplied by the ratio of actual claims for the previous year

(determined on a plan-wide basis) over the expected claims for the previous year (determined on a plan-wide basis).

(ii) Based on the limited facts described above, this arrangement exhibits none of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). Unlike the arrangement discussed in *Example 1*, there is no differential pricing under the arrangement because the only differences in the amounts charged to the employers are solely reflective of differences in current risk or rating factors that are commonly taken into account in manual rates used by insurers for the particular benefit or benefits being provided.

(iii) Nothing in the facts described in this *Example 2* indicates that the arrangement maintains experience-rating arrangements prohibited under section 419A(f)(6) and this section. An employer's cost of coverage under the arrangement is based, in part, on the benefits experience of that employer (as well as of all the other participating employers). However, pursuant to paragraph (b)(4)(iii) of this section, the arrangement will not be treated as maintaining experience-rating arrangements with respect to the individual employers merely because the employers' cost of coverage is based on the benefits experience of a group of employees eligible under the plan, provided no employer normally contributes more than 10 percent of all contributions with respect to the rating group that includes the employees of an individual employer. Under the arrangement described in this *Example 2*, the rating group includes all the participating employers (or all of their employees), and no employer normally contributes more than 10 percent of the contributions made under the arrangement by all the employers. Accordingly, absent other facts, the arrangement will not be treated as maintaining experience-rating arrangements with respect to individual employers.

Example 3. (i) Arrangement A provides welfare benefits to employees of participating employers. Each year an employer is required to contribute an amount equal to the claims and other expenses expected with respect to that employer for the year (based on current risk or rating factors commonly taken into account in manual rates used by insurers for the benefits being provided), adjusted based on the employer's notional account. An employer's notional account is determined as follows. The account is credited with the sum of the employer's contributions previously paid under the plan less the benefit claims for that employer's employees. The notional account is further increased by a fixed five percent investment return (regardless of the actual investment return earned on the funds). If an employer's notional account is positive, the employer's contributions are reduced by a specified percentage of the notional account. If an employer's notional account is negative, the employer's contributions are increased by a specified percentage of the notional account.

(ii) Arrangement A exhibits at least two of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, assets under the plan are allocated to specific employers. Second, differential pricing exists because the amount charged under the plan is not the same for all the participating employers, and those differences are not merely reflective of differences in current risk or rating factors that are commonly taken into account in manual rates used by insurers for the particular benefit or benefits being provided.

(iii) Arrangement A does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Under the arrangement, a participating employer's cost of coverage for each year is based on a proxy for that employer's overall experience. An employer's *overall experience*, as that term is defined in paragraph (d)(3) of this section, includes the balance that would have accumulated in the fund if that employer's employees were the only employees being provided benefits under the plan. Under that definition, the overall experience is credited with the sum of the contributions paid under the plan by or on behalf of that employer less the benefits or other amounts provided to with respect to that employer's employees, and adjusted for gain or loss from insurance contracts, expenses, and investment return. Under the formula used by the arrangement in this example to determine employer contributions, expenses are disregarded and a fixed investment return of five percent is used instead of actual investment return. The disregard of expenses and substitution of the fixed investment return for the actual investment return merely results in an employer's notional account that is a proxy for the overall experience of that employer. Accordingly, the arrangement maintains experience-rating arrangements with respect to individual employers.

Example 4. (i) Under Arrangement B, death benefits are provided for eligible employees of each participating employer. Individual level premium whole life insurance policies are purchased to provide the death benefits. Each policy has a face amount equal to the death benefit payable with respect to the individual employee. Each year, a participating employer is charged an amount equal to the level premiums payable with respect to the employees of that employer. One participating employer, F, has an employee, P,

whose coverage under the arrangement commenced at the beginning of 2000, when P was age 50. P is covered under the arrangement for $1 million of death benefits, and a life insurance policy with a face amount of $1 million has been purchased on P's life. The level annual premium on the policy is $23,000. At the beginning of 2005, when P is age 55, the $23,000 premium amount has been paid for five years and the policy, which continues to have a face amount of $1 million, has a cash value of $92,000. Another employer, G, has an employee, R, who is also 55 years old at the beginning of 2005 and is covered under Arrangement B for $1 million, for which a level premium life insurance policy with a face amount of $1 million has been purchased. However, R did not become covered under Arrangement B until the beginning of 2005. Because R's coverage began at age 55, the level annual premium charged for the policy on R's life is $30,000, or $7,000 more than the premiums payable on the policy in effect on P's life. Employer F is charged $23,000 and employer G is charged $30,000 for the death benefit for employees P and R, respectively. Assume that employees P and R are the only covered employees of their respective employers and that they are identical with respect to current risk and rating factors that are commonly taken into account in manual rates used by insurers for death benefits.

(ii) Arrangement B exhibits at least three of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, assets of the plan are effectively allocated to specific employers. Second, there is differential pricing under the arrangement. That is, the amount charged under the plan during the year for a specific amount of death benefit coverage is not the same for all the employers (employer F is charged $23,000 each year for $1 million of death benefit coverage while employer G is charged $30,000 each year for the same coverage), and the difference is not merely reflective of differences in current risk or rating factors that are commonly taken into account in manual rates used by insurers for the death benefit being provided. (The differences in amounts charged are attributable to differences in issue age and not to differences in current risk or rating factors, as employees P and R are the same age). Third, during the early years of the arrangement, the amounts charged are unreasonably high for the covered risk for the plan as a whole.

(iii) Arrangement B does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Arrangement B maintains experience-rating arrangements with respect to individual employers because the cost of coverage for each year for any employer participating in the arrangement is based on a proxy for the overall experience of that employer. Under Arrangement B, employer F's cost of coverage for 2005 is $23,000 for $1 million of coverage. The $92,000 cash value at the beginning of 2005 in the policy insuring P's life is a proxy for employer F's overall experience. (The $92,000 is essentially the balance that would have accumulated in the fund if employer F were the only employer providing welfare benefits under Arrangement B.) Further, the $23,000 charged to F for the $1 million of coverage in 2005 is based on the $92,000 since, in the absence of the $92,000, employer F would have been charged $30,000 for P's $1 million death benefit coverage. (Note that the conclusion that the $92,000 balance is the basis for the lower premium charged to employer F is consistent with the fact that a $92,000 balance, if converted to a life annuity using the same actuarial assumptions as were used to calculate the cash value amount, would be sufficient to provide for annual annuity payments of $7,000 for the life of P—an amount equal to the $7,000 difference from the premium charged in 2005 to employer G for the $1 million of coverage on employee R's life.) Thus, F's cost of coverage for 2005 is based on a proxy for F's overall experience. Accordingly, Arrangement B maintains an experience-rating arrangement with respect to employer F.

(iv) Arrangement B also maintains an experience-rating arrangement with respect to employer G because it can be expected that each year G will be charged $30,000 for the $1 million of coverage on R's life. Each year, G's cost of coverage will reflect G's prior contributions and allocable earnings, so that G's cost of coverage will be based on a proxy for G's overall experience. Accordingly, Arrangement B maintains an experience-rating arrangement with respect to employer G. Similarly, Arrangement B maintains an experience-rating arrangement with respect to each other participating employer. Accordingly, Arrangement B maintains experience-rating arrangements with respect to individual employers. This would also be the result if Arrangement B maintained an experience-rating arrangement with respect to only one individual employer.

Example 5. (i) The facts are the same as in *Example 4* except that the death benefits are provided under 10-year level term life insurance policies. One participating employer, H, has an employee, M, whose coverage under the arrangement commenced at the beginning of 2000, when M was age 35. M is covered under the arrangement for $1 million of death benefits, and a 10-year level term life insurance policy with a face amount of $1 million has been purchased on M's life. The level annual premium on the policy for the first 10 years is $700. At the beginning of 2007, when M is age 42, the $700 premium amount

has been paid for seven years. Another employer, J, has an employee, N, who is also 42 years old at the beginning of 2007 and is covered under the arrangement for $1 million, for which a 10-year level term life insurance policy with a face amount of $1 million has been purchased. However, N did not become covered under the arrangement until the beginning of 2007. Because N's coverage began at age 42, the 10-year level term premium charged for the policy on N's life is $1,100, or $400 more than the premiums then payable on the policy in effect on M's life. Neither the policy on employee M nor the policy on employee N has any cash value at any point during its term. Assume that employees M and N are the only covered employees of their respective employers and that they are identical with respect to any current risk and rating factors that are commonly taken into account in manual rates used by insurers for the death benefit being provided.

(ii) Based on the facts described in this *Example 5,* this arrangement exhibits at least two of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, for the same reasons as described in paragraph (ii) of *Example 4,* there is differential pricing under the arrangement. Second, assets of the plan are effectively allocated to specific employers. This is the case even though the insurance policies used by employers H and J have no accessible cash value.

(iii) The facts described in this *Example 5* indicate that the arrangement does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. This arrangement maintains experience-rating arrangements with respect to individual employers because the cost of coverage for each year for any employer participating in the arrangement is based on a proxy for the overall experience of that employer. Under this arrangement employer H's cost of coverage in 2007 is $700 for $1 million of coverage. Although the policy insuring M's life has no cash value accessible to employer H, the accumulation of the excesses of the amounts paid by employer H on behalf of employee M over each year's underlying mortality and expense charges for providing life insurance coverage to employee M provide economic value to employer H (*i.e.,* the ability to purchase future coverage on M's life at a premium that is less than the underlying mortality and expense charges as those underlying charges increase with M's increasing age). Thus, H's cost of coverage for 2007 is based on a proxy for H's overall experience. Accordingly, this arrangement maintains an experience-rating arrangement with respect to employer H.

(iv) This arrangement also maintains an experience-rating arrangement with respect to employer J because it can be expected that for each of the next nine years J will be charged $1,100 for the $1 million of coverage on N's life. Each year, J's cost of coverage will reflect J's prior contributions, so that J's cost of coverage will be based on a proxy for J's overall experience. Accordingly, this arrangement maintains an experience-rating arrangement with respect to employer J. Similarly, this arrangement maintains an experiencing-rating arrangement with respect to each other participating employer. Accordingly, this arrangement maintains experience-rating arrangements with respect to individual employers. This would also be the result if this arrangement maintained an experience-rating arrangement with respect to only one individual employer.

Example 6. (i) Under Arrangement C, death benefits are provided for eligible employees of each participating employer. Flexible premium universal life insurance policies are purchased to provide the death benefits. Each policy has a face amount equal to the death benefit payable with respect to the individual employee. Each participating employer can make any contributions to the arrangement provided that the amount paid for each employee is at least the amount needed to prevent the lapse of the policy. The amount needed to prevent the lapse of the universal life insurance policy is the excess, if any, of the mortality and expense charges for the year over the policy balance. All contributions made by an employer are paid as premiums to the universal life insurance policies purchased on the lives of the covered employees of that employer. Participating employers S and V each have a 50-year-old employee covered under Arrangement C for death benefits of $1 million, which is the face amount of the respective universal life insurance policies on the lives of the employees. In the first year of coverage employer S makes a contribution of $23,000 (the amount of a level premium) while employer V contributes only $6,000, which is the amount of the mortality and expense charges for the first year. At the beginning of year two, the balance in employer S's policy (including earnings) is $18,000, but the balance in V's policy is zero. Although S is not required to contribute anything in the second year of coverage, S contributes an additional $15,000 in the second year. Employer V contributes $7,000 in the second year.

(ii) Arrangement C exhibits at least two of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, assets of the plan are effectively allocated to specific employers. Second, the arrangement does not provide for fixed welfare benefits for a fixed coverage period for a fixed cost.

(iii) Arrangement C does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Arrangement C maintains experience-rating arrangements with respect to individual employers because the cost of coverage of an employer participating in the arrangement is based on a proxy for the overall experience of that employer. Pursuant to paragraph (b)(4)(ii) of this section (concerning treatment of flexible contribution arrangements), solely for purposes of determining an employer's cost of coverage, the Commissioner may treat an employer as contributing the minimum amount needed to maintain the coverage. Applying this treatment, H's cost of coverage for the first year of coverage under Arrangement C is $6,000 for $1 million of death benefit coverage, but for the second year it is zero for the same amount of coverage because that is the minimum amount needed to keep the insurance policy from lapsing. Employer H's overall experience at the beginning of the second year of coverage is $18,000, because that is the balance that would have accumulated in the fund if H were the only employer providing benefits under Arrangement C. (The special rule of paragraph (b)(4)(ii) of this section only applies to determine cost of coverage; it does not apply in determining overall experience.) The $18,000 balance in the policy insuring the life of employer H's employee is a proxy for H's overall experience. Employer H can choose not to make any contributions in the second year of coverage due to the $18,000 policy balance. Thus, H's cost of coverage for the second year is based on a proxy for H's overall experience. Accordingly, Arrangement C maintains an experience-rating arrangement with respect to employer H.

(iv) Arrangement C also maintains an experience-rating arrangement with respect to employer J because in each year J can contribute more than the amount needed to prevent a lapse of the policy on the life of its employee and can expect that its cost of coverage for subsequent years will reflect its prior contributions and allocable earnings. Accordingly, Arrangement C maintains an experience-rating arrangement with respect to employer J.

Example 7. (i) Arrangement D provides death benefits for eligible employees of each participating employer. Each employer can choose to provide a death benefit of either one, two, or three times the annual compensation of the covered employees. Under Arrangement D, the death benefit is payable only if the employee dies while employed by the employer. If an employee terminates employment with the employer or if the employer withdraws from the arrangement, the death benefit is no longer payable, no refund or other credit is payable to the employer or to the employees, and no policy or other property is transferrable to the employer or the employees. Furthermore, the employees are not provided with any right under Arrangement D to coverage under any other arrangement, nor with any right to purchase or to convert to an individual insurance policy, other than any conversion rights the employees may have in accordance with state law (and which provide no additional economic benefit). Arrangement D determines the amount required to be contributed by each employer for each month of coverage by aggregating the amount required to be contributed for each covered employee of the employer. The amount required to be contributed for each covered employee is determined by multiplying the amount of the death benefit coverage (in thousands) for the employee by five-year age bracket rates in a table specified by the plan, which is used uniformly for all covered employees of all participating employers. The rates in the specified table do not exceed the rates set forth in Table I of §1.79–3(d)(2), and differences in the rates in the table are merely reflective of differences in mortality risk for the various age brackets. The rates in the table are not based in whole or in part on the experience of the employers participating in Arrangement D. Arrangement D uses the amount contributed by each employer to purchase one-year term insurance coverage on the lives of the covered employees with a face amount equal to the death benefit provided by the plan. No employer is entitled to any rebates or refunds provided under the insurance contract.

(ii) Arrangement D does not exhibit any of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). Under Arrangement D, assets are not allocated to a specific employer or employers. Differences in the amounts charged to the employers are solely reflective of differences in risk or rating factors that are commonly taken into account in manual rates used by insurers for the particular benefit or benefits being provided. The arrangement provides for fixed welfare benefits for a fixed coverage period for a fixed cost, within the meaning of paragraph (d)(5) of this section. The cost charged under the arrangement is not unreasonably high for the covered risk of the plan as a whole. Finally, benefits and other amounts payable can be paid, distributed, transferred, or otherwise made available only by reason of the death of the employee, so that there is no nonstandard benefit trigger under the arrangement.

(iii) Nothing in the facts of this *Example 7* indicates that Arrangement D fails to satisfy the requirements of section 419A(f)(6) or this section by reason of maintaining experience-rating arrangements with respect to individual employers. Based solely on the facts

described above, Arrangement D does not maintain an experience rating-arrangement with respect to any individual employer because for each participating employer there is no period for which the employer's cost of coverage under the arrangement is based, in whole or in part, on either the benefits experience or the overall experience (or a proxy for either type of experience) of that employer or its employees.

Example 8. (i) The facts are the same as in *Example 7,* except that under the arrangement, any refund or rebate provided under that year's insurance contract is allocated among all the employers participating in the arrangement in proportion to their contributions, and is used to reduce the employers' contributions for the next year.

(ii) This arrangement exhibits at least one of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). The arrangement includes nonstandard benefit triggers because amounts are made available to an employer by reason of the insurer providing a refund or rebate to the plan, an event that is other than the illness, personal injury, or death of an employee or family member, or an employee's involuntary separation from employment.

(iii) Based on the limited and specific facts described in this *Example 8,* an employer participating in this arrangement should be able to establish to the satisfaction of the Commissioner that the plan does not maintain experience-rating arrangements with respect to individual employers. A participating employer's cost of coverage is the relationship of its contributions to the death benefit coverage or other amounts payable with respect to that employer, including the employer's portion of the insurance company rebate and refund amounts. The rebate and refund amounts are allocated to an employer based on that employer's contribution for the prior year. However, even though an employer's overall experience includes its past contributions, contributions alone are not a proxy for an employer's overall experience under the particular facts described in this Example 8. As a result, a participating employer's cost of coverage under the arrangement for each year (or any other period) is not based on that employer's benefits experience or its overall experience (or a proxy for either type of experience), except as follows: If the total of the insurance company refund or rebate amounts is a proxy for the overall experience of all participating employers, a participating employer's cost of coverage will be based in part on that employer's overall experience (or a proxy therefor) by reason of that employer's overall experience being a portion of the overall experience of all participating employers. Under the special rule of paragraph (b)(2)(iii) of this section, however, that fact alone will not cause the arrangement to be treated as maintaining an experience-rating arrangement with respect to an individual employer because no employer normally contributes more than 10 percent of the total contributions under the plan by all employers (the rating group). Accordingly, the arrangement will not be treated as maintaining experience-rating arrangements with respect to individual employers.

Example 9. (i) Arrangement E provides medical benefits for covered employees of 90 participating employers. The level of medical benefits is determined by a schedule set forth in the trust document and does not vary by employer. Other than any rights an employee may have to COBRA continuation coverage, the medical benefits cease when an employee terminates employment with the employer. If an employer withdraws from the arrangement, there is no refund of any contributions and there is no transfer of anything of value to employees of the withdrawing employer, to the withdrawing employer, or to another plan or arrangement maintained by the withdrawing employer. Arrangement E determines the amount required to be contributed by each employer for each year of coverage, and the aggregate amounts charged are not unreasonably high for the covered risk for the plan as a whole. To determine the amount to be contributed for each employer, Arrangement E classifies an employer based on the employer's location. These geographic areas are not changed once established under the arrangement. The amount charged for the coverage under the arrangement to the employers in a geographic area is determined from a rate-setting manual based on the benefit package and geographic area, and differences in the rates in the manual are merely reflective of current differences in those risk or rating factors. The rates in the rate-setting manual are not based in whole or in part on the experience of the employers participating in Arrangement E.

(ii) Arrangement E does not exhibit any of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). Although the amounts charged under the arrangement to an employer in one geographic area can be expected to differ from those charged to an employer in another geographic area, the differences are merely reflective of differences in current risk or rating factors that are commonly taken into account in manual rates used by insurers for medical benefits.

(iii) Nothing in the facts of this *Example 9* indicates that Arrangement E fails to satisfy the requirements of section 419A(f)(6) or this section by reason of maintaining experience-rating arrangements with respect to individual employers. Based solely on the facts

described above, Arrangement E does not maintain an experience rating-arrangement with respect to any individual employer because for each participating employer there is no period for which the employer's cost of coverage under the arrangement is based, in whole or in part, on either the benefits experience or the overall experience (or a proxy for either type of experience) of that employer or its employees.

Example 10. (i) The facts are the same as in *Example 9*, except that the amount charged for the coverage under the arrangement to the employers in a geographic area is initially determined from a rate-setting manual based on the benefit package and then adjusted to reflect the claims experience of the employers in that classification as a whole. The arrangement does not have any geographic area classification for which one of the employers in the classification normally contributes more than 10 percent of the contributions made by all the employers in that classification.

(ii) This arrangement exhibits at least one of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). There is differential pricing under the arrangement because the amounts charged to an employer in one geographic area can be expected to differ from those charged to an employer in another geographic area, and the differences are not merely reflective of current risk or rating factors that are commonly taken into account in manual rates used by insurers for medical benefits.

(iii) Based on the facts described in this *Example 10*, an employer participating in this arrangement should be able to establish to the satisfaction of the Commissioner that the plan does not maintain experience-rating arrangements with respect to individual employers even though there is differential pricing. Although an employer's cost of coverage for each year is based, in part, on its benefits experience (as well as the benefits experience of the other employers in its geographic area), that does not result in experience-rating arrangements with respect to any individual employer because the employers in each geographic area are a rating group and no employer normally contributes more than 10 percent of the contributions made by all the employers in its rating group. (See paragraph (b)(4)(iii) of this section.)

Example 11. (i) The facts of Arrangement F are the same as those described in *Example 10*, except that K, an employer in one of Arrangement F's geographic areas, normally contributes more than 10 percent of the contributions made by the employers in that geographic area.

(ii) For the same reasons as described in *Example 10*, Arrangement F results in differential pricing.

(iii) Arrangement F does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. An employer's cost of coverage for each year is based, in part, on its benefits experience (as well as the benefits experience of the other employers in its geographic area) and the special rule for experience-rating by a rating group does not apply to Arrangement F because employer K normally contributes more than 10 percent of the contributions made by the employers in its rating group. Accordingly, Arrangement F maintains experience-rating arrangements with respect to individual employers.

Example 12. (i) The facts of Arrangement G are the same as those described in Example 10, except for the way that the arrangement classifies the employers. Under Arrangement G, the experience of each employer for the prior year is reviewed and then the employer is assigned to one of three classifications (low cost, intermediate cost, or high cost) based on the ratio of actual claims with respect to that employer to expected claims with respect to that employer. No employer in any classification normally contributes more than 10 percent of the contributions of all employers in that classification.

(ii) For the same reasons as described in *Example 10*, Arrangement G results in differential pricing.

(iii) Arrangement G does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. The special rule in paragraph (b)(4)(iii) of this section for rating groups can prevent a plan from being treated as maintaining experience-rating arrangements with respect to individual employers if the mere use of a rating group is the only reason a plan would be so treated. Under Arrangement G, however, an employer's cost of coverage for each year is based on the employer's benefits experience in two ways: the employer's benefits experience is part of the benefits experience of a rating group that is otherwise permitted under the special rule of paragraph (b)(4)(iii) of this section, and the employer's benefits experience is considered annually in redetermining the rating group to which the employer is assigned. Accordingly, Arrangement G maintains experience-rating arrangements with respect to individual employers.

Example 13. (i) Arrangement H provides a death benefit equal to a multiple of one, two, or three times compensation as elected by the participating employer for all of its covered employees. Universal life insurance contracts are purchased on the lives of the covered employees. The face amount of each

contract is the amount of the death benefit payable upon the death of the covered employee. Under the arrangement, each employer is charged annually an amount equal to 200 percent of the mortality and expense charges under the contracts for that year covering the lives of the covered employees of that employer. Arrangement H pays the amount charged each employer to the insurance company. Thus, the insurance company receives an amount equal to 200 percent of the mortality and expense charges under the policies. The excess amounts charged and paid to the insurance company increase the policy value of the universal life insurance contracts. When an employer ceases to participate in Arrangement H, the insurance policies are distributed to each of the covered employees of the withdrawing employer.

(ii) Arrangement H exhibits at least three of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, assets are effectively allocated to specific employers. Second, because the amount of the withdrawal benefit (*i.e.*, the value of the life insurance policies to be distributed) is unknown, the arrangement does not provide for fixed welfare benefits for a fixed coverage period for a fixed cost. Finally, Arrangement H includes nonstandard benefit triggers because amounts can be distributed under the arrangement for a reason other than the illness, personal injury, or death of an employee or family member, or an employee's involuntary separation from employment.

(iii) Arrangement H does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Pursuant to paragraph (b)(1) of this section, the prohibition against maintaining experience-rating arrangements applies under all circumstances, including employer withdrawals. Arrangement H maintains experience-rating arrangements with respect to individual employers because the cost of coverage for a participating employer is based on a proxy for the overall experience of that employer. Under Arrangement H, the contributions of a participating employer are fixed. The benefits or other amounts payable with respect to an employer include the value of the life insurance policies that are distributable to the employees of that employer upon the withdrawal of that employer from the plan. Thus, the cost of coverage for any period of an employer's participation in Arrangement H is the relationship between the fixed contributions for that period and the variable benefits payable under the arrangement. The value of those variable benefits depends on the value of the policies that would be distributed if the employer were to withdraw at the end of the period. (Each year the insurance policies to be distributed to the employees in the event of the employer's withdrawal will increase in value due to the premium amounts paid on the policy in excess of current mortality and expense charges.) For reasons similar to those discussed above in Example 6, the aggregate value of the life insurance policies on the lives of an employer's employees is a proxy for that employer's overall experience. Thus, a participating's employer's cost of coverage for any period is based on a proxy for the overall experience of that employer. Accordingly, Arrangement H maintains experience-rating arrangements with respect to individual employers.

(iv) The result would be the same if, rather than distributing the policies, Arrangement H distributed cash amounts equal to the cash values of the policies. The result would also be the same if the distribution of policies or cash values is triggered by employees terminating their employment rather than by employers ceasing to participate in the arrangement.

Example 14. (i)(1) The facts of Arrangement J are the same as those described in *Example 13* for Arrangement H, except that—

(A) Arrangement J purchases a special term insurance policy on the life of each covered employee with a face amount equal to the death benefit payable upon the death of the covered employee; and

(B) there is no benefit distributable upon an employer's withdrawal.

(2) The special term policy includes a rider that extends the term protection for a period of time beyond the term provided on the policy's face. The length of the extended term is not guaranteed, but is based on the excess of premiums over mortality and expense charges during the period of original term protection, increased by any investment return credited to the policies.

(ii) Arrangement J exhibits two of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, assets of the plan are effectively allocated to specific employers. Second, the plan does not provide for fixed welfare benefits for a fixed coverage period for a fixed cost because the coverage period is not fixed.

(iii) Arrangement J does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Arrangement J maintains experience-rating arrangements with respect to individual employers because the cost of coverage for a participating employer is based on a proxy for the overall experience of that employer. Under Arrangement J, the contributions of a participating employer are fixed. The benefits or other amounts payable with respect to an employer are the one-

, two-, or three-times-compensation death benefit for each employee of the employer for the current year, plus the extended term protection coverage for future years. Thus, for any period extending to or beyond the end of the original term of one or more of the policies on the lives of an employer's employees, the employer's cost of coverage is the relationship between the fixed contributions for that period and the variable benefits payable under the arrangement. The value of those variable benefits depends on the aggregate value of the policies insuring the employer's employees (*i.e.*, the total of the premiums paid on the policies by Arrangement J to the insurance company, reduced by the mortality and expense charges that were needed to provide the original term protection, and increased by any investment return credited to the policies). The aggregate value of the policies insuring an employer's employees is, at any time, a proxy for the employer's overall experience. Thus, a participating employer's cost of coverage for any period described above is based on a proxy for the overall experience of that employer. Accordingly, Arrangement J maintains experience-rating arrangements with respect to individual employers.

Example 15. (i) Arrangement K provides a death benefit to employees of participating employers equal to a specified multiple of compensation. Under the arrangement, a flexible-premium universal life insurance policy is purchased on the life of each covered employee in the amount of that employee's death benefit. Each policy has a face amount equal to the employee's death benefit under the arrangement. Each participating employer is charged annually with the aggregate amount (if any) needed to maintain the policies covering the lives of its employees. However, each employer is permitted to make additional contributions to the arrangement and, upon doing so, the additional contributions are paid to the insurance company and allocated to one or more contracts covering the lives of the employer's employees. In the event that any policy covering the life of an employee would lapse in the absence of new contributions from that employee's employer, and if at the same time there are policies covering the lives of other employees of the employer that have cash values in excess of the amounts needed to prevent their lapse, the employer has the option of reducing its otherwise-required contribution by amounts withdrawn from those other policies.

(ii) Arrangement K exhibits at least two of the characteristics listed in paragraph (c) of this section generally indicating that an arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, assets of the plan are allocated to specific employers. Second, because the plan allows an employer to choose to contribute an amount that is different than that contributed by another employer for the same benefit, the amount charged under the plan is not the same for all participating employers (and the differences in the amounts are not merely reflective of differences in current risk or rating factors that are commonly taken into account in manual rates used by insurers for the particular benefit or benefits being provided), resulting in differential pricing.

(iii) Arrangement K does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Arrangement K maintains experience-rating arrangements with respect to individual employers because the cost of coverage for any employer participating in the arrangement is based on a proxy for the overall experience of that employer. Under Arrangement K the benefits with respect to an employer for any year are a fixed amount. For purposes of determining the employer's cost of coverage for that year, the Commissioner may treat the employer's contribution under the special rule of paragraph (b)(4)(ii) of this section (concerning treatment of flexible contribution/arrangements) as being the minimum contribution amount needed to maintain the universal life policies with respect to that employer for the death benefit coverage for that year. Because the employer has the option to prevent the lapse of one policy by having amounts withdrawn from other policies, that minimum contribution amount will be based in part on the aggregate value of the policies on the lives of that employer's employees. That aggregate value is a proxy for the employer's overall experience. Accordingly, Arrangement K maintains experience-rating arrangements with respect to individual employers.

(g) *Effective date*—(1) *In general.* Except as set forth in paragraph (g)(2) of this section, this section applies to contributions paid or incurred in taxable years of an employer beginning on or after July 11, 2002.

(2) *Compliance information and recordkeeping.* Paragraphs (a)(1)(iv), (a)(2), and (e) of this section apply for taxable years of a welfare benefit fund beginning after July 17, 2003.

[T.D. 9079, 68 FR 42259, July 17, 2003]

§ 1.420–1 Significant reduction in retiree health coverage during the cost maintenance period.

(a) In *general.* Notwithstanding section 420(c)(3)(A), the minimum cost requirements of section 420(c)(3) are not

met if the employer significantly reduces retiree health coverage during the cost maintenance period.

(b) *Significant reduction*—(1) *In general.* An employer significantly reduces retiree health coverage during the cost maintenance period if, for any taxable year beginning on or after January 1, 2002, that is included in the cost maintenance period, either—

(i) The employer-initiated reduction percentage for that taxable year exceeds 10 percent; or

(ii) The sum of the employer-initiated reduction percentages for that taxable year and all prior taxable years during the cost maintenance period exceeds 20 percent.

(2) *Employer-initiated reduction percentage.* The employer-initiated reduction percentage for any taxable year is the fraction B/A, expressed as a percentage, where:

A = The total number of individuals (retired employees plus their spouses plus their dependents) receiving coverage for applicable health benefits as of the day before the first day of the taxable year.

B = The total number of individuals included in A whose coverage for applicable health benefits ended during the taxable year by reason of employer action.

(3) *Special rules for taxable years beginning before January 1, 2002.* The following rules apply for purposes of computing the amount in paragraph (b)(1)(ii) of this section if any portion of the cost maintenance period precedes the first day of the first taxable year beginning on or after January 1, 2002—

(i) *Aggregation of taxable years.* The portion of the cost maintenance period that precedes the first day of the first taxable year beginning on or after January 1, 2002 (the initial period) is treated as a single taxable year and the employer-initiated reduction percentage for the initial period is computed as set forth in paragraph (b)(2) of this section, except that the words ''initial period'' apply instead of ''taxable year.''

(ii) *Loss of coverage.* If coverage for applicable health benefits for an individual ends by reason of employer action at any time during the initial period, an employer may treat that coverage as not having ended if the employer restores coverage for applicable health benefits to that individual by the end of the initial period.

(4) *Employer action*—(i) *General rule.* For purposes of paragraph (b)(2) of this section, an individual's coverage for applicable health benefits ends during a taxable year by reason of employer action, if on any day within the taxable year, the individual's eligibility for applicable health benefits ends as a result of a plan amendment or any other action of the employer (e.g., the sale of all or part of the employer's business) that, in conjunction with the plan terms, has the effect of ending the individual's eligibility. An employer action is taken into account for this purpose regardless of when the employer action actually occurs (e.g., the date the plan amendment is executed), except that employer actions occurring before the later of December 18, 1999, and the date that is 5 years before the start of the cost maintenance period are disregarded.

(ii) *Special rule.* Notwithstanding paragraph (b)(4)(i) of this section, coverage for an individual will not be treated as having ended by reason of employer action merely because such coverage ends under the terms of the plan if those terms were adopted contemporaneously with the provision under which the individual became eligible for retiree health coverage. This paragraph (b)(4)(ii) does not apply with respect to plan terms adopted contemporaneously with a plan amendment that restores coverage for applicable health benefits before the end of the initial period in accordance with paragraph (b)(3)(ii) of this section.

(iii) *Sale transactions.* If a purchaser provides coverage for retiree health benefits to one or more individuals whose coverage ends by reason of a sale of all or part of the employer's business, the employer may treat the coverage of those individuals as not having ended by reason of employer action. In such a case, for the remainder of the year of the sale and future taxable years of the cost maintenance period—

(A) For purposes of computing the applicable employer cost under section 420(c)(3), those individuals are treated as individuals to whom coverage for applicable health benefits was provided

(for as long as the purchaser provides retiree health coverage to them), and any amounts expended by the purchaser of the business to provide for health benefits for those individuals are treated as paid by the employer;

(B) For purposes of determining whether a subsequent termination of coverage is by reason of employer action under this paragraph (b)(4), the purchaser is treated as the employer. However, the special rule in paragraph (b)(4)(ii) of this section applies only to the extent that any terms of the plan maintained by the purchaser that have the effect of ending retiree health coverage for an individual are the same as terms of the plan maintained by the employer that were adopted contemporaneously with the provision under which the individual became eligible for retiree health coverage under the plan maintained by the employer.

(c) *Definitions*. The following definitions apply for purposes of this section:

(1) *Applicable health benefits*. Applicable health benefits means applicable health benefits as defined in section 420(e)(1)(C).

(2) *Cost maintenance period*. Cost maintenance period means the cost maintenance period as defined in section 420(c)(3)(D).

(3) *Sale*. A sale of all or part of an employer's business means a sale or other transfer in connection with which the employees of a trade or business of the employer become employees of another person. In the case of such a transfer, the term *purchaser* means a transferee of the trade or business.

(d) *Examples*. The following examples illustrate the application of this section:

Example 1. (i) Employer W maintains a defined benefit pension plan that includes a 401(h) account and permits qualified transfers that satisfy section 420. The number of individuals receiving coverage for applicable health benefits as of the day before the first day of Year 1 is 100. In Year 1, Employer W makes a qualified transfer under section 420. There is no change in the number of individuals receiving health benefits during Year 1. As of the last day of Year 2, applicable health benefits are provided to 99 individuals, because 2 individuals became eligible for coverage due to retirement and 3 individuals died in Year 2. During Year 3, Employer W amends its health plan to eliminate coverage for 5 individuals, 1 new retiree becomes eligible for coverage and an additional 3 individuals are no longer covered due to their own decision to drop coverage. Thus, as of the last day of Year 3, applicable health benefits are provided to 92 individuals. During Year 4, Employer W amends its health plan to eliminate coverage under its health plan for 8 more individuals, so that as of the last day of Year 4, applicable health benefits are provided to 84 individuals. During Year 5, Employer W amends its health plan to eliminate coverage for 8 more individuals.

(ii) There is no significant reduction in retiree health coverage in either Year 1 or Year 2, because there is no reduction in health coverage as a result of employer action in those years.

(iii) There is no significant reduction in Year 3. The number of individuals whose health coverage ended during Year 3 by reason of employer action (amendment of the plan) is 5. Since the number of individuals receiving coverage for applicable health benefits as of the last day of Year 2 is 99, the employer-initiated reduction percentage for Year 3 is 5.05 percent (5/99), which is less than the 10 percent annual limit.

(iv) There is no significant reduction in Year 4. The number of individuals whose health coverage ended during Year 4 by reason of employer action is 8. Since the number of individuals receiving coverage for applicable health benefits as of the last day of Year 3 is 92, the employer-initiated reduction percentage for Year 4 is 8.70 percent (8/92), which is less than the 10 percent annual limit. The sum of the employer-initiated reduction percentages for Year 3 and Year 4 is 13.75 percent, which is less than the 20 percent cumulative limit.

(v) In Year 5, there is a significant reduction under paragraph (b)(1)(ii) of this section. The number of individuals whose health coverage ended during Year 5 by reason of employer action (amendment of the plan) is 8. Since the number of individuals receiving coverage for applicable health benefits as of the last day of Year 4 is 84, the employer-initiated reduction percentage for Year 5 is 9.52 percent (8/84), which is less than the 10 percent annual limit. However, the sum of the employer-initiated reduction percentages for Year 3, Year 4, and Year 5 is 5.05 percent + 8.70 percent + 9.52 percent = 23.27 percent, which exceeds the 20 percent cumulative limit.

Example 2. (i) Employer X, a calendar year taxpayer, maintains a defined benefit pension plan that includes a 401(h) account and permits qualified transfers that satisfy section 420. X also provides lifetime health benefits to employees who retire from Division A as a result of a plant shutdown, no health benefits to employees who retire from Division B, and lifetime health benefits to all employees who retire from Division C. In 2000, X amends its health plan to provide

coverage for employees who retire from Division B as a result of a plant shutdown, but only for the 2-year period coinciding with their severance pay. Also in 2000, X amends the health plan to provide that employees who retire from Division A as a result of a plant shutdown receive health coverage only for the 2-year period coinciding with their severance pay. A plant shutdown that affects Division A and Division B employees occurs in 2000. The number of individuals receiving coverage for applicable health benefits as of the last day of 2001 is 200. In 2002, Employer X makes a qualified transfer under section 420. As of the last day of 2002, applicable health benefits are provided to 170 individuals, because the 2-year period of benefits ends for 10 employees who retired from Division A and 20 employees who retired from Division B as a result of the plant shutdown that occurred in 2000.

(ii) There is no significant reduction in retiree health coverage in 2002. Coverage for the 10 retirees from Division A who lose coverage as a result of the end of the 2-year period is treated as having ended by reason of employer action, because coverage for those Division A retirees ended by reason of a plan amendment made after December 17, 1999. However, the terms of the health plan that limit coverage for employees who retired from Division B as a result of the 2000 plant shutdown (to the 2-year period) were adopted contemporaneously with the provision under which those employees became eligible for retiree coverage under the health plan. Accordingly, under the rule provided in paragraph (b)(4)(ii) of this section, coverage for those 20 retirees from Division B is not treated as having ended by reason of employer action. Thus, the number of individuals whose health benefits ended by reason of employer action in 2002 is 10. Since the number of individuals receiving coverage for applicable health benefits as of the last day of 2001 is 200, the employer-initiated reduction percentage for 2002 is 5 percent (10/200), which is less than the 10 percent annual limit.

(e) *Regulatory effective date.* This section is applicable to transfers of excess pension assets occurring on or after December 18, 1999.

[T.D. 8948, 66 FR 32900, June 19, 2001]

CERTAIN STOCK OPTIONS

§ 1.421–1 Meaning and use of certain terms.

(a) *Option.* (1) For purposes of this section and §§ 1.421–2 through 1.424–1, the term ''option'' means the right or privilege of an individual to purchase stock from a corporation by virtue of an offer of the corporation continuing for a stated period of time, whether or not irrevocable, to sell such stock at a price determined under paragraph (e) of this section, such individual being under no obligation to purchase. The individual who has such right or privilege is referred to as the optionee and the corporation offering to sell stock under such an arrangement is referred to as the optionor. While no particular form of words is necessary, the option must express, among other things, an offer to sell at the option price, the maximum number of shares purchasable under the option, and the period of time during which the offer remains open. The term *option* includes a warrant that meets the requirements of this paragraph (a)(1).

(2) An option may be granted as part of or in conjunction with an employee stock purchase plan or subscription contract. See section 423.

(3) An option must be in writing (in paper or electronic form), provided that such writing is adequate to establish an option right or privilege that is enforceable under applicable law.

(b) *Statutory options.* (1) The term *statutory option*, for purposes of this section and §§ 1.421–2 through 1.424–1, means an *incentive stock option*, as defined in § 1.422–2(a), or an option granted under an *employee stock purchase plan*, as defined in § 1.423–2.

(2) An option qualifies as a statutory option only if the option is not transferable (other than by will or by the laws of descent and distribution) by the individual to whom the option was granted, and is exercisable, during the lifetime of such individual, only by such individual. See §§ 1.422–2(a)(2)(v) and 1.423–2(j). Accordingly, an option which is transferable or transferred by the individual to whom the option is granted during such individual's lifetime, or is exercisable during such individual's lifetime by another person, is not a statutory option. However, if the option or the plan under which the option was granted contains a provision permitting the individual to designate the person who may exercise the option after such individual's death,

neither such provision, nor a designation pursuant to such provision, disqualifies the option as a statutory option. A pledge of the stock purchasable under an option as security for a loan that is used to pay the option price does not cause the option to violate the nontransferability requirements of this paragraph (b). Also, the transfer of an option to a trust does not disqualify the option as a statutory option if, under section 671 and applicable State law, the individual is considered the sole beneficial owner of the option while it is held in the trust. If an option is transferred incident to divorce (within the meaning of section 1041) or pursuant to a domestic relations order, the option does not qualify as a statutory option as of the day of such transfer. For the treatment of nonstatutory options, see § 1.83–7.

(3)(i) The determination of whether an option is a statutory option is made as of the date such option is granted. An option which is a statutory option when granted does not lose its character as such an option by reason of subsequent events, and an option which is not a statutory option when granted does not become such an option by reason of subsequent events. See, however, paragraph (e) of § 1.424–1, relating to modification, extension, or renewal of an option. For rules concerning options that are not statutory options, see § 1.83–7.

(ii) The application of this subparagraph may be illustrated by the following examples:

Example 1. X Corporation is a subsidiary of S Corporation which, in turn, is a subsidiary of P Corporation. On June 1, 2004, P grants to an employee of P a statutory option to purchase a share of stock of X. On January 1, 2005, S sells a portion of the X stock which it owns to an unrelated corporation and, as of that date, X ceases to be a subsidiary of S. Because X was a subsidiary of P on the date of the grant of the statutory option, the option does not fail to be a statutory option even though X ceases to be a subsidiary of P.

Example 2. Assume P grants an option to an employee under the same facts as in example (1) above, except that on June 1, 2004, X is not a subsidiary of either S or P. Such option is not a statutory option on June 1, 2004. On January 1, 2005, S purchases from an unrelated corporation a sufficient number of shares of X stock to make X, as of that date, a subsidiary of S. Because X was not a subsidiary of S or P on the date of the grant of the option, the option is not a statutory option even though X later becomes a subsidiary of P. See §§ 1.422–2(a)(2) and 1.423–2(b).

(c) *Time and date of granting option.* (1) For purposes of this section and §§ 1.421–2 through 1.424–1, the language ''the date of the granting of the option'' and ''the time such option is granted,'' and similar phrases refer to the date or time when the granting corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option. Except as set forth in § 1.423–2(h)(2), a corporate action constituting an offer of stock for sale is not considered complete until the date on which the maximum number of shares that can be purchased under the option and the minimum option price are fixed or determinable.

(2) If the corporation imposes conditions on the granting of an option (as distinguished from conditions governing the exercise of the option), such conditions shall be given effect in accordance with the intent of the corporation. However, under section 424(i), if the grant of an option is subject to approval by stockholders, the date of grant of the option shall be determined as if the option had not been subject to such approval. A condition which does not require corporate action, such as the approval of, or registration with, some regulatory or governmental agency, for example, a stock exchange or the Securities and Exchange Commission, is ordinarily considered a condition upon the exercise of the option unless the corporate action clearly indicates that the option is not to be granted until such condition is satisfied. If an option is granted to an individual upon the condition that such individual will become an employee of the corporation granting the option or of a related corporation, such option is not granted prior to the date the individual becomes such an employee.

(3) In general, conditions imposed upon the exercise of an option will not operate to make ineffective the granting of the option. For example, on June 1, 2004, the A Corporation grants to X, an employee, an option to purchase 5,000 shares of the corporation's stock,

exercisable by X on or after June 1, 2005, provided he is employed by the corporation on June 1, 2005, and provided that A's profits during the fiscal year preceding the year of exercise exceed $200,000. Such an option is granted to X on June 1, 2004, and will be treated as outstanding as of such date.

(d) *Stock and voting stock*. (1) For purposes of this section and §§ 1.421–2 through 1.424–1, the term *stock* means capital stock of any class, including voting or nonvoting common or preferred stock. Except as otherwise provided, the term includes both treasury stock and stock of original issue. Special classes of stock authorized to be issued to and held by employees are within the scope of the term *stock* as used in such sections, provided such stock otherwise possesses the rights and characteristics of capital stock.

(2) For purposes of determining what constitutes voting stock in ascertaining whether a plan has been approved by stockholders under § 1.422–2(b) or 1.423–2(c) or whether the limitations pertaining to voting power contained in §§ 1.422–2(f) and 1.423–2(d) have been met, stock which does not have voting rights until the happening of an event, such as the default in the payment of dividends on preferred stock, is not voting stock until the happening of the specified event. Generally, stock which does not possess a general voting power, and may vote only on particular questions, is not voting stock. However, if such stock is entitled to vote on whether a stock option plan may be adopted, it is voting stock.

(3) In general, for purposes of this section and §§ 1.421–2 through 1.424–1, ownership interests other than capital stock are considered stock.

(e) *Option price*. (1) For purposes of this section and §§ 1.421–2 through 1.424–1, the term *option price*, *price paid under the option*, or *exercise price* means the consideration in cash or property which, pursuant to the terms of the option, is the price at which the stock subject to the option is purchased. The term *option price* does not include any amounts paid as interest under a deferred payment arrangement or treated as interest.

(2) Any reasonable valuation method may be used to determine whether, at the time the option is granted, the option price satisfies the pricing requirements of sections 422(b)(4), 422(c)(5), 422(c)(7), and 423(b)(6) with respect to the stock subject to the option. Such methods include, for example, the valuation method described in § 20.2031–2 of this chapter (Estate Tax Regulations).

(f) *Exercise*. For purposes of this section and §§ 1.421–2 through 1,424–1, the term ''exercise'', when used in reference to an option, means the act of acceptance by the optionee of the offer to sell contained in the option. In general, the time of exercise is the time when there is a sale or a contract to sell between the corporation and the individual. A promise to pay the option price does not constitute an exercise of the option unless the optionee is subject to personal liability on such promise. An agreement or undertaking by the employee to make payments under a stock purchase plan does not constitute the exercise of an option to the extent the payments made remain subject to withdrawal by or refund to the employee.

(g) *Transfer*. For purposes of this section and §§ 1.421–2 through 1.424–1, the term ''transfer'', when used in reference to the transfer to an individual of a share of stock pursuant to his exercise of a statutory option, means the transfer of ownership of such share, or the transfer of substantially all the rights of ownership. Such transfer must, within a reasonable time, be evidenced on the books of the corporation. For purposes of section 422, a transfer may occur even if a share of stock is subject to a substantial risk of forfeiture or is not otherwise transferable immediately after the date of exercise. See § 1.422–1(b)(3) *Example 2*. A transfer does not fail to occur merely because, under the terms of the arrangement, the individual may not dispose of the share for a specified period of time, or the share is subject to a right of first refusal or a right to reacquire the share at the share's fair market value at the time of sale.

(h) *Employment relationship*. (1) An option is a statutory option only if, at the time the option is granted, the optionee is an employee of the corporation granting the option, or a related corporation of such corporation. If the

option has been assumed or a new option has been substituted in its place under §1.424–1(a), the optionee must, at the time of such substitution or assumption, be an employee (or a former employee within the 3-month period following termination of the employment relationship) of the corporation so substituting or assuming the option, or a related corporation of such corporation. The determination of whether the optionee is an employee at the time the option is granted (or at the time of the substitution or assumption under §1.424–1(a)) is made in accordance with section 3401(c) and the regulations thereunder. As to the granting of an option conditioned upon employment, see paragraph (c)(2) of this section. A statutory option must be granted for a reason connected with the individual's employment by the corporation or by its related corporation.

(2) In addition, §1.421–2(a) is applicable to the transfer of a share pursuant to the exercise of the statutory option only if the optionee is, at all times during the period beginning with the date of the granting of such option and ending on the day 3 months before the date of such exercise, an employee of either the corporation granting such option, a related corporation of such corporation, or a corporation (or a related corporation of such corporation) substituting or assuming a stock option in a transaction to which §1.424–1(a) applies. For purposes of the preceding sentence, the employment relationship is treated as continuing intact while the individual is on military leave, sick leave, or other bona fide leave of absence (such as temporary employment by the Government) if the period of such leave does not exceed 3 months, or if longer, so long as the individual's right to reemployment with the corporation granting the option (or a related corporation of such corporation) or a corporation (or a related corporation of such corporation) substituting or assuming a stock option in a transaction to which §1.424–1(a) applies, is provided either by statute or by contract. If the period of leave exceeds 3 months and the individual's right to reemployment is not provided either by statute or by contract, the employment relationship is deemed to terminate on the first day immediately following such three-month period. Thus, if the option is not exercised before such deemed termination of employment, §1.421–2(a) applies to the transfer of a share pursuant to an exercise of the option only if the exercise occurs within 3 months from the date the employment relationship is deemed terminated.

(3) For purposes of determining whether an individual meets the requirements of this paragraph, the term ''employer corporation'', as used in section 424 (e) and (f), shall be read as ''grantor corporation'' or ''corporation issuing or assuming a stock option in a transaction to which section 424(a) is applicable'', as the case may be. For purposes of the employment requirement, a corporation employing an optionee is considered a related corporation if it was a parent or subsidiary of the corporation granting the option or substituting or assuming the option during the entire portion of the requisite period of employment during which it was the employer of such optionee.

(4) The application of this paragraph may be illustrated by the following examples:

Example 1. On June 1, 2004, X Corporation granted a statutory option to A, an employee of X Corporation, to purchase a share of X stock. On February 1, 2005, X sold the plant where A was employed to M Corporation, an unrelated corporation, and A was employed by M. If A exercises his statutory option on June 1, 2005, section 421 is not applicable to such exercise, because on June 1, 2005, A is not employed by the corporation which granted the option or by a related corporation of such corporation, nor was he employed by any of such corporations within 3 months before June 1, 2005.

Example 2. Assume the facts to be the same as in example (1), except that when A was employed by M Corporation, the option to purchase X stock was terminated and was replaced by an option to buy M stock in such circumstances that M Corporation is treated as a corporation substituting an option under section 424(a). If A exercises the option to purchase the share of M stock on June 1, 2005, section 421 is applicable to the transfer of the M stock because, at all times during the period beginning with the date of grant of the X option and ending with the date of exercise of the M option, A was an employee of the corporation granting the option or

substituting or assuming the option under §1.424–1(a).

Example 3. E is an employee of P Corporation. On June 1, 2004, P grants E a statutory option to purchase a share of P stock. On June 1, 2005, P acquires 100 percent of the stock of S Corporation; on such date S becomes a subsidiary of P. On July 1, 2005, E ceases to be employed by P and becomes employed by S. On October 10, 2005, while still employed by S, E exercises his option to buy P stock. Since E was at all times during the requisite period of employment an employee of either P, the corporation granting the option, or S, a subsidiary of the grantor during the period in which such corporation was E's employer, section 421 is applicable to the exercise of the option.

Example 4. Assume the same facts as in example (3) except assume that at the time E became an employee of S Corporation, S assumed E's option to purchase P stock under section 424(a). Section 421 is applicable to E's exercise of his option to buy P stock.

Example 5. M Corporation grants a statutory option to E, an employee of such corporation. E is an officer in a reserve Air Force unit. E goes on military leave with his unit for 3 weeks. Regardless of whether E is an employee of M within the meaning of section 3401(c) and the regulations thereunder during such 3-week period, E's employment relationship with M is treated as uninterrupted during the period of E's military leave.

Example 6. Assume the same facts as in example (5) and assume further that E's active duty status is extended indefinitely, but that E has a right to reemployment with M or a related corporation on the termination of any military duty E may be required to serve. E exercises his M option while on active military duty. Irrespective of whether E is an employee of M or a related corporation within the meaning of section 3401(c) and the regulations thereunder at the time of such exercise or within 3 months before such exercise, section 421 applies to such exercise.

Example 7. X Corporation grants an incentive option to A, an employee of X Corporation, whose employment contract provides that in the event of illness, A's right to reemployment with X, or a related corporation of X, will continue for 1 year after the time A becomes unable to perform his duties for X. A falls ill for 90 days. For purposes of section 422(a)(2), A's employment relationship with X will be treated as uninterrupted during the 90-day period. If A's incapacity extends beyond 90 days, then, for purposes of section 422(a)(2), A's employment relationship with X will be treated as continuing uninterrupted until A's reemployment rights terminate. Under section 422(a)(2), A has 3 months in which to exercise an incentive option after his employment relationship with X (and related corporations) is deemed terminated.

(i) *Additional definitions.* (1) *Corporation.* For purposes of this section and §§1.421–2 through 1.424–1, the term *corporation* has the meaning prescribed by section 7701(a)(3) and §301.7701–2(b) of this chapter. For example, a *corporation* for purposes of the preceding sentence includes an S corporation (as defined in section 1361), a foreign corporation (as defined in section 7701(a)(5)), and a limited liability company that is treated as a corporation for all Federal tax purposes.

(2) *Parent corporation and subsidiary corporation.* For the definition of the terms *parent corporation* (and *parent*) and *subsidiary corporation* (and *subsidiary*), for purposes of this section and §§1.421–2 through 1.424–1, see §1.424–1(f)(i) and (ii), respectively. *Related corporation* as used in this section and in §§1.421–2 through 1.424–1 means either a parent corporation or subsidiary corporation.

(j) *Effective/applicability date*—(1) *In general.* Except for paragraph (c)(1) of this section, the regulations under this section are effective on August 3, 2004. Paragraph (c)(1) of this section is effective on November 17, 2009. Paragraph (c)(1) of this section applies to statutory options granted on or after January 1, 2010.

(2) *Reliance and transition period.* For statutory options granted on or before June 9, 2003, taxpayers may rely on the 1984 proposed regulations LR–279–81 (49 FR 4504), the 2003 proposed regulations REG–122917–02 (68 FR 34344), or this section until the earlier of January 1, 2006, or the first regularly scheduled stockholders meeting of the granting corporation occurring 6 months after August 3, 2004. For statutory options granted after June 9, 2003, and before the earlier of January 1, 2006, or the first regularly scheduled stockholders meeting of the granting corporation occurring at least 6 months after August 3, 2004, taxpayers may rely on either REG–122917–02 or this section. Taxpayers may not rely on LR–279–81 or REG–122917–02 after December 31, 2005. Reliance on LR–279–81, REG–122917–02, or this section must be in its entirety, and all statutory options

granted during the reliance period must be treated consistently.

[T.D. 6887, 31 FR 8787, June 24, 1966, as amended by T.D. 6975, 33 FR 14779, Oct. 3, 1968; T.D. 7554, 43 FR 31927, July 24, 1978. Redesignated and amended by T.D. 9144, 69 FR 46406, Aug. 3, 2004; 69 FR 61310, Oct. 18, 2004; 69 FR 70551, Dec. 7, 2004; T.D. 9471, 74 FR 59077, Nov. 17, 2009]

§ 1.421–2 General rules.

(a) *Effect of qualifying transfer*. (1) If a share of stock is transferred to an individual pursuant to the individual's exercise of a statutory option, and if the requirements of § 1.422–1(a) (relating to incentive stock options) or § 1.423–1(a) (relating to employee stock purchase plans) whichever is applicable, are met, then—

(i) No income results under section 83 at the time of the transfer of such share to the individual upon the exercise of the option with respect to such share;

(ii) No deduction under sections 83(h) or 162 or the regulations thereunder (relating to trade or business expenses) is allowable at any time with respect to the share so transferred; and

(iii) No amount other than the price paid under the option is considered as received by the employer corporation, a related corporation of such corporation, or a corporation substituting or assuming a stock option in a transaction to which § 1.424–1(a) (relating to corporate reorganizations, liquidations, etc.) applies, for the share so transferred.

(2) For the purpose of this paragraph, each share of stock transferred pursuant to a statutory option is treated separately. For example, if an individual, while employed by a corporation granting him a statutory option, exercises the option with respect to part of the stock covered by the option, and if such individual exercises the balance of the option more than three months after leaving such employment, the application of section 421 to the stock obtained upon the earlier exercise of the option is not affected by the fact that the income taxes of the employer and the individual with respect to the stock obtained upon the later exercise of the option are not determined under section 421.

(b) *Effect of disqualifying disposition*. (1)(i) The disposition (as defined in § 1.424–1(c)) of a share of stock acquired by the exercise of a statutory option before the expiration of the applicable holding periods as determined under § 1.422–1(a) or 1.423–1(a) is a disqualifying disposition and makes paragraph (a) of this section inapplicable to the transfer of such share. See section 83(a) to determine the amount includible on a disqualifying disposition. The income attributable to such transfer (determined without reduction for any brokerage fees or other costs paid in connection with the disposition) is treated by the individual as compensation income received in the taxable year in which such disqualifying disposition occurs. A deduction attributable to such transfer is allowable, to the extent otherwise allowable under section 162, for the taxable year in which such disqualifying disposition occurs to the employer corporation, or a related corporation of such corporation, or a corporation substituting or assuming an option in a transaction to which § 1.424–1(a) applies. Additionally, the amount allowed as a deduction must be determined as if the requirements of section 83(h) and § 1.83–6(a) apply. No amount is treated as income, and no amount is allowed as a deduction, for any taxable year other than the taxable year in which the disqualifying disposition occurs. If the amount realized on the disposition exceeds (or is less than) the sum of the amount paid for the share and the amount of compensation income recognized as a result of such disposition, the extent to which the difference is treated as gain (or loss) is determined under the rules of section 302 or 1001, as applicable.

(ii) The following examples illustrate the principles of this paragraph (b):

Example 1. On June 1, 2006, X Corporation grants an incentive stock option to A, an employee of X, entitling A to purchase 100 shares of X stock at $10 per share. On August 1, 2006, A exercises the option when the fair market value of X stock is $20 per share, and 100 shares of X stock are transferred to A on that date. On December 15, 2007, A sells the stock for $20 per share. Because A disposed of the stock before June 2, 2008, A did not satisfy the holding period requirements of § 1.422–1(a). Under paragraph (b)(1)(i) of this section, A therefore made a disqualifying

disposition of the stock. Thus, paragraph (a) of this section is inapplicable to the transfer of the shares, and A must include the compensation income attributable to the transfer of the shares in gross income in the year of the disqualifying disposition. The amount of compensation income A must include in income is $1,000 ($2,000, the fair market value of X stock on transfer less $1,000, the exercise price per share). If the requirements of § 83(h) and § 1.83–6(a) are satisfied and otherwise allowable under section162, X is allowed a deduction of $1,000 for its taxable year in which the disqualifying disposition occurs.

Example 2. Y Corporation grants an incentive stock option for 100 shares of its stock to E, an employee of Y. The option has an exercise price of $10 per share. E exercises the option and is transferred the shares when the fair market value of a share of Y stock is $30. Before the applicable holding periods are met, Y redeems the shares for $70 per share. Because the holding period requirements of § 1.422–1(a) are not met, the redemption of the shares is a disqualifying disposition of the shares. Under paragraph (b)(1)(i) of this section, A made a disqualifying disposition of the stock. Thus, paragraph (a) of this section is inapplicable to the transfer of the shares, and E must include the compensation income attributable to the transfer of the shares in gross income in the year of the disqualifying disposition. The amount of compensation income that E must include in income is $2,000 ($3,000, the fair market value of Y stock on transfer, less $1,000, the exercise price paid by E). The character of the additional gain that is includible in E's income as a result of the redemption is determined under the rules of section 302. If the requirements of § 83(h) and § 1.83–6(a) are satisfied and otherwise allowable under section 162, Y is allowed a deduction for the taxable year in which the disqualifying disposition occurs for the compensation income of $2,000. Y is not allowed a deduction for the additional gain includible in E's income as a result of the redemption.

(2) If an optionee transfers stock acquired through the optionee's exercise of a statutory option prior to the expiration of the applicable holding periods, paragraph (a) of this section continues to apply to the transfer of the stock pursuant to the exercise of the option if such transfer is not a disposition of the stock as defined in § 1.424–1(c) (for example, a transfer from a decedent to the decedent's estate or a transfer by bequest or inheritance). Similarly, a subsequent transfer by the executor, administrator, heir, or legatee is not a disqualifying disposition by the decedent. If a statutory option is exercised by the estate of the optionee or by a person who acquired the option by bequest or inheritance or by reason of the death of such optionee, see paragraph (c) of this section. If a statutory option is exercised by the individual to whom the option was granted and the individual dies before the expiration of the holding periods, see paragraph (d) of this section.

(3) For special rules relating to the disqualifying disposition of a share of stock acquired by exercise of an incentive stock option, see §§ 1.422–5(b)(2) and 1.424–1(c)(3).

(c) *Exercise by estate.* (1) If a statutory option is exercised by the estate of the individual to whom the option was granted (or by any person who acquired such option by bequest or inheritance or by reason of the death of such individual), paragraph (a) of this section applies to the transfer of stock pursuant to such exercise in the same manner as if the option had been exercised by the deceased optionee. Consequently, neither the estate nor such person is required to include any amount in gross income as a result of a transfer of stock pursuant to the exercise of the option. Paragraph (a) of this section applies even if the executor, administrator, or such person disposes of the stock so acquired before the expiration of the applicable holding periods as determined under § 1.422–1(a) or 1.423–1(a). This special rule does not affect the applicability of section 423(c), relating to the estate's or other qualifying person's recognition of compensation income, or section 1222, relating to what constitutes a short-term and long-term capital gain or loss. Paragraph (a) of this section also applies even if the executor, administrator, or such person does not exercise the option within three months after the death of the individual or is not employed as described in § 1.421–1(h), either when the option is exercised or at any time. However, paragraph (a) of this section does not apply to a transfer of shares pursuant to an exercise of the option by the estate or by such person unless the individual met the employment requirements described in § 1.421–1(h) either at the time of the individual's death or within three

months before such time (or, if applicable, within the period described in §1.422–1(a)(3)). Additionally, paragraph (a) of this section does not apply if the option is exercised by a person other than the executor or administrator, or other than a person who acquired the option by bequest or inheritance or by reason of the death of such deceased individual. For example, if the option is sold by the estate, paragraph (a) of this section does not apply to the transfer of stock pursuant to an exercise of the option by the buyer, but if the option is distributed by the administrator to an heir as part of the estate, paragraph (a) of this section applies to the transfer of stock pursuant to an exercise of the option by such heir.

(2) Any transfer by the estate, whether a sale, a distribution of assets, or otherwise, of the stock acquired by its exercise of the option under this paragraph is a disposition of the stock for purposes of section 423(c). Therefore, if section 423(c) is applicable, the estate must include an amount as compensation in its gross income. Similarly, if section 423(c) is applicable in case of an exercise of the option under this paragraph by a person who acquired the option by bequest or inheritance or by reason of the death of the individual to whom the option was granted, there must be included in the gross income of such person an amount as compensation, either when such person disposes of the stock, or when he dies owning the stock.

(3)(i) If, under section 423(c) an amount is required to be included in the gross income of the estate or of such person, the estate or such person shall be allowed a deduction as a result of the inclusion of the value of the option in the estate of the individual to whom the option was granted. Such deduction shall be computed under section 691(c) by treating the option as an item of gross income in respect of a decedent under section 691 and by treating the amount required to be included in gross income under section 423(c) as an amount included in gross income under section 691 in respect of such item of gross income. No such deduction shall be allowable with respect to any amount other than an amount includible under section 423(c). For the rules relating to the computation of a deduction under section 691(c), see §1.691(c)–1.

(ii) The application of subdivision (i) may be illustrated by the following example:

Example. On June 1, 2004, E was granted an option under an employee stock purchase plan to purchase for $85 one share of the stock of his employer. On such day, the fair market value of such stock was $100 per share. E died on February 1, 2006, without having exercised such option. The option was, however, exercisable by his estate, and for purposes of the estate tax was valued at $30. On March 1, 2006, the estate exercised the option, and on March 15, 2006, sold for $150 the share of stock so acquired. For its taxable year including March 15, 2006, the estate is required by sections 421(c)(1)(B) and 423(c) to include in its gross income as compensation the amount of $15. During such taxable year, no amounts of income were properly paid, credited, or distributable to the beneficiaries of the estate. However, under section 421(c)(2), the estate is entitled to a deduction determined in the following manner. E's estate includes no other items of income in respect of a decedent referred to in section 691(a), and no deductions referred to in section 691(b), so that the value for estate tax purposes of the option, $30, is also the net value of all items of income in respect of the decedent. The estate tax attributable to the inclusion of the option in the estate of E is $10. Since $15, the amount includible in gross income by reason of sections 421(c)(1)(B) and 423(c), is less than the value for estate tax purposes of the option, only 15/30 of the estate tax attributable to the inclusion of the option in the estate is deductible; that is, 15/30 of $10, or $5. No deduction under section 421(c)(2) is allowable with respect to any capital gain.

(4)(i)(*a*) In the case of the death of an optionee, the basis of any share of stock acquired by the exercise of an option under this paragraph, determined under section 1011, shall be increased by an amount equal to the portion of the basis of the option attributable to such share. For example, if a statutory option to acquire 10 shares of stock has a basis of $100, the basis of one share acquired by a partial exercise of the option, determined under section 1011, would be increased by 1/10th of $100, or $10. The option acquires a basis, determined under section 1014(a), only if the transfer of the share pursuant to the exercise of such option qualifies for the

special tax treatment provided by section 421(a). To the extent the option is so exercised, in whole or in part, it will acquire a basis equal to its fair market value at the date of the employee's death or, if an election is made under section 2032, its value at its applicable valuation date. In certain cases, the basis of the share is subject to the adjustments provided by (*b*) and (*c*) of this subdivision, but such adjustments are only applicable in the case of an option which is subject to section 423(c).

(*b*) If the amount which would have been includible in gross income under section 423(c) had the employee exercised the option on the date of his death and held the share at the time of his death exceeds the amount which is includible in gross income under such section, the basis of the share, determined under (*a*) of this subdivision, shall be reduced by such excess. For example, if $15 would have been includible in the gross income of the employee had he exercised the option and held such share at the time of his death, and only $10 is includible under section 423(c), the basis of the share, determined under (*a*) of this subdivision, would be reduced by $5. For purposes of determining the amount which would have been includible in gross income under section 423(c), if the employee had exercised the option and held such share at the time of his death, the amount which would have been paid for the share shall be computed as if the option had been exercised on the date the employee died.

(*c*) If the amount includible in gross income under section 423(c) exceeds the portion of the basis of the option attributable to the share, the basis of the share, determined under (*a*) of this subdivision, shall be increased by such excess. Thus, if $15 is includible in gross income under such section, and the basis of the option with respect to the share is $10, the basis of the share, determined under (*a*) of this subdivision, will be increased by $5.

(ii) If a statutory option is not exercised by the estate of the individual to whom the option was granted, or by the person who acquired such option by bequest or inheritance or by reason of the death of such individual, the option shall be considered to be property which constitutes a right to receive an item of income in respect of a decedent to which the rules of sections 691 and 1014(c) apply.

(iii) The application of this subparagraph may be illustrated by the following examples:

Example 1. On June 1, 2005, the X Corporation granted to E, an employee, an option under its employee stock purchase plan to purchase a share of X Corporation stock for $85. The fair market value of X Corporation stock on such date was $100 per share. On June 1, 2006, E died. The fair market value of X Corporation stock on such date exceeded $100 per share and the fair market value of the option on the applicable valuation date was $35. On August 1, 2006, the estate of E exercised the option and sold the share of X Corporation stock at a time when the fair market value of the share was $120. The basis of the share is $120 (the $85 paid for the stock plus the $35 basis of the option). When the share is sold for $120, the estate is required to include $15 in its gross income as compensation. Since $15 would have been includible in E's gross income if he had exercised the option and held such share at the time of his death, paragraph (c)(4)(i)(*b*) of this section does not apply. Moreover, since the $15 includible in the gross income of the estate does not exceed the basis of the option ($35), paragraph (c)(4)(i)(*c*) of this section does not apply. Since the basis of the stock and the sale price are the same, no gain or loss is realized by the estate on the disposition of the share.

Example 2. Assume the same facts as in Example 1, except that the fair market value of the share of stock at the time of its sale was $90. The basis of the share, determined under paragraph (c)(4)(i)(*a*) of this section, is $120 (the $85 paid for the stock plus the $35 basis of the option). When the share is sold for $90, the estate is required to include $5 in its gross income as compensation. If the employee had exercised the option and held the share at the time of his death, $15 would have been includible in gross income as compensation for the taxable year ending with his death. Since such amount exceeds by $10 the amount which the estate is required to include in its gross income, paragraph (c)(4)(i)(*b*) of this section applies, and the basis of the share ($120), determined under paragraph (c)(4)(i)(*a*) of this section is reduced by $10. Accordingly, the basis is $110, and a capital loss of $20 is realized on the disposition of the share.

Example 3. Assume the same facts as in Example 1, except that the fair market value of the option on the applicable valuation date was $5, and that the fair market value of X Corporation stock on the date the employee died did not exceed $100. The basis of the

share, determined under paragraph (c)(4)(i)(*a*) of this section, is $90 (the $85 paid for the stock plus the $5 basis of the option). When the share is sold for $120, the estate is required to include $15 in its gross income as compensation. Since such amount exceeds by $10 the basis of the option, paragraph (c)(4)(i)(*c*) of this section applies, and the basis of the share ($90), determined under paragraph (c)(4)(i)(*b*) of this section, is increased by $10. Accordingly, the basis is $100 and a capital gain of $20 is realized on the disposition of the share.

Example 4. Assume the same facts as in Example 1, except that on June 1, 2006, the date the employee died, the fair market value of X Corporation stock was $98, and that on June 1, 2007, the alternate valuation date, the fair market value of the stock had declined substantially, and the fair market value of the option was $5. On August 1, 2007, the estate of E exercised the option and sold the share when its fair market value was $92. The basis of the share, determined under paragraph (c)(4)(i)(*a*) of this section, is $90 (the $85 paid for the stock plus the $5 basis of the option). When the share is sold for $92, the estate is required to include $7 in its gross income as compensation. Since $13 would have been includible in E's gross income if he had exercised the option and held such share at the time of his death, paragraph (c)(4)(i)(*b*) of this section applies, and the basis of the share ($90), determined under paragraph (c)(4)(i)(*a*) of this section, is reduced by $6 to $84. Furthermore, since the $7 that the estate is required to include in its gross income when the share is sold for $92 exceeds by $2 the basis of the option, paragraph (c)(4)(i)(*c*) of this section applies, and the basis of the share ($84), determined under paragraph (c)(4)(i)(*a*) of this section and paragraph (c)(4)(i)(*b*) of this section, is increased by $2. Accordingly, the basis is $86 and a capital gain of $6 is realized on the disposition of the share.

(d) *Option exercised by the individual to whom the option was granted if the individual dies before expiration of the applicable holding periods*. If a statutory option is exercised by the individual to whom the option was granted and such individual dies before the expiration of the applicable holding periods as determined under §1.422–1(a) or 1.423–1(a), paragraph (a) of this section does not become inapplicable if the executor or administrator of the estate of such individual, or any person who acquired such stock by bequest or inheritance or by reason of the death of such individual, disposes of such stock before the expiration of such applicable holding periods. This rule does not affect the applicability of section 423(c), relating to the individual's recognition of compensation income, or section 1222, relating to what constitutes a short-term and long-term capital gain or loss.

(e) *Incorporation by reference*. Any requirement that an option expressly contain or state a prescribed limitation or term will be considered met if such limitation or term is set forth in a statutory option plan and is incorporated by reference by the option. Thus, if a statutory option plan expressly provides that no option granted thereunder shall be exercisable after five years from the date of grant, and if an option granted thereunder expressly provides that the option is granted subject to the terms and limitations of such plan, the option will be regarded as being, by its terms, not exercisable after the expiration of 5 years from the date such option is granted.

(f) *Effective date*—(1) *In general*. These regulations are effective on August 3, 2004.

(2) *Reliance and transition period*. For statutory options granted on or before June 9, 2003, taxpayers may rely on the 1984 proposed regulations LR–279–81 (49 FR 4504), the 2003 proposed regulations REG–122917–02 (68 FR 34344), or this section until the earlier of January 1, 2006, or the first regularly scheduled stockholders meeting of the granting corporation occurring 6 months after August 3, 2004. For statutory options granted after June 9, 2003, and before the earlier of January 1, 2006, or the first regularly scheduled stockholders meeting of the granting corporation occurring at least 6 months after August 3, 2004, taxpayers may rely on either REG–122917–02 or this section. Taxpayers may not rely on LR–279–81 or REG–122917–02 after December 31, 2005. Reliance on LR–279–81, REG–122917–02, or this section must be in its entirety, and all statutory options granted during the reliance period must be treated consistently.

[T.D. 6887, 31 FR 8789, June 24, 1966. Redesignated and amended by T.D. 9144, 69 FR 46406, Aug. 3, 2004; 69 FR 61310, Oct. 18, 2004; 69 FR 70551, Dec. 7, 2004]

§ 1.422–1 Incentive stock options; general rules.

(a) *Applicability of section 421(a).* (1)(i) Section 1.421–2(a) applies to the transfer of a share of stock to an individual pursuant to the individual's exercise of an incentive stock option if the following conditions are satisfied—

(A) The individual makes no disposition of such share before the later of the expiration of the 2-year period from the date of grant of the option pursuant to which such share was transferred, or the expiration of the 1-year period from the date of transfer of such share to the individual; and

(B) At all times during the period beginning on the date of grant of the option and ending on the day 3 months before the date of exercise, the individual was an employee of either the corporation granting the option, a related corporation of such corporation, or a corporation (or a related corporation of such corporation) substituting or assuming a stock option in a transaction to which § 1.424–1(a) applies.

(ii) For rules relating to the disposition of shares of stock acquired pursuant to the exercise of a statutory option, see § 1.424–1(c). For rules relating to the requisite employment relationship, see § 1.421–1(h).

(2)(i) The holding period requirement of section 422(a)(1), described in paragraph (a)(1)(i)(A) of this section, does not apply to the transfer of shares by an insolvent individual described in this paragraph (a)(2). If an insolvent individual holds a share of stock acquired pursuant to the individual's exercise of an incentive stock option, and if such share is transferred to a trustee, receiver, or other similar fiduciary in any proceeding under the Bankruptcy Act or any other similar insolvency proceeding, neither such transfer, nor any other transfer of such share for the benefit of the individual's creditors in such proceeding is a disposition of such share for purposes of this paragraph (a). For purposes of this paragraph (a)(2), an individual is insolvent only if the individual's liabilities exceed the individual's assets or the individual is unable to satisfy the individual's liabilities as they become due. See section 422(c)(3).

(ii) A transfer by the trustee or other fiduciary that is not treated as a disposition for purposes of this paragraph (a) may be a sale or exchange for purposes of recognizing capital gain or loss with respect to the share transferred. For example, if the trustee transfers the share to a creditor in an insolvency proceeding, capital gain or loss must be recognized by the insolvent individual to the extent of the difference between the amount realized from such transfer and the adjusted basis of such share.

(iii) If any transfer by the trustee or other fiduciary (other than a transfer back to the insolvent individual) is not for the exclusive benefit of the creditors in an insolvency proceeding, then whether such transfer is a disposition of the share by the individual for purposes of this paragraph (a) is determined under § 1.424–1(c). Similarly, if the trustee or other fiduciary transfers the share back to the insolvent individual, any subsequent transfer of the share by such individual which is not made in respect of the insolvency proceeding may be a disposition of the share for purposes of this paragraph (a).

(3) If the employee exercising an option ceased employment because of permanent and total disability, within the meaning of section 22(e)(3), 1 year is used instead of 3 months in the employment period requirement of paragraph (a)(1)(i)(B) of this section.

(b) *Failure to satisfy holding period requirements*—(1) *General rule.* For general rules concerning a disqualifying disposition of a share of stock acquired pursuant to the exercise of an incentive stock option, see § 1.421–2(b)(1).

(2)(i) *Special rule.* If an individual makes a disqualifying disposition of a share of stock acquired by the exercise of an incentive stock option, and if such disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized to the individual, then, under this paragraph (b)(2)(i), the amount includible (determined without reduction for brokerage fees or other costs paid in connection with the disposition) in the gross income of such individual, and deductible from the income of the employer corporation (or a related corporation of such corporation, or of a corporation

substituting or assuming the option in a transaction to which §1.424–1(a) applies) as compensation attributable to the exercise of such option, shall not exceed the excess (if any) of the amount realized on such sale or exchange over the adjusted basis of such share. Subject to the special rule provided by this paragraph (b)(2)(i), the amount of compensation attributable to the exercise of the option is determined under section 83(a); see §1.421–2(b)(1)(i).

(ii) *Limitation to special rule*. The special rule described in paragraph (b)(2)(i) of this section does not apply if the disposition is a sale or exchange with respect to which a loss (if sustained) would not be recognized by the individual. Thus, for example, if a disqualifying disposition is a sale described in section 1091 (relating to loss from wash sales of stock or securities), a gift (or any other transaction which is not at arm's length), or a sale described in section 267(a)(1) (relating to sales between related persons), the special rule described in paragraph (b)(2)(i) of this section does not apply because a loss sustained in any such transaction would not be recognized.

(3) *Examples*. The following examples illustrate the principles of this paragraph (b):

Example 1. Disqualifying disposition of vested stock. On June 1, 2006, X Corporation grants an incentive stock option to A, an employee of X Corporation, entitling A to purchase one share of X Corporation stock. On August 1, 2006, A exercises the option, and the share of X Corporation stock is transferred to A on that date. The option price is $100 (the fair market value of a share of X Corporation stock on June 1, 2006), and the fair market value of a share of X Corporation stock on August 1, 2006 (the date of transfer) is $200. The share transferred to A is transferable and not subject to a substantial risk of forfeiture. A makes a disqualifying disposition by selling the share on June 1, 2007, for $250. The amount of compensation attributable to A's exercise is $100 (the difference between the fair market value of the share at the date of transfer, $200, and the amount paid for the share, $100). Because the amount realized ($250) is greater than the value of the share at transfer ($200), paragraph (b)(2)(i) of this section does not apply and thus does not affect the amount includible as compensation in A's gross income and deductible by X. A must include in gross income for the taxable year in which the sale occurred $100 as compensation and $50 as capital gain ($250, the amount realized from the sale, less A's basis of $200 (the $100 paid for the share plus the $100 increase in basis resulting from the inclusion of that amount in A's gross income as compensation attributable to the exercise of the option)). If the requirements of section 83(h) and §1.83–6(a) are satisfied and the deduction is otherwise allowable under section 162, for its taxable year in which the disqualifying disposition occurs, X Corporation is allowed a deduction of $100 for compensation attributable to A's exercise of the incentive stock option.

Example 2.@Disqualifying disposition of unvested stock. Assume the same facts as in *Example 1*, except that the share of X Corporation stock received by A is subject to a substantial risk of forfeiture and not transferable for a period of six months after such exercise. Assume further that the fair market value of X Corporation stock is $225 on February 1, 2007, the date on which the six-month restriction lapses. Because section 83 does not apply for ordinary income tax purposes on the date of exercise, A cannot make an effective section 83(b) election at that time (although such an election is permissible for alternative minimum tax purposes). Additionally, at the time of the disposition, section 422 and §1.422–1(a) no longer apply, and thus, section 83(a) is used to measure the consequences of the disposition, and the holding period for capital gain purposes begins on the vesting date, six months after exercise. The amount of compensation attributable to A's exercise of the option and disqualifying disposition of the share is $125 (the difference between the fair market value of the share on the date that the restriction lapsed, $225, and the amount paid for the share, $100). Because the amount realized ($225) is greater than the value of the share at transfer ($200), paragraph (b)(2)(i) of this section does not apply and thus does not affect the amount includible as compensation in A's gross income and deductible by X. A must include $125 of compensation income and $25 of capital gain in gross income for the taxable year in which the disposition occurs ($250, the amount realized from the sale, less A's basis of $225 (the $100 paid for the share plus the $125 increase in basis resulting from the inclusion of that amount of compensation in A's gross income)). If the requirements of section 83(h) and §1.83–6(a) are satisfied and the deduction is otherwise allowable under section 162, for its taxable year in which the disqualifying disposition occurs, X Corporation is allowed a deduction of $125 for the compensation attributable to A's exercise of the option.

Example 3. (i) *Disqualifying disposition and application of special rule*. Assume the same facts as in *Example 1*, except that A sells the share for $150 to M.

(ii) If the sale to M is a disposition that meets the requirements of paragraph (b)(2)(i) of this section, instead of $100 which otherwise would have been includible as compensation under §1.83–7, under paragraph (b)(2)(i) of this section, A must include only $50 (the excess of the amount realized on such sale, $150, over the adjusted basis of the share, $100) in gross income as compensation attributable to the exercise of the incentive stock option. Because A's basis for the share is $150 (the $100 which A paid for the share, plus the $50 increase in basis resulting from the inclusion of that amount in A's gross income as compensation attributable to the exercise of the option), A realizes no capital gain or loss as a result of the sale. If the requirements of section 83(h) and §1.83–6(a) are satisfied and the deduction is otherwise allowable under section 162, for its taxable year in which the disqualifying disposition occurs, X Corporation is allowed a deduction of $50 for the compensation attributable to A's exercise of the option and disqualifying disposition of the share.

(iii) Assume the same facts as in paragraph (i) of this *Example 3*, except that 10 days after the sale to M, A purchases substantially identical stock. Because under section 1091(a) a loss (if it were sustained on the sale) would not be recognized on the sale, under paragraph (b)(2)(ii) of this section, the special rule described in paragraph (b)(2)(i) of this section does not apply. A must include $100 (the difference between the fair market value of the share on the date of transfer, $200, and the amount paid for the share, $100) in gross income as compensation attributable to the exercise of the option for the taxable year in which the disqualifying disposition occurred. A recognizes no capital gain or loss on the transaction. If the requirements of section 83(h) and §1.83–6(a) are satisfied and the deduction is otherwise allowable under section 162, for its taxable year in which the disqualifying disposition occurs X Corporation is allowed a $100 deduction for compensation attributable to A's exercise of the option and disqualifying disposition of the share.

(iv) Assume the same facts as in paragraph (ii) of this *Example 3*, except that A sells the share for $50. Under paragraph (b)(2)(i) of this section, A is not required to include any amount in gross income as compensation attributable to the exercise of the option. A is allowed a capital loss of $50 (the difference between the amount realized on the sale, $50, and the adjusted basis of the share, $100). X Corporation is not allowed any deduction attributable to A's exercise of the option and disqualifying disposition of the share.

(c) *Failure to satisfy employment requirement*. Section 1.421–2(a) does not apply to the transfer of a share of stock pursuant to the exercise of an incentive stock option if the employment requirement, as determined under paragraph (a)(1)(i)(B) of this section, is not met at the time of the exercise of such option. Consequently, the effects of such a transfer are determined under the rules of §1.83–7. For rules relating to the employment relationship, see §1.421–1(h).

[T.D. 9144, 69 FR 46411, Aug. 3, 2004; 69 FR 61310, Oct. 18, 2004; 69 FR 70551, Dec. 7, 2004]

§1.422–2 Incentive stock options defined.

(a) *Incentive stock option defined*—(1) *In general*. The term *incentive stock option* means an option that meets the requirements of paragraph (a)(2) of this section on the date of grant. An incentive stock option is also subject to the $100,000 limitation described in §1.422–4. An incentive stock option may contain a number of permissible provisions that do not affect the status of the option as an incentive stock option. See §1.422–5 for rules relating to permissible provisions of an incentive stock option.

(2) *Option requirements*. To qualify as an incentive stock option under this section, an option must be granted to an individual in connection with the individual's employment by the corporation granting such option (or by a related corporation as defined in §1.421–1(i)(2)), and granted only for stock of any of such corporations. In addition, the option must meet all of the following requirements—

(i) It must be granted pursuant to a plan that meets the requirements described in paragraph (b) of this section;

(ii) It must be granted within 10 years from the date of the adoption of the plan or the date such plan is approved by the stockholders, whichever is earlier (see paragraph (c) of this section);

(iii) It must not be exercisable after the expiration of 10 years from the date of grant (see paragraph (d) of this section);

(iv) It must provide that the option price per share is not less than the fair market value of the share on the date of grant (see paragraph (e) of this section);

(v) By its terms, it must not be transferrable by the individual to

whom the option is granted other than by will or the laws of descent and distribution, and must be exercisable, during such individual's lifetime, only by such individual (see §§1.421–1(b)(2) and 1.421–2(c)); and

(vi) Except as provided in paragraph (f) of this section, it must be granted to an individual who, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the corporation employing such individual or of any related corporation of such corporation.

(3) *Amendment of option terms.* Except as otherwise provided in §1.424–1, the amendment of the terms of an incentive stock option may cause it to cease to be an option described in this section. If the terms of an option that has lost its status as an incentive stock option are subsequently changed with the intent to re-qualify the option as an incentive stock option, such change results in the grant of a new option on the date of the change. See §1.424–1(e).

(4) *Terms provide option not an incentive stock option.* If the terms of an option, when granted, provide that it will not be treated as an incentive stock option, such option is not treated as an incentive stock option.

(b) *Option plan*—(1) *In general.* An incentive stock option must be granted pursuant to a plan that meets the requirements of this paragraph (b). The authority to grant other stock options or other stock-based awards pursuant to the plan, where the exercise of such other options or awards does not affect the exercise of incentive stock options granted pursuant to the plan, does not disqualify such incentive stock options. The plan must be in writing or electronic form, provided that such writing or electronic form is adequate to establish the terms of the plan. See §1.422–5 for rules relating to permissible provisions of an incentive stock option.

(2) *Stockholder approval.* (i) The plan required by this paragraph (b) must be approved by the stockholders of the corporation granting the incentive stock option within 12 months before or after the date such plan is adopted. Ordinarily, a plan is adopted when it is approved by the granting corporation's board of directors, and the date of the board's action is the reference point for determining whether stockholder approval occurs within the applicable 24-month period. However, if the board's action is subject to a condition (such as stockholder approval) or the happening of a particular event, the plan is adopted on the date the condition is met or the event occurs, unless the board's resolution fixes the date of approval as the date of the board's action.

(ii) For purposes of paragraph (b)(2)(i) of this section, the stockholder approval must comply with the rules described in §1.422–3.

(iii) The provisions relating to the maximum aggregate number of shares to be issued under the plan (described in paragraph (b)(3) of this section) and the employees (or class or classes of employees) eligible to receive options under the plan (described in paragraph (b)(4) of this section) are the only provisions of a stock option plan that, if changed, must be re-approved by stockholders for purposes of section 422(b)(1). Any increase in the maximum aggregate number of shares that may be issued under the plan (other than an increase merely reflecting a change in the number of outstanding shares, such as a stock dividend or stock split), or change in the designation of the employees (or class or classes of employees) eligible to receive options under the plan is considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period. In addition, a change in the granting corporation or the stock available for purchase or award under the plan is considered the adoption of a new plan requiring new stockholder approval within the prescribed 24-month period. Any other changes in the terms of an incentive stock option plan are not considered the adoption of a new plan and, thus, do not require stockholder approval.

(3) *Maximum aggregate number of shares.* (i) The plan required by this paragraph (b) must designate the maximum aggregate number of shares that may be issued under the plan through incentive stock options. If nonstatutory options or other stock-based awards may be granted, the plan may

separately designate terms for each type of option or other stock-based awards and designate the maximum number of shares that may be issued under such option or other stock-based awards. Unless otherwise specified, all terms of the plan apply to all options and other stock-based awards that may be granted under the plan.

(ii) A plan that merely provides that the number of shares that may be issued as incentive stock options under such plan may not exceed a stated percentage of the shares outstanding at the time of each offering or grant under such plan does not satisfy the requirement that the plan state the maximum aggregate number of shares that may be issued under the plan. However, the maximum aggregate number of shares that may be issued under the plan may be stated in terms of a percentage of the authorized, issued, or outstanding shares at the date of the adoption of the plan. The plan may specify that the maximum aggregate number of shares available for grants under the plan may increase annually by a specified percentage of the authorized, issued, or outstanding shares at the date of the adoption of the plan. A plan which provides that the maximum aggregate number of shares that may be issued as incentive stock options under the plan may change based on any other specified circumstances satisfies the requirements of this paragraph (b)(3) only if the stockholders approve an immediately determinable maximum aggregate number of shares that may be issued under the plan in any event.

(iii) It is permissible for the plan to provide that, shares purchasable under the plan may be supplied to the plan through acquisitions of stock on the open market; shares purchased under the plan and forfeited back to the plan; shares surrendered in payment of the exercise price of an option; shares withheld for payment of applicable employment taxes and/or withholding obligations resulting from the exercise of an option.

(iv) If there is more than one plan under which incentive stock options may be granted and stockholders of the granting corporation merely approve a maximum aggregate number of shares that are available for issuance under such plans, the stockholder approval requirements described in paragraph (b)(2) of this section are not satisfied. A separate maximum aggregate number of shares available for issuance pursuant to incentive stock options must be approved for each plan.

(4) *Designation of employees.* The plan described in this paragraph (b), as adopted and approved, must indicate the employees (or class or classes of employees) eligible to receive the options or other stock-based awards to be granted under the plan. This requirement is satisfied by a general designation of the employees (or the class or classes of employees) eligible to receive options or other stock-based awards under the plan. Designations such as ''key employees of the grantor corporation''; ''all salaried employees of the grantor corporation and its subsidiaries, including subsidiaries which become such after adoption of the plan;'' or ''all employees of the corporation'' meet this requirement. This requirement is considered satisfied even though the board of directors, another group, or an individual is given the authority to select the particular employees who are to receive options or other stock-based awards from a described class and to determine the number of shares to be optioned or granted to each such employee. If individuals other than employees may be granted options or other stock-based awards under the plan, the plan must separately designate the employees or classes of employees eligible to receive incentive stock options.

(5) *Conflicting option terms.* An option on stock available for purchase or grant under the plan is treated as having been granted pursuant to a plan even if the terms of the option conflict with the terms of the plan, unless such option is granted to an employee who is ineligible to receive options under the plan, options have been granted on stock in excess of the aggregate number of shares which may be issued under the plan, or the option provides otherwise.

(6) The following examples illustrate the principles of this paragraph (b):

Example 1. Stockholder approval. (i) S Corporation is a subsidiary of P Corporation, a

publicly traded corporation. On January 1, 2006, S adopts a plan under which incentive stock options for S stock are granted to S employees.

(ii) To meet the requirements of paragraph (b)(2) of this section, the plan must be approved by the stockholders of S (in this case, P) within 12 months before or after January 1, 2006.

(iii) Assume the same facts as in paragraph (i) of this *Example 1*, except that the plan was adopted on January 1, 2010. Assume further that the plan was approved by the stockholders of S (in this case, P) on March 1, 2010. On January 1, 2012, S changes the plan to provide that incentive stock options for P stock will be granted to S employees under the plan. Because there is a change in the stock available for grant under the plan, the change is considered the adoption of a new plan that must be approved by the stockholder of S (in this case, P) within 12 months before or after January 1, 2012.

Example 2. Stockholder approval. (i) Assume the same facts as in paragraph (i) of *Example 1*, except that on March 15, 2007, P completely disposes of its interest in S. Thereafter, S continues to grant options for S stock to S employees under the plan.

(ii) The new S options are granted under a plan that meets the stockholder approval requirements of paragraph (b)(2) of this section without regard to whether S seeks approval of the plan from the stockholders of S after P disposes of its interest in S.

(iii) Assume the same facts as in paragraph (i) of this *Example 2*, except that under the plan as adopted on January 1, 2006, only options for P stock are granted to S employees. Assume further that after P disposes of its interest in S, S changes the plan to provide for the grant of options for S stock to S employees. Because there is a change in the stock available for purchase or grant under the plan, under paragraph (b)(2)(iii) of this section, the stockholders of S must approve the plan within 12 months before or after the change to the plan to meet the stockholder approval requirements of paragraph (b) of this section.

Example 3. Stockholder approval. (i) Corporation X maintains a plan under which incentive stock options may be granted to all eligible employees. Corporation Y does not maintain an incentive stock option plan. On May 15, 2006, Corporation X and Corporation Y consolidate under state law to form one corporation. The new corporation will be named Corporation Y. The consolidation agreement describes the Corporation X plan, including the maximum aggregate number of shares available for issuance pursuant to incentive stock options after the consolidation and the employees eligible to receive options under the plan. Additionally, the consolidation agreement states that the plan will be continued by Corporation Y after the consolidation and incentive stock options will be issued by Corporation Y. The consolidation agreement is unanimously approved by the shareholders of Corporations X and Y on May 1, 2006. Corporation Y assumes the plan formerly maintained by Corporation X and continues to grant options under the plan to all eligible employees.

(ii) Because there is a change in the granting corporation (from Corporation X to Corporation Y), under paragraph (b)(2)(iii) of this section, Corporation Y is considered to have adopted a new plan. Because the plan is fully described in the consolidation agreement, including the maximum aggregate number of shares available for issuance pursuant to incentive stock options and employees eligible to receive options under the plan, the approval of the consolidation agreement by the shareholders constitutes approval of the plan. Thus, the shareholder approval of the consolidation agreement satisfies the shareholder approval requirements of paragraph (b)(2) of this section, and the plan is considered to be adopted by Corporation Y and approved by its shareholders on May 1, 2006.

Example 4. Maximum aggregate number of shares. X Corporation maintains a plan under which statutory options and nonstatutory options may be granted. The plan designates the number of shares that may be used for incentive stock options. Because the maximum aggregate number of shares that will be used for incentive stock options is designated in the plan, the requirements of paragraph (b)(3) of this section are satisfied.

Example 5. Maximum aggregate number of shares. Y Corporation adopts an incentive stock option plan on November 1, 2006. On that date, there are two million outstanding shares of Y Corporation stock. The plan provides that the maximum aggregate number of shares that may be issued under the plan may not exceed 15% of the outstanding number of shares of Y Corporation on November 1, 2006. Because the maximum aggregate number of shares that may be issued under the plan is designated in the plan, the requirements of paragraph (b)(3) of this section are met.

Example 6. Maximum aggregate number of shares. (i) B Corporation adopts an incentive stock option plan on March 15, 2005. The plan provides that the maximum aggregate number of shares available for issuance under the plan is 50,000, increased on each anniversary date of the adoption of the plan by 5 percent of the then-outstanding shares.

(ii) Because the maximum aggregate number of shares is not designated under the plan, the requirements of paragraph (b)(3) of this section are not met.

(iii) Assume the same facts as in paragraph (i) of this *Example 6*, except that the plan provides that the maximum aggregate number of shares available under the plan is the

lesser of (a) 50,000 shares, increased each anniversary date of the adoption of the plan by 5 percent of the then-outstanding shares, or (b) 200,000 shares. Because the maximum aggregate number of shares that may be issued under the plan is designated as the lesser of one of two numbers, one of which provides an immediately determinable maximum aggregate number of shares that may be issued under the plan in any event, the requirements of paragraph (b)(3) of this section are met.

(c) *Duration of option grants under the plan.* An incentive stock option must be granted within 10 years from the date that the plan under which it is granted is adopted or the date such plan is approved by the stockholders, whichever is earlier. To grant incentive stock options after the expiration of the 10-year period, a new plan must be adopted and approved.

(d) *Period for exercising options.* An incentive stock option, by its terms, must not be exercisable after the expiration of 10 years from the date such option is granted, or 5 years from the date such option is granted to an employee described in paragraph (f) of this section. An option that does not contain such a provision when granted is not an incentive stock option.

(e) *Option price.* (1) Except as provided by paragraph (e)(2) of this section, the option price of an incentive stock option must not be less than the fair market value of the stock subject to the option at the time the option is granted. The option price may be determined in any reasonable manner, including the valuation methods permitted under § 20.2031–2 of this chapter, so long as the minimum price possible under the terms of the option is not less than the fair market value of the stock on the date of grant. For general rules relating to the option price, see § 1.421–1(e). For rules relating to the determination of when an option is granted, see § 1.421–1(c).

(2)(i) If a share of stock is transferred to an individual pursuant to the exercise of an option which fails to qualify as an incentive stock option merely because there was a failure of an attempt, made in good faith, to meet the option price requirements of paragraph (e)(1) of this section, the requirements of such paragraph are considered to have been met. Whether there was a good-faith attempt to set the option price at not less than the fair market value of the stock subject to the option at the time the option was granted depends on the relevant facts and circumstances.

(ii) For publicly held stock that is actively traded on an established market at the time the option is granted, determining the fair market value of such stock by the appropriate method described in § 20.2031–2 of this chapter establishes that a good-faith attempt to meet the option price requirements of this paragraph (e) was made.

(iii) For non-publicly traded stock, if it is demonstrated, for example, that the fair market value of the stock at the date of grant was based upon an average of the fair market values as of such date set forth in the opinions of completely independent and well-qualified experts, such a demonstration generally establishes that there was a good-faith attempt to meet the option price requirements of this paragraph (e). The optionee's status as a majority or minority stockholder may be taken into consideration.

(iv) Regardless of whether the stock offered under an option is publicly traded, a good-faith attempt to meet the option price requirements of this paragraph (e) is not demonstrated unless the fair market value of the stock on the date of grant is determined with regard to *nonlapse restrictions* (as defined in § 1.83–3(h)) and without regard to *lapse restrictions* (as defined in § 1.83–3(i)).

(v) Amounts treated as interest and amounts paid as interest under a deferred payment arrangement are not includible as part of the option price. See § 1.421–1(e)(1). An attempt to set the option price at not less than fair market value is not regarded as made in good faith where an adjustment of the option price to reflect amounts treated as interest results in the option price being lower than the fair market value on which the option price was based.

(3) Notwithstanding that the option price requirements of paragraphs (e)(1) and (2) of this section are satisfied by an option granted to an employee whose stock ownership exceeds the limitation provided by paragraph (f) of

this section, such option is not an incentive stock option when granted unless it also complies with paragraph (f) of this section. If the option, when granted, does not comply with the requirements described in paragraph (f) of this section, such option can never become an incentive stock option, even if the employee's stock ownership does not exceed the limitation of paragraph (f) of this section when such option is exercised.

(f) *Options granted to certain stockholders.* (1) If, immediately before an option is granted, an individual owns (or is treated as owning) stock possessing more than 10 percent of the total combined voting power of all classes of stock of the corporation employing the optionee or of any related corporation of such corporation, then an option granted to such individual cannot qualify as an incentive stock option unless the option price is at least 110 percent of the stock's fair market value on the date of grant and such option by its terms is not exercisable after the expiration of 5 years from the date of grant. For purposes of determining the minimum option price for purposes of this paragraph (f), the rules described in paragraph (e)(2) of this section, relating to the good-faith determination of the option price, do not apply.

(2) For purposes of determining the stock ownership of the optionee, the stock attribution rules of §1.424–1(d) apply. Stock that the optionee may purchase under outstanding options is not treated as stock owned by the individual. The determination of the percentage of the total combined voting power of all classes of stock of the employer corporation (or of its related corporations) that is owned by the optionee is made with respect to each such corporation in the related group by comparing the voting power of the shares owned (or treated as owned) by the optionee to the aggregate voting power of all shares of each such corporation actually issued and outstanding immediately before the grant of the option to the optionee. The aggregate voting power of all shares actually issued and outstanding immediately before the grant of the option does not include the voting power of treasury shares or shares authorized for issue under outstanding options held by the individual or any other person.

(3) *Examples.* The rules of this paragraph (f) are illustrated by the following examples:

Example 1. (i) E, an employee of M Corporation, owns 15,000 shares of M Corporation common stock, which is the only class of stock outstanding. M has 100,000 shares of its common stock outstanding. On January 1, 2005, when the fair market value of M stock is $100, E is granted an option with an option price of $100 and an exercise period of 10 years from the date of grant.

(ii) Because E owns stock possessing more than 10 percent of the total combined voting power of all classes of M Corporation stock, M cannot grant an incentive stock option to E unless the option is granted at an option price of at least 110 percent of the fair market value of the stock subject to the option and the option, by its terms, expires no later than 5 years from its date of grant. The option granted to E fails to meet the option-price and term requirements described in paragraph (f)(1) of this section and, thus, the option is not an incentive stock option.

(iii) Assume the same facts as in paragraph (i) of this *Example 1*, except that E's father and brother each owns 7,500 shares of M Corporation stock, and E owns no M stock in E's own name. Because under the attribution rules of §1.424–1(d), E is treated as owning stock held by E's parents and siblings, M cannot grant an incentive stock option to E unless the option price is at least 110 percent of the fair market value of the stock subject to the option, and the option, by its terms, expires no later than 5 years from the date of grant.

Example 2. Assume the same facts as in paragraph (i) of this *Example 1.* Assume further that M is a subsidiary of P Corporation. Regardless of whether E owns any P stock and the number of P shares outstanding, if P Corporation grants an option to E which purports to be an incentive stock option, but which fails to meet the 110-percent-option-price and 5-year-term requirements, the option is not an incentive stock option because E owns more than 10 percent of the total combined voting power of all classes of stock of a related corporation of P Corporation (*i.e.*, M Corporation). An individual who owns (or is treated as owning) stock in excess of the ownership specified in paragraph (f)(1) of this section, in any corporation in a group of corporations consisting of the employer corporation and its related corporations, cannot be granted an incentive stock option by any corporation in the group unless such option meets the 110-percent-option-price and 5-

year-term requirements of paragraph (f)(1) of this section.

Example 3. (i) F is an employee of R Corporation. R has only one class of stock, of which 100,000 shares are issued and outstanding. F owns no stock in R Corporation or any related corporation of R Corporation. On January 1, 2005, R grants a 10-year incentive stock option to F to purchase 50,000 shares of R stock at $3 per share, the fair market value of R stock on the date of grant of the option. On April 1, 2005, F exercises half of the January option and receives 25,000 shares of R stock that previously were not outstanding. On July 1, 2005, R grants a second 50,000 share option to F which purports to be an incentive stock option. The terms of the July option are identical to the terms of the January option, except that the option price is $3.25 per share, which is the fair market value of R stock on the date of grant of the July option.

(ii) Because F does not own more than 10% of the total combined voting power of all classes of stock of R Corporation or any related corporation on the date of the grant of the January option and the pricing requirements of paragraph (e) of this section are satisfied on the date of grant of such option, the unexercised portion of the January option remains an incentive stock option regardless of the changes in F's percentage of stock ownership in R after the date of grant. However, the July option is not an incentive stock option because, on the date that it is granted, F owns 20 percent (25,000 shares owned by F divided by 125,000 shares of R stock issued and outstanding) of the total combined voting power of all classes of R Corporation stock and, thus the pricing requirements of paragraph (f)(1) of this section are not met.

(iii) Assume the same facts as in paragraph (i) of this *Example 3* except that the partial exercise of the January incentive stock option on April 1, 2003, is for only 10,000 shares. Under these circumstances, the July option is an incentive stock option, because, on the date of grant of the July option, F does not own more than 10 percent of the total combined voting power (10,000 shares owned by F divided by 110,000 shares of R issued and outstanding) of all classes of R Corporation stock.

[T.D. 9144, 69 FR 46412, Aug. 3, 2004; T.D. 9471, 74 FR 59077, Nov. 17, 2009]

§ 1.422–3 Stockholder approval of incentive stock option plans.

This section addresses the stockholder approval of incentive stock option plans required by section 422(b)(1) of the Internal Revenue Code. (Section 422 was added to the Code as section 422A by section 251 of the Economic Recovery Tax Act of 1981, and was redesignated as section 422 by section 11801 of the Omnibus Budget Reconciliation Act of 1990.) The approval of stockholders must comply with all applicable provisions of the corporate charter, bylaws, and applicable State law prescribing the method and degree of stockholder approval required for the issuance of corporate stock or options. If the applicable State law does not prescribe a method and degree of stockholder approval in such cases an incentive stock option plan must be approved:

(a) By a majority of the votes cast at a duly held stockholders' meeting at which a quorum representing a majority of all outstanding voting stock is, either in person or by proxy, present and voting on the plan; or

(b) By a method and in a degree that would be treated as adequate under applicable State law in the case of an action requiring stockholder approval (i.e., an action on which stockholders would be entitled to vote if the action were taken at a duly held stockholders' meeting).

[T.D. 8374, 56 FR 61160, Dec. 2, 1991. Redesignated by T.D. 9144, 69 FR 46415, Aug. 3, 2004]

§ 1.422–4 $100,000 limitation for incentive stock options.

(a) *$100,000 per year limitation*—(1) *General rule.* An option that otherwise qualifies as an incentive stock option nevertheless fails to be an incentive stock option to the extent that the $100,000 limitation described in paragraph (a)(2) of this section is exceeded.

(2) *$100,000 per year limitation.* To the extent that the aggregate fair market value of stock with respect to which an incentive stock option (determined without regard to this section) is exercisable for the first time by any individual during any calendar year (under all plans of the employer corporation and related corporations) exceeds $100,000, such option is treated as a nonstatutory option. See §1.83–7 for rules applicable to nonstatutory options.

(b) *Application.* To determine whether the limitation described in paragraph (a)(2) of this section has been exceeded, the following rules apply:

(1) An option that does not meet the requirements of § 1.422–2 when granted (including an option which, when granted, contains terms providing that it will not be treated as an incentive stock option) is disregarded. See § 1.422–2(a)(4).

(2) The fair market value of stock is determined as of the date of grant of the option for such stock.

(3) Except as otherwise provided in paragraph (b)(4) of this section, options are taken into account in the order in which they are granted.

(4) For purposes of this section, an option is considered to be first exercisable during a calendar year if the option will become exercisable at any time during the year assuming that any condition on the optionee's ability to exercise the option related to the performance of services is satisfied. If the optionee's ability to exercise the option in the year is subject to an acceleration provision, then the option is considered first exercisable in the calendar year in which the acceleration provision is triggered. After an acceleration provision is triggered, the options subject to such provision are then taken into account in accordance with paragraph (b)(3) of this section for purposes of applying the limitation described in paragraph (a)(2) of this section to all options first exercisable during a calendar year. However, because an acceleration provision is not taken into account prior to its triggering, an incentive stock option that becomes exercisable for the first time during a calendar year by operation of such a provision does not affect the application of the $100,000 limitation with respect to any option (or portion thereof) exercised prior to such acceleration. For purposes of this paragraph (b)(4), an acceleration provision includes, for example, a provision that accelerates the exercisability of an option on a change in ownership or control or a provision that conditions exercisability on the attainment of a performance goal. See paragraph (d), *Example 4* of this section.

(5)(i) An option (or portion thereof) is disregarded if, prior to the calendar year during which it would otherwise have become exercisable for the first time, the option (or portion thereof) is modified and thereafter ceases to be an incentive stock option described in § 1.422–2, is canceled, or is transferred in violation of § 1.421–1(b)(2).

(ii) If an option (or portion thereof) is modified, canceled, or transferred at any other time, such option (or portion thereof) is treated as outstanding according to its original terms until the end of the calendar year during which it would otherwise have become exercisable for the first time.

(6) A disqualifying disposition has no effect on the determination of whether an option exceeds the $100,000 limitation.

(c) *Bifurcation*—(1) *Options*. The application of the rules described in paragraph (b) of this section may result in an option being treated, in part, as an incentive stock option and, in part, as a nonstatutory option. *See* § 1.83–7 for the treatment of nonstatutory options.

(2) *Stock*. A corporation may issue a separate certificate for incentive option stock or designate such stock as incentive stock option stock in the corporation's transfer records or plan records. In such a case, the issuance of separate certificates or designation in the corporation's transfer records or plan records is not a modification under § 1.424–1(e). In the absence of such an issuance or designation, shares are treated as first purchased under an incentive stock option to the extent of the $100,000 limitation, and the excess shares are treated as purchased under a nonstatutory option. *See* § 1.83–7 for the treatment of nonstatutory options.

(d) *Examples*. The following examples illustrate the principles of this section. In each of the following examples E is an employee of X Corporation. The examples are as follows:

Example 1. General rule. Effective January 1, 2004, X Corporation adopts a plan under which incentive stock options may be granted to its employees. On January 1, 2004, and each succeeding January 1 through January 1, 2013, E is granted immediately exercisable options for X Corporation stock with a fair market value of $100,000 determined on the date of grant. The options qualify as incentive stock options (determined without regard to this section). On January 1, 2014, E exercises all of the options. Because the $100,000 limitation has not been exceeded during any calendar year, all of the options are treated as incentive stock options.

Example 2. Order of grant. X Corporation is a parent corporation of Y Corporation, which is a parent corporation of Z Corporation. Each corporation has adopted its own separate plan, under which an employee of any member of the corporate group may be granted options for stock of any member of the group. On January 1, 2004, X Corporation grants E an incentive stock option (determined without regard to this section) for stock of Y Corporation with a fair market value of $100,000 on the date of grant. On December 31, 2004, Y Corporation grants E an incentive stock option (determined without regard to this section) for stock of Z Corporation with a fair market value of $75,000 as of the date of grant. Both of the options are immediately exercisable. For purposes of this section, options are taken into account in the order in which granted using the fair market value of stock as of the date on the option is granted. During calendar year 2004, the aggregate fair market value of stock with respect to which E's options are exercisable for the first time exceeds $100,000. Therefore, the option for Y Corporation stock is treated as an incentive stock option, and the option for Z Corporation stock is treated as a nonstatutory option.

Example 3. Acceleration provision. (i) In 2004, X Corporation grants E three incentive stock options (determined without regard to this section) to acquire stock with an aggregate fair market value of $150,000 on the date of grant. The dates of grant, the fair market value of the stock (as of the applicable date of grant) with respect to which the options are exercisable, and the years in which the options are first exercisable (without regard to acceleration provisions) are as follows:

	Date of grant	Fair market value of stock	First exercisable
Option 1	April 1, 2004	$60,000	2004
Option 2	May 1, 2004	50,000	2006
Option 3	June 1, 2004	40,000	2004

(ii) In July of 2004, a change in control of X Corporation occurs, and, under the terms of its option plan, all outstanding options become immediately exercisable. Under the rules of this section, Option 1 is treated as an incentive stock option in its entirety; Option 2 exceeds the $100,000 aggregate fair market value limitation for calendar year 2004 by $10,000 (Option 1's $60,000 + Option 2's $50,000 = $110,000) and is, therefore, bifurcated into an incentive stock option for stock with a fair market value of $40,000 as of the date of grant and a nonstatutory option for stock with a fair market value of $10,000 as of the date of grant. Option 3 is treated as a nonstatutory option in its entirety.

Example 4. Exercise of option and acceleration provision. (i) In 2004, X Corporation grants E three incentive stock options (determined without regard to this section) to acquire stock with an aggregate fair market value of $120,000 on the date of grant. The dates of grant, the fair market value of the stock (as of the applicable date of grant) with respect to which the options are exercisable, and the years in which the options are first exercisable (without regard to acceleration provisions) are as follows:

	Date of grant	Fair market value of stock	First exercisable
Option 1	April 1, 2004	$60,000	2005
Option 2	May 1, 2004	40,000	2006
Option 3	June 1, 2004	20,000	2005

(ii) On June 1, 2005, E exercises Option 3. At the time of exercise of Option 3, the fair market value of X stock (at the time of grant) with respect to which options held by E are first exercisable in 2005 does not exceed $100,000. On September 1, 2005, a change of control of X Corporation occurs, and, under the terms of its option plan, Option 2 becomes immediately exercisable. Under the rules of this section, because E's exercise of Option 3 occurs before the change of control and the effects of an acceleration provision are not taken into account until it is triggered, Option 3 is treated as an incentive stock option in its entirety. Option 1 is treated as an incentive stock option in its entirety. Option 2 is bifurcated into an incentive stock option for stock with a fair market value of $20,000 on the date of grant and a nonstatutory option for stock with a fair market value of $20,000 on the date of grant because it exceeds the $100,000 limitation for 2003 by $20,000 (Option 1 for $60,000 + Option 3 for $20,000 + Option 2 for $40,000 = $120,000).

(iii) Assume the same facts as in paragraph (ii) of this *Example 4*, except that the change of control occurs on May 1, 2005. Because options are taken into account in the order in which they are granted, Option 1 and Option 2 are treated as incentive stock options in their entirety. Because the exercise of Option 3 (on June 1, 2005) takes place after the acceleration provision is triggered, Option 3 is treated as a nonstatutory option in its entirety.

Example 5. Cancellation of option. (i) In 2004, X Corporation grants E three incentive stock options (determined without regard to this section) to acquire stock with an aggregate fair market value of $140,000 as of the date of grant. The dates of grant, the fair market value of the stock (as of the applicable date of grant) with respect to which the options are exercisable, and the years in which the options are first exercisable (without regard to acceleration provisions) are as follows:

	Date of grant	Fair market value of stock	First exercisable
Option 1	April 1, 2004	$60,000	2005
Option 2	May 1, 2004	40,000	2005
Option 3	June 1, 2004	40,000	2005

(ii) On December 31, 2004, Option 2 is canceled. Because Option 2 is canceled before the calendar year during which it would have become exercisable for the first time, it is disregarded. As a result, Option 1 and Option 3 are treated as incentive stock options in their entirety.

(iii) Assume the same facts as in paragraph (ii) of this *Example 5*, except that Option 2 is canceled on January 1, 2005. Because Option 2 is not canceled prior to the calendar year during which it would have become exercisable for the first time (2005), it is treated as an outstanding option for purposes of determining whether the $100,000 limitation for 2005 has been exceeded. Because options are taken into account in the order in which granted, Option 1 is treated as an incentive stock option in its entirety. Because Option 3 exceeds the $100,000 limitation by $40,000 (Option 1 for $60,000 + Option 2 for $40,000 + Option 3 for $40,000 = $140,000), it is treated as a nonstatutory option in its entirety.

(iv) Assume the same facts as in paragraph (i) of this *Example 5*, except that on January 1, 2005, E exercises Option 2 and immediately sells the stock in a disqualifying disposition. A disqualifying disposition has no effect on the determination of whether the underlying option is considered outstanding during the calendar year during which it is first exercisable. Because options are taken into account in the order in which granted, Option 1 is treated as an incentive stock option in its entirety. Because Option 3 exceeds the $100,000 limitation by $40,000 (Option 1 for $60,000 + Option 2 for $40,000 + Option 3 for $40,000 = $140,000), it is treated as a nonstatutory option in its entirety.

Example 6. Designation of stock. On January 1, 2004, X grants E an immediately exercisable incentive stock option (determined without regard to this section) to acquire X stock with a fair market value of $150,000 on that date. Under the rules of this section, the option is bifurcated and treated as an incentive stock option for X stock with a fair market value of $100,000 and a nonstatutory option for X stock with a fair market value of $50,000. In these circumstances, X may designate the stock that is treated as stock acquired pursuant to the exercise of an incentive stock option by issuing a separate certificate (or certificates) for $100,000 of stock and identifying such certificates as Incentive Stock Option Stock in its transfer records. In the absence of such a designation (or a designation in the corporation's transfer records or the plan records) shares with a fair market value of $100,000 are deemed purchased first under an incentive stock option, and shares with a fair market value of $50,000 are deemed purchased under a nonstatutory option.

[T.D. 9144, 69 FR 46415, Aug. 3, 2004; 69 FR 70551, Dec. 7, 2004]

§ 1.422–5 Permissible provisions.

(a) *General rule.* An option that otherwise qualifies as an incentive stock option does not fail to be an incentive stock option merely because such option contains one or more of the provisions described in paragraphs (b), (c), and (d) of this section.

(b) *Cashless exercise.* (1) An option does not fail to be an incentive stock option merely because the optionee may exercise the option with previously acquired stock of the corporation that granted the option or stock of the corporation whose stock is being offered for purchase under the option. For special rules relating to the use of statutory option stock to pay the option price of an incentive stock option, see § 1.424–1(c)(3).

(2) All shares acquired through the exercise of an incentive stock option are individually subject to the holding period requirements described in § 1.422–1(a) and the disqualifying disposition rules of § 1.422–1(b), regardless of whether the option is exercised with previously acquired stock of the corporation that granted the option or stock of the corporation whose stock is being offered for purchase under the option. If an incentive stock option is exercised with such shares, and the exercise results in the basis allocation described in paragraph (b)(3) of this section, the optionee's disqualifying disposition of any of the stock acquired through such exercise is treated as a disqualifying disposition of the shares with the lowest basis.

(3) If the exercise of an incentive stock option with previously acquired shares is comprised in part of an exchange to which section 1036 (and so much of section 1031 as relates to section 1036) applies, then:

(i) The optionee's basis in the incentive stock option shares received in the section 1036 exchange is the same as the optionee's basis in the shares surrendered in the exchange, increased, if applicable, by any amount included in

gross income as compensation pursuant to sections 421 through 424 or section 83. Except for purposes of § 1.422–1(a), the holding period of the shares is determined under section 1223. For purposes of § 1.422–1 and sections 421(b) and 83 and the regulations thereunder, the amount paid for the shares purchased under the option is the fair market value of the shares surrendered on the date of the exchange.

(ii) The optionee's basis in the incentive stock option shares not received pursuant to the section 1036 exchange is zero. For all purposes, the holding period of such shares begins as of the date that such shares are transferred to the optionee. For purposes of § 1.422–1(b) and sections 421(b) and 83 and the regulations thereunder, the amount paid for the shares is considered to be zero.

(c) *Additional compensation.* An option does not fail to be an incentive stock option merely because the optionee has the right to receive additional compensation, in cash or property, when the option is exercised, provided such additional compensation is includible in income under section 61 or section 83. The amount of such additional compensation may be determined in any manner, including by reference to the fair market value of the stock at the time of exercise or to the option price.

(d) *Option subject to a condition.* (1) An option does not fail to be an incentive stock option merely because the option is subject to a condition, or grants a right, that is not inconsistent with the requirements of §§ 1.422–2 and 1.422–4.

(2) An option that includes an alternative right is not an incentive stock option if the requirements of § 1.422–2 are effectively avoided by the exercise of the alternative right. For example, an alternative right extending the option term beyond ten years, setting an option price below fair market value, or permitting transferability prevents an option from qualifying as an incentive stock option. If either of two options can be exercised, but not both, each such option is a disqualifying alternative right with respect to the other, even though one or both options would individually satisfy the requirements of §§ 1.422–2, 1.422–4, and this section.

(3) An alternative right to receive a taxable payment of cash and/or property in exchange for the cancellation or surrender of the option does not disqualify the option as an incentive stock option if the right is exercisable only when the then fair market value of the stock exceeds the exercise price of the option and the option is otherwise exercisable, the right is transferable only when the option is otherwise transferable, and the exercise of the right has economic and tax consequences no more favorable than the exercise of the option followed by an immediate sale of the stock. For this purpose, the exercise of the alternative right does not have the same economic and tax consequences if the payment exceeds the difference between the then fair market value of the stock and the exercise price of the option.

(e) *Examples.* The principles of this section are illustrated by the following examples:

Example 1. On June 1, 2004, X Corporation grants an incentive stock option to A, an employee of X Corporation, entitling A to purchase 100 shares of X Corporation common stock at $10 per share. The option provides that A may exercise the option with previously acquired shares of X Corporation common stock. X Corporation has only one class of common stock outstanding. Under the rules of section 83, the shares transferable to A through the exercise of the option are transferable and not subject to a substantial risk of forfeiture. On June 1, 2005, when the fair market value of an X Corporation share is $25, A uses 40 shares of X Corporation common stock, which A had purchased on the open market on June 1, 2002, for $5 per share, to pay the full option price. After exercising the option, A owns 100 shares of incentive stock option stock. Under section 1036 (and so much of section 1031 as relates to section 1036), 40 of the shares have a $200 aggregate carryover basis (the $5 purchase price × 40 shares) and a three-year holding period for purposes of determining capital gain, and 60 of the shares have a zero basis and a holding period beginning on June 1, 2005, for purposes of determining capital gain. All 100 shares have a holding period beginning on June 1, 2005, for purposes of determining whether the holding period requirements of § 1.422–1(a) are met.

Example 2. Assume the same facts as in *Example 1.* Assume further that, on September 1, 2005, A sells 75 of the shares that A acquired through exercise of the incentive stock option for $30 per share. Because the

holding period requirements were not satisfied, A made a disqualifying disposition of the 75 shares on September 1, 2005. Under the rules of paragraphs (b)(2) and (b)(3) of this section, A has sold all 60 of the non-section-1036 shares and 15 of the 40 section-1036 shares. Therefore, under paragraph (b)(3) of this section and section 83(a), the amount of compensation attributable to A's exercise of the option and subsequent disqualifying disposition of 75 shares is $1,500 (the difference between the fair market value of the stock on the date of transfer, $1,875 (75 shares at $25 per share), and the amount paid for the stock, $375 (60 shares at $0 per share plus 15 shares at $25 per share)). In addition, A must recognize a capital gain of $675, which consists of $375 ($450, the amount realized from the sale of 15 shares, less A's basis of $75) plus $300 ($1,800, the amount realized from the sale of 60 shares, less A's basis of $1,500 resulting from the inclusion of that amount in income as compensation). Accordingly, A must include in gross income for the taxable year in which the sale occurs $1,500 as compensation and $675 as capital gain. For its taxable year in which the disqualifying disposition occurs, if otherwise allowable under section 162 and if the requirements of § 1.83–6(a) are met, X Corporation is allowed a deduction of $1,500 for the compensation paid to A.

Example 3. Assume the same facts as in *Example 2*, except that, instead of selling the 75 shares of incentive stock option stock on September 1, 2005, A uses those shares to exercise a second incentive stock option. The second option was granted to A by X Corporation on January 1, 2005, entitling A to purchase 100 shares of X Corporation common stock at $22.50 per share. As in *Example 2*, A has made a disqualifying disposition of the 75 shares of stock pursuant to § 1.424–1(c). Under paragraph (b) of this section, A has disposed of all 60 of the non-section-1036 shares and 15 of the 40 section-1036 shares. Therefore, pursuant to paragraph (b)(3) of this section and section 83(a), the amount of compensation attributable to A's exercise of the first option and subsequent disqualifying disposition of 75 shares is $1,500 (the difference between the fair market value of the stock on the date of transfer, $1,875 (75 shares at $25 per share), and the amount paid for the stock, $375 (60 shares at $0 per share plus 15 shares at $25 per share)). Unlike *Example 2*, A does not recognize any capital gain as a result of exercising the second option because, for all purposes other than the determination of whether the exercise is a disposition pursuant to section 424(c), the exercise is considered an exchange to which section 1036 applies. Accordingly, A must include in gross income for the taxable year in which the disqualifying disposition occurs $1,500 as compensation. If the requirements of § 83(h) and § 1.83–6(a) are satisfied and the deduction is otherwise allowable under section 162, for its taxable year in which the disqualifying disposition occurs, X Corporation is allowed a deduction of $1,500 for the compensation paid to A. After exercising the second option, A owns a total of 125 shares of incentive stock option stock. Under section 1036 (and so much of section 1031 as relates to section 1036), the 100 ''new'' shares of incentive stock option stock have the following bases and holding periods: 15 shares have a $75 carryover basis and a three-year-and-three-month holding period for purposes of determining capital gain, 60 shares have a $1,500 basis resulting from the inclusion of that amount in income as compensation and a three-month holding period for purposes of determining capital gain, and 25 shares have a zero basis and a holding period beginning on September 1, 2005, for purposes of determining capital gain. All 100 shares have a holding period beginning on September 1, 2005, for purposes of determining whether the holding period requirements of § 1.422–1(a) are met.

Example 4. Assume the same facts as in *Example 2*, except that, instead of selling the 75 shares of incentive stock option stock on September 1, 2005, A uses those shares to exercise a nonstatutory option. The nonstatutory option was granted to A by X Corporation on January 1, 2005, entitling A to purchase 100 shares of X Corporation common stock at $22.50 per share. Unlike *Example 3*, A has not made a disqualifying disposition of the 75 shares of stock. After exercising the nonstatutory option, A owns a total of 100 shares of incentive stock option stock and 25 shares of nonstatutory stock option stock. Under section 1036 (and so much of section 1031 as relates to section 1036), the 75 new shares of incentive stock option stock have the same basis and holding period as the 75 old shares used to exercise the nonstatutory option. The additional 25 shares of stock received upon exercise of the nonstatutory option are taxed under the rules of section 83(a). Accordingly, A must include in gross income for the taxable year in which the transfer of such shares occurs $750 (25 shares at $30 per share) as compensation. A's basis in such shares is the same as the amount included in gross income. For its taxable year in which the transfer occurs, X Corporation is allowed a deduction of $750 for the compensation paid to A to the extent the requirements of section 83(h) and § 1.83–6(a) are satisfied and the deduction is otherwise allowable under section 162.

Example 5. Assume the same facts in *Example 1*, except that the shares transferred pursuant to the exercise of the incentive stock option are subject to a substantial risk of forfeiture and not transferable (substantially nonvested) for a period of six months after such transfer. Assume further that the shares that A uses to exercise the incentive stock option are similarly restricted. Such

shares were transferred to A on January 1, 2005, through A's exercise of a nonstatutory stock option which was granted to A on January 1, 2004. A paid $5 per share for the stock when its fair market value was $22.50 per share. A did not file a section 83(b) election to include the $700 spread (the difference between the option price and the fair market value of the stock on date of exercise of the nonstatutory option) in gross income as compensation. After exercising the incentive stock option with the 40 substantially-nonvested shares, A owns 100 shares of substantially-nonvested incentive stock option stock. Section 1036 (and so much of section 1031 as relates to section 1036) applies to the 40 shares exchanged in exercise of the incentive stock option. However, pursuant to section 83(g), the stock received in such exchange, because it is incentive stock option stock, is not subject to restrictions and conditions substantially similar to those to which the stock given in such exchange was subject. For purposes of section 83(a) and §1.83–1(b)(1), therefore, A has disposed of the 40 shares of substantially-nonvested stock on June 1, 2005, and must include in gross income as compensation $800 (the difference between the amount realized upon such disposition, $1,000, and the amount paid for the stock, $200). Accordingly, 40 shares of the incentive stock option stock have a $1,000 basis (the $200 original basis plus the $800 included in income as compensation) and 60 shares of the incentive stock option stock have a zero basis. For its taxable year in which the disposition of the substantially-nonvested stock occurs, X Corporation is allowed a deduction of $800 for the compensation paid to A, provided the requirements of section 83(h) and §1.83–6(a) are satisfied and the deduction is otherwise allowable under section 162.

(f) *Effective/applicability date*—(1) *In general*. Except for §1.422–2(b)(6) *Example 1* (iii), the regulations under this section are effective on August 3, 2004. Section 1.422–2(b)(6) *Example 1* (iii) is effective on November 17, 2009. Section 1.422–2(b)(6) *Example 1* (iii) applies to statutory options granted on or after January 1, 2010.

(2) *Reliance and transition period*. For statutory options granted on or before June 9, 2003, taxpayers may rely on the 1984 proposed regulations LR–279–81 (49 FR 4504), the 2003 proposed regulations REG–122917–02 (68 FR 34344), or this section until the earlier of January 1, 2006, or the first regularly scheduled stockholders meeting of the granting corporation occurring 6 months after August 3, 2004. For statutory options granted after June 9, 2003, and before the earlier of January 1, 2006, or the first regularly scheduled stockholders meeting of the granting corporation occurring at least 6 months after August 3, 2004, taxpayers may rely on either REG–122917–02 or this section. Taxpayers may not rely on LR–279–81 or REG–122917–02 after December 31, 2005. Reliance on LR–279–81, REG–122917–02, or this section must be in its entirety, and all statutory options granted during the reliance period must be treated consistently.

[T.D. 9144, 69 FR 46417, Aug. 3, 2004; 69 FR 61310, Oct. 18, 2004; 69 FR 70551, Dec. 7, 2004; T.D. 9471, 74 FR 59078, Nov. 17, 2009]

§ 1.423–1 Applicability of section 421(a).

(a) *General rule*. Subject to the provisions of section 423(c) and §1.423–2(k), the special rules of income tax treatment provided in section 421(a) apply with respect to the transfer of a share of stock to an individual pursuant to the individual's exercise of an option granted under an employee stock purchase plan, as defined in §1.423–2, if the following conditions are satisfied—

(1) The individual makes no disposition of such share before the later of the expiration of the two-year period from the date of the grant of the option pursuant to which such share was transferred or the expiration of the one-year period from the date of transfer of such share to the individual; and

(2) At all times during the period beginning on the date of the grant of the option and ending on the day three months before the date of exercise, the individual was an employee of the corporation granting the option, a related corporation, or a corporation (or a related corporation) substituting or assuming the stock option in a transaction to which section 424(a) applies.

(b) *Cross-references*. For rules relating to the requisite employment relationship, see §1.421–1(h). For rules relating to the effect of a disqualifying disposition, see section 421(b) and §1.421–2(b). For the definition of the term ''disposition,'' see section 424(c) and §1.424–1(c). For the definition of the term ''related corporation,'' see §1.421–1(i).

(c) *Effective/applicability date.* The regulations under this section are effective on November 17, 2009. The regulations under this section apply to options granted under an employee stock purchase plan on or after January 1, 2010.

[T.D. 9471, 74 FR 59078, Nov. 17, 2009]

§ 1.423–2 Employee stock purchase plan defined.

(a) *In general*—(1) The term ''employee stock purchase plan'' means a plan that meets the requirements of paragraphs (a)(2) and (a)(3) of this section. If the terms of the plan do not satisfy the requirements of paragraph (a)(3) of this section, then such requirements may be satisfied by the terms of an offering made under the plan. However, where the requirements of paragraph (a)(3) of this section are satisfied by the terms of an offering, such requirements will be treated as satisfied only with respect to options exercised under that offering. One or more offerings may be made under an employee stock purchase plan. Offerings may be consecutive or overlapping, and the terms of each offering need not be identical provided the terms of the plan and the offering together satisfy the requirements of paragraphs (a)(2) and (a)(3) of this section. The plan and the terms of an offering must be in writing or electronic form, provided that such writing or electronic form is adequate to establish the terms of the plan or offering, as applicable.

(2) To satisfy the requirements of this paragraph (a)(2) and § 1.423–1, the plan must meet both of the following requirements—

(i) The plan must provide that options can be granted only to employees of the employer corporation or of a related corporation (as defined in paragraph (i) of § 1.421–1) to purchase stock in any such corporation (see paragraph (b) of this section); and

(ii) The plan must be approved by the stockholders of the granting corporation within 12 months before or after the date the plan is adopted (see paragraph (c) of this section).

(3) To satisfy the requirements of this paragraph (a)(3) and § 1.423–1, the terms of the plan or offering must meet all of the following requirements—

(i) An employee cannot be granted an option if, immediately after the option is granted, the employee owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or of a related corporation (see paragraph (d) of this section);

(ii) Options must be granted to all employees of any corporation whose employees are granted any options by reason of their employment by the corporation (see paragraph (e) of this section);

(iii) All employees granted options must have the same rights and privileges (see paragraph (f) of this section);

(iv) The option price cannot be less than the lesser of—

(A) An amount equal to 85 percent of the fair market value of the stock at the time the option is granted, or

(B) An amount not less than 85 percent of the fair market value of the stock at the time the option is exercised (see paragraph (g) of this section).

(v) Options cannot be exercised after the expiration of—

(A) Five years from the date the option is granted if, under the terms of such plan, the option price cannot be less than 85 percent of the fair market value of the stock at the time the option is exercised, or

(B) Twenty-seven months from the date the option is granted, if the option price is not determined in the manner described in paragraph (a)(3)(v)(A) of this section (see paragraph (h) of this section).

(vi) No employee may be granted an option that permits the employee's rights to purchase stock under all employee stock purchase plans of the employer corporation and its related corporations to accrue at a rate that exceeds $25,000 of fair market value of the stock (determined at the time the option is granted) for each calendar year in which the option is outstanding at any time (see paragraph (i) of this section); and

(vii) Options are not transferable by the optionee other than by will or the laws of descent and distribution, and are exercisable, during the lifetime of the optionee, only by the optionee (see paragraph (j) of this section).

(4) The determination of whether a particular option is an option granted under an employee stock purchase plan is made at the time the option is granted. If the terms of an option are inconsistent with the terms of the employee stock purchase plan or the offering under the plan pursuant to which the option is granted, the option will not be treated as granted under an employee stock purchase plan. If an option with terms that are inconsistent with the terms of the plan or an offering under the plan is granted to an employee who is entitled to the grant of an option under the terms of the plan or offering, and the employee is not granted an option under the offering that qualifies as an option granted under an employee stock purchase plan, the offering will not meet the requirements of paragraph (e) of this section. Accordingly, none of the options granted under the offering will be eligible for the special tax treatment of section 421. However, if an option with terms that are inconsistent with the terms of the plan or an offering under the plan is granted to an individual who is not entitled to the grant of an option under the terms of the plan or offering, the option will not be treated as an option granted under an employee stock purchase plan but the grant of the option will not disqualify the options granted under the plan or offering. If, at the time of grant, an option qualifies as an option granted under an employee stock purchase plan, but after the time of grant one or more of the requirements of paragraph (a)(3) of this section is not satisfied with respect to the option, the option will not be treated as granted under an employee stock purchase plan but this failure to comply with the terms of the option will not disqualify the other options granted under the plan or offering.

(5) *Examples*. The following examples illustrate the principles of paragraph (a):

Example 1. Corporation A operates an employee stock purchase plan under which options for A stock are granted to employees of A. The terms of an offering provide that the option price will be 90 percent of the fair market value of A stock on the date of exercise. A grants an option under the offering to Employee Z, an employee of A. The terms of the option provide that the option price will be 85 percent of the fair market value of A stock on the date of exercise. Because the terms of Z's option are inconsistent with the terms of the offering, the option granted to Z will not be treated as an option granted under the employee stock purchase plan. Further, unless Z is granted an option under the offering that qualifies as an option granted under the employee stock purchase plan, the offering will not meet the requirements of paragraph (e) of this section and none of the options granted under the offering will be eligible for the special tax treatment of section 421.

Example 2. Corporation B operates an employee stock purchase plan that provides that options for B stock may only be granted to employees of B. Under the terms of the plan, options may not be granted to consultants and other non-employees. B grants an option to Consultant Y, a consultant of B. Because Y is ineligible to receive an option under the plan because Y is not an employee, the grant of the option to Y is inconsistent with the terms of the plan and the option granted to Y will not be treated as an option granted under the employee stock purchase plan. However, the grant of the option to Y will not disqualify the options granted under the plan or any offering because Y was not entitled to the grant of an option under the plan.

Example 3. Corporation C operates an employee stock purchase plan under which options for C stock are granted to employees of C. C grants an option pursuant to an offering under the plan to Employee X, an employee of C who is a highly compensated employee. The terms of the employee stock purchase plan exclude highly compensated employees from participation in the plan. Because X is ineligible to receive an option under the plan by reason of X's exclusion from participation in the plan, the option granted to X will not be treated as an option granted under the employee stock purchase plan. However, the grant of the option to X will not disqualify the options granted under the plan or offering because X was not entitled to the grant of an option under the plan.

Example 4. Corporation D operates an employee stock purchase plan under which options for D stock are granted to employees of D. D grants an option pursuant to an offering under the plan to Employee W, an employee of D. The terms of the option provide that the option price will be 90 percent of the fair market value of D stock on the date of exercise. On the date of exercise, W pays only 85 percent of the fair market value of D stock. Because the terms of W's option are not satisfied, the option granted to W will not be treated as an option granted under the employee stock purchase plan. However, the

failure to comply with the terms of the option granted to W will not disqualify the options granted under the plan or offering.

(b) *Options restricted to employees.* An employee stock purchase plan must provide that options can be granted only to employees of the employer corporation (or employees of its related corporations) to purchase stock in the employer corporation (or one of its related corporations). If such a provision is not included in the terms of the plan, the plan will not be an employee stock purchase plan and options granted under the plan will not qualify for the special tax treatment of section 421. For rules relating to the employment requirement, see §1.421–1(h).

(c) *Stockholder approval*—(1) An employee stock purchase plan must be approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted. The approval of the stockholders must comply with all applicable provisions of the corporate charter and bylaws and of applicable State law prescribing the method and degree of stockholder approval required for the issuance of corporate stock or options. If the applicable State law does not prescribe a method and degree of stockholder approval, then an employee stock purchase plan must be approved—

(i) By a majority of the votes cast at a duly held stockholder's meeting at which a quorum representing a majority of all outstanding voting stock is, either in person or by proxy, present and voting on the plan; or

(ii) By a method and in a degree that would be treated as adequate under applicable State law in the case of an action requiring stockholder approval (such as, an action on which stockholders would be entitled to vote if the action were taken at a duly held stockholders' meeting).

(2) For purposes of the stockholder approval required by this paragraph (c), ordinarily, a plan is adopted when it is approved by the granting corporation's board of directors, and the date of the board's action is the reference point for determining whether stockholder approval occurs within the applicable 24-month period. However, if the board's action is subject to a condition (such as stockholder approval) or the happening of a particular event, the plan is adopted on the date the condition is met or the event occurs, unless the board's resolution fixes the date of adoption as the date of the board's action.

(3) An employee stock purchase plan, as adopted and approved, must designate the maximum aggregate number of shares that may be issued under the plan, and the corporations or class of corporations whose employees may be offered options under the plan. A plan that merely provides that the number of shares that may be issued under the plan may not exceed a stated percentage of the shares outstanding at the time of each offering or grant under the plan does not satisfy the requirements of this paragraph (c)(3). However, the maximum aggregate number of shares that may be issued under the plan may be stated in terms of a percentage of the authorized, issued, or outstanding shares on the date of the adoption of the plan. The plan may specify that the maximum aggregate number of shares available for grants under the plan may increase annually by a specified percentage of the authorized, issued, or outstanding shares on the date of the adoption of the plan. A plan that provides that the maximum aggregate number of shares that may be issued as options under the plan may change based on any other specific circumstances satisfies the requirements of this paragraph only if the stockholders approve an immediately determinable maximum number of shares that may be issued under the plan in any event. If there is more than one employee stock purchase plan under which options may be granted and stockholders of the granting corporation merely approve a maximum aggregate number of shares that are available for issuance under the plans, the stockholder approval requirements described in paragraph (c)(1) of this section are not satisfied. A separate maximum aggregate number of shares available for issuance pursuant to options must be specified and approved for each plan.

(4) Once an employee stock purchase plan is approved by the stockholders of the granting corporation, the plan need

not be reapproved by the stockholders of the granting corporation unless the plan is amended or changed in a manner that is considered the adoption of a new plan, in which case the plan must be reapproved within the prescribed 24-month period. Any increase in the aggregate number of shares that may be issued under the plan (other than an increase merely reflecting a change in the number of outstanding shares, such as a stock dividend or stock split) will be considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period. Similarly, a change in the designation of corporations whose employees may be offered options under the plan will be considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period unless the plan provides that designations of participating corporations may be made from time to time from among a group consisting of the granting corporation and its related corporations. The group from among which such changes and designations are permitted without additional stockholder approval may include corporations having become parents or subsidiaries of the granting corporation after the adoption and approval of the plan. In addition, a change in the granting corporation or the stock available for purchase under the plan will be considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period. Any other changes in the terms of an employee stock purchase plan are not considered the adoption of a new plan and, thus, do not require stockholder approval.

(5) *Examples*. The following examples illustrate the principles of this paragraph (c):

Example 1. (i) Corporation E is a subsidiary of Corporation F, a publicly traded corporation. On January 1, 2010, E adopts an employee stock purchase plan under which options for E stock are granted to E employees.

(ii) To meet the requirements of paragraph (c)(1) of this section, the plan must be approved by the stockholders of E (in this case, F) within 12 months before or after January 1, 2010.

(iii) Assume the same facts as in paragraph (i) of this *Example 1*, except that the plan was approved by the stockholders of E (in this case, F) on March 1, 2010. On January 1, 2012, E changes the plan to provide that options for F stock will be granted to E employees under the plan. Because there is a change in the stock available for grant under the plan, under paragraph (c)(4) of this section, the change is considered the adoption of a new plan that must be approved by the stockholders of E (in this case, F) within 12 months before or after January 1, 2012.

Example 2. (i) Assume the same facts as in paragraph (i) of *Example 1*, except that on March 15, 2011, F completely disposes of its interest in E. Thereafter, E continues to grant options for E stock to E employees under the plan.

(ii) The new E options are granted under a plan that meets the stockholder approval requirements of paragraph (c)(1) of this section without regard to whether E seeks approval of the plan from the stockholders of E after F disposes of its interest in E.

(iii) Assume the same facts as in paragraph (i) of this *Example 2*, except that under the plan as adopted on January 1, 2010, only options for F stock are granted to E employees. Assume further that, after F disposes of its interest in E, E changes the plan to provide for the grant of options for E stock to E employees. Because there is a change in the stock available for purchase or grant under the plan, under paragraph (c)(4) of this section, the stockholders of E must approve the plan within 12 months before or after the change to the plan to meet the stockholder approval requirements of paragraph (c) of this section.

Example 3. (i) Corporation G maintains an employee stock purchase plan providing options for G stock. Corporation H does not maintain an employee stock purchase plan. On May 15, 2010, G and H consolidate under State law to form one corporation. The new corporation is named Corporation H. The consolidation agreement describes the G plan, including the maximum aggregate number of shares available for issuance under the plan after the consolidation. Additionally, the consolidation agreement states that the plan will be continued by H after the consolidation. The consolidation agreement is approved by the stockholders of G and H on May 1, 2010. H assumes the plan formerly maintained by G and continues to grant options under the plan to all eligible employees, but the options are for H stock.

(ii) Because there is a change in the granting corporation (from G to H) and the stock available for purchase, under paragraph (c)(4) of this section, H is considered to have adopted a new plan. Because the plan is fully described in the consolidation agreement, including the maximum aggregate number of shares available for issuance under the plan, the approval of the consolidation agreement by the stockholders constitutes approval of the plan. Thus, the stockholder approval of the consolidation agreement satisfies the

stockholder approval requirements of paragraph (c)(1) of this section, and the plan is considered to be adopted by H and approved by its stockholders on May 1, 2010.

Example 4. Corporation I adopts an employee stock purchase plan on November 1, 2010. On that date, there are two million shares of I stock outstanding. The plan provides that the maximum aggregate number of shares that may be issued under the plan may not exceed 15 percent of the number of shares of I stock outstanding on November 1, 2010. Because the maximum aggregate number of shares that may be issued under the plan is designated in the plan, the requirements of paragraph (c)(3) of this section are met.

Example 5. (i) Corporation J adopts an employee stock purchase plan on March 15, 2010. The plan provides that the maximum aggregate number of shares of J stock available for issuance under the plan is 50,000, increased on each anniversary date of the adoption of the plan by 5 percent of the then outstanding shares. Because the maximum aggregate number of shares is not designated under the plan, the requirements of paragraph (c)(3) of this section are not met.

(ii) Assume the same facts as in paragraph (i) of this *Example 5,* except that the plan provides that the maximum aggregate number of shares available under the plan is the lesser of (a) 50,000 shares, increased each anniversary date of the adoption of the plan by 5 percent of the then-outstanding shares, or (b) 200,000 shares. Because the maximum aggregate number of shares that may be issued under the plan is designated as the lesser of two numbers, one of which provides an immediately determinable maximum aggregate number of shares that may be issued under the plan in any event, the requirements of paragraph (c)(3) of this section are met.

(d) *Options granted to certain shareholders*—(1) An employee stock purchase plan or offering must, by its terms, provide that an employee cannot be granted an option if the employee, immediately after the option is granted, owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or a related corporation. In determining whether the stock ownership of an employee equals or exceeds this 5 percent limit, the rules of section 424(d) (relating to attribution of stock ownership) shall apply, and stock that the employee may purchase under outstanding options (whether or not the options qualify for the special tax treatment afforded by section 421(a)) shall be treated as stock owned by the employee. An option is outstanding for purposes of this paragraph (d) although under its terms it may be exercised only in installments or after the expiration of a fixed period of time. If an option is granted to an employee whose stock ownership (as determined under this paragraph (d)) exceeds the limitation set forth in this paragraph (d), no portion of the option will be treated as having been granted under an employee stock purchase plan.

(2) The determination of the percentage of the total combined voting power or value of all classes of stock of the employer corporation (or a related corporation) that is owned by the employee is made by comparing the voting power or value of the shares owned (or treated as owned) by the employee to the aggregate voting power or value of all shares actually issued and outstanding immediately after the grant of the option to the employee. The aggregate voting power or value of all shares actually issued and outstanding immediately after the grant of the option does not include the voting power or value of treasury shares or shares authorized for issue under outstanding options held by the employee or any other person.

(3) *Examples.* The following examples illustrate the principles of this paragraph (d):

Example 1. Employee V, an employee of Corporation K, owns 6,000 shares of K common stock, the only class of K stock outstanding. K has 100,000 shares of its common stock outstanding. Because V owns 6 percent of the combined voting power or value of all classes of K stock, K cannot grant an option to V under K's employee stock purchase plan. If V's father and brother each owned 3,000 shares of K stock and V did not own any K stock, then the result would be the same because, under section 424(d), an individual is treated as owning stock held by the person's father and brother. Similarly, the result would be the same if, instead of actually owning 6,000 shares, V merely held an option on 6,000 shares of K stock, irrespective of whether the transfer of stock under the option could qualify for the special tax treatment of section 421, because this paragraph (d) provides that stock the employee may purchase under outstanding options is treated as stock owned by such employee.

Example 2. Assume the same facts as in *Example 1,* except that K is a 50 percent subsidiary corporation of Corporation L. Irrespective of whether V owns any L stock, V

cannot receive an option from L under L's employee stock purchase plan because he owns 5 percent of the total combined voting power of all classes of stock of a subsidiary of L, in this example, K. An employee who owns (or is treated as owning) stock in excess of the limitation of this paragraph (d), in any corporation in a group of related corporations, consisting of a parent and its subsidiary corporations, cannot receive an option under an employee stock purchase plan from any corporation in the group.

Example 3. Employee U is an employee of Corporation M. M has only one class of stock, of which 100,000 shares are issued and outstanding. Assuming U does not own (and is not treated as owning) any stock in M or in any related corporation of M, M may grant an option to U under its employee stock purchase plan for 4,999 shares, because immediately after the grant of the option, U would not own 5 percent or more of the combined voting power or value of all classes of M stock actually issued and outstanding at such time. The 4,999 shares that U would be treated as owning under this paragraph (d) would not be added to the 100,000 shares actually issued and outstanding immediately after the grant for purposes of determining whether U's stock ownership exceeds the limitation of this paragraph (d).

Example 4. Assume the same facts as in *Example 3* but instead of an option for 4,999 shares, M grants U an option, purportedly under its employee stock purchase plan, for 5,000 shares. No portion of this option will be treated as granted under an employee stock purchase plan because U's stock ownership exceeds the limitation of this paragraph (d).

(e) *Employees covered by plan*—(1) Subject to the provisions of this paragraph (e) and the limitations of paragraphs (d), (f) and (i) of this section, an employee stock purchase plan or offering must, by its terms, provide that options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by that corporation, except that one or more of the following categories of employees may be excluded from the coverage of the plan or offering—

(i) Employees who have been employed less than two years;

(ii) Employees whose customary employment is 20 hours or less per week;

(iii) Employees whose customary employment is for not more than five months in any calendar year; and

(iv) Highly compensated employees (within the meaning of section 414(q)).

(2) A plan or offering does not fail to satisfy the coverage provision of paragraph (e)(1) of this section in the following circumstances—

(i) The plan or offering excludes employees who have completed a shorter period of service or whose customary employment is for fewer hours per week or fewer months in a calendar year than is specified in paragraphs (e)(1)(i), (ii) and (iii) of this section, provided the exclusion is applied in an identical manner to all employees of every corporation whose employees are granted options under the plan or offering.

(ii) The plan or offering excludes highly compensated employees (within the meaning of section 414(q)) with compensation above a certain level or who are officers or subject to the disclosure requirements of section 16(a) of the Securities Exchange Act of 1934, provided the exclusion is applied in an identical manner to all highly compensated employees of every corporation whose employees are granted options under the plan or offering.

(3) Notwithstanding paragraph (e)(1) of this section, employees who are citizens or residents of a foreign jurisdiction (without regard to whether they are also citizens of the United States or resident aliens (within the meaning of section 7701(b)(1)(A))) may be excluded from the coverage of an employee stock purchase plan or offering under the following circumstances—

(i) The grant of an option under the plan or offering to a citizen or resident of the foreign jurisdiction is prohibited under the laws of such jurisdiction; or

(ii) Compliance with the laws of the foreign jurisdiction would cause the plan or offering to violate the requirements of section 423.

(4) No option granted under a plan or offering that excludes from participation any employees, other than those who may be excluded under this paragraph (e), and those barred from participation by reason of paragraphs (d), (f) and (i) of this section, can be regarded as having been granted under an employee stock purchase plan. If an option is not granted to any employee who is entitled to the grant of an option under the terms of the plan or offering, none of the options granted

under such offering will be treated as having been granted under an employee stock purchase plan. However, a plan that, by its terms, permits all eligible employees to elect to participate in an offering will not violate the requirements of this paragraph solely because eligible employees who elect not to participate in the offering are not granted options pursuant to such offering.

(5) For purposes of this paragraph (e), the existence of the employment relationship between an individual and the corporation participating under the plan will be determined under § 1.421–1(h).

(6) *Examples*. The following examples illustrate the principles of this paragraph (e):

Example 1. Corporation N has a stock purchase plan that meets all the requirements of paragraphs (a)(2) and (a)(3) of this section except that options are not required to be granted to employees whose weekly rate of pay is less than $1,000. As a matter of corporate practice, however, N grants options under its plan to all employees, irrespective of their weekly rate of pay. Even though N's plan is operated in compliance with the requirements of this paragraph (e), N's plan is not an employee stock purchase plan because the terms of the plan exclude a category of employees that is not permitted under this paragraph (e).

Example 2. Assume the same facts as in *Example 1*, except that the first offering under N's plan provides that options will be granted to all employees of N. The terms of the first offering will be treated as part of the terms of N's plan, but only for purposes of the first offering. Because the terms of the first offering satisfy the requirements of this paragraph (e), stock transferred pursuant to options exercised under the first offering will be treated as stock transferred pursuant to the exercise of options granted under an employee stock purchase plan for purposes of section 421.

Example 3. Corporation O has a stock purchase plan that excludes from participation all employees who have been employed less than one year. Assuming all other requirements of paragraphs (a)(2) and (a)(3) of this section are satisfied, O's plan qualifies as an employee stock purchase plan under section 423.

Example 4. Corporation P has a stock purchase plan that excludes from participation clerical employees who have been employed less than two years. However, non-clerical employees with less than two years of service are permitted to participate in the plan. P's plan is not an employee stock purchase plan because the exclusion of employees who have been employed less than two years applies only to certain employees of P and is not applied in an identical manner to all employees of P. If, instead, P's plan excludes from participation all employees (both clerical and non-clerical) who have been employed less than two years, then P's plan would qualify as an employee stock purchase plan under section 423 assuming all other requirements of paragraphs (a)(2) and (a)(3) of this section are satisfied.

Example 5. Corporation Q has a stock purchase plan that excludes from participation all officers who are highly compensated employees (within the meaning of section 414(q)). Assuming all other requirements of paragraphs (a)(2) and (a)(3) of this section are satisfied, Q's plan qualifies as an employee stock purchase plan under section 423.

Example 6. Corporation R maintains an employee stock purchase plan that excludes from participation all highly compensated employees (within the meaning of section 414(q)), except highly compensated employees who are officers of R. R's plan is not an employee stock purchase plan because the exclusion of all highly compensated employees except highly compensated employees who are officers of R is not a permissible exclusion under paragraph (e)(2)(ii) of this section.

Example 7. Corporation S is the parent corporation of Subsidiary YY and Subsidiary ZZ. S maintains an employee stock purchase plan with both YY and ZZ participating in the same offering under the plan. Under the terms of the offering under the plan, all employees of YY and ZZ are permitted to participate in the plan with the exception of ZZ's highly compensated employees with annual compensation greater than $300,000. None of the options granted under the offering will be considered granted under an employee stock purchase plan because the exclusion of highly compensated employees with annual compensation greater than $300,000 is not applied in an identical manner to all employees of YY and ZZ granted options in the same offering.

Example 8. Assume the same facts as in *Example 7*, except that Corporation S establishes separate offerings under the plan for YY and ZZ. Under the terms of the separate offering for YY, all employees of YY are permitted to participate in the plan. Under the terms of the separate offering established for ZZ, all employees of ZZ are permitted to participate in the plan with the exception of ZZ's highly compensated employees with annual compensation greater than $300,000. The options granted under the separate offering for YY will be considered granted under an employee stock purchase plan. Further, the options granted under the separate offering for ZZ will be considered granted under an employee stock purchase plan because the

exclusion of highly compensated employees with annual compensation greater than $300,000 is applied in an identical manner to all employees of ZZ granted options in the same offering.

Example 9. The laws of Country A require that options granted to residents of Country A be transferable during the lifetime of the option recipient. Corporation T has a stock purchase plan that excludes residents of Country A from participation in the plan. Because compliance with the laws of Country A would cause options granted to residents of Country A to violate paragraph (j) of this section, T may exclude residents of Country A from participation in the plan. Assuming all other requirements of paragraph (a)(2) of this section are satisfied, T's plan qualifies as an employee stock purchase plan under section 423.

(f) *Equal rights and privileges*—(1) Except as otherwise provided in paragraphs (f)(2) through (f)(6) of this section, an employee stock purchase plan or offering must, by its terms, provide that all employees granted options under the plan or offering shall have the same rights and privileges. Thus, the provisions applying to one option under an offering (such as the provisions relating to the method of payment for the stock and the determination of the purchase price per share) must apply to all other options under the offering in the same manner. If all the options granted under a plan or offering do not, by their terms, give the respective optionees the same rights and privileges, none of the options will be treated as having been granted under an employee stock purchase plan for purposes of section 421.

(2) The requirements of this paragraph (f) do not prevent the maximum amount of stock that an employee may purchase from being determined on the basis of a uniform relationship to the total compensation, or the basic or regular rate of compensation, of all employees.

(3) A plan or offering will not fail to satisfy the requirements of this paragraph (f) because the plan or offering provides that no employee may purchase more than a maximum amount of stock fixed under the plan or offering.

(4) A plan or offering will not fail to satisfy the requirements of this paragraph (f) if, in order to comply with the laws of a foreign jurisdiction, the terms of an option granted under a plan or offering to citizens or residents of such foreign jurisdiction (without regard to whether they are also citizens of the United States or resident aliens (within the meaning of section 7701(b)(1)(A))) are less favorable than the terms of options granted under the same plan or offering to employees resident in the United States.

(5)(i) Except as provided in this paragraph and paragraph (f)(5)(ii) of this section, a plan or offering permitting one or more employees to carry forward amounts that were withheld but not applied toward the purchase of stock under an earlier plan or offering and apply the amounts towards the purchase of additional stock under a subsequent plan or offering will be a violation of the equal rights and privileges under paragraph (f)(1) of this section. However, the carry forward of amounts withheld but not applied toward the purchase of stock under an earlier plan or offering will not violate the equal rights and privileges requirement of paragraph (f)(1) of this section, if all other employees participating in the current plan or offering are permitted to make direct payments toward the purchase of shares under a subsequent plan or offering in an amount equal to the excess of the greatest amount which any employee is allowed to carry forward from an earlier plan or offering over the amount, if any, the employee will carry forward from an earlier plan or offering.

(ii) A plan or offering will not fail to satisfy the requirements of this section merely because employees are permitted to carry forward amounts representing a fractional share, that were withheld but not applied toward the purchase of stock under an earlier plan or offering and apply the amounts toward the purchase of additional stock under a subsequent plan or offering.

(6) Paragraph (f) does not prohibit the delaying of the grant of an option to any employee who is barred from being granted an option solely by reason of the employee's failing to meet a minimum service requirement set forth in paragraph (e)(1) of this section until the employee meets such requirement.

(7) *Examples*. The following examples illustrate the principles of this paragraph (f):

Example 1. Corporation U has an employee stock purchase plan that provides that the maximum amount of stock that each employee may purchase under the offering is one share for each $100 of annual gross pay. The plan meets the requirements of this paragraph (f).

Example 2. Corporation V has an employee stock purchase plan that provides that the maximum amount of stock that each employee may purchase under the offering is one share for each $100 of annual gross pay up to and including $10,000, and two shares for each $100 of annual gross pay in excess of $10,000. The plan will not meet the requirements of this paragraph (f) because the amount of stock that may be purchased under the plan is not based on a uniform relationship to the total compensation of all employees.

Example 3. Corporation W has an employee stock purchase plan that provides that options to purchase stock in an amount equal to ten percent of an employee's annual salary at a price equal to 85 percent of the fair market value on the first day of the offering will be granted to all employees other than those who have been employed less than 18 months. In addition, the plan provides that employees who have not yet met the minimum service requirements on the first day of the offering will be granted similar options on the date the 18 month service requirement has been attained. The plan meets the requirements of this paragraph (f).

Example 4. Corporation X is the parent corporation of Subsidiary AA, Subsidiary BB and Subsidiary CC. X maintains an employee stock purchase plan with AA, BB and CC participating in the same offering under the plan. Under the terms of the offering under the plan, options to purchase stock at a price equal to 90 percent of the fair market value at the time the option is exercised will be granted to all employees. Certain employees of AA are residents of Country B. The laws of Country B provide that options granted to employees who are residents of Country B must have a purchase price not less than 95 percent of the fair market value at the time the option is exercised. The plan will not fail to satisfy the requirements of this paragraph (f) merely because the residents of Country B are granted options under the plan to purchase stock at a price equal to 95 percent of the fair market value at the time the option is exercised.

Example 5. Assume the same facts as in *Example 4*, except that Corporation X establishes two separate offerings under the plan: A separate offering for the employees of AA and a separate offering for the employees of BB and CC. Under the separate offering for the employees of BB and CC, options are granted to all employees with an exercise price equal to 90 percent of the fair market value at the time the option is exercised. Under the separate offering for the employees of AA, options are granted to all employees with an exercise price equal to 95 percent of the fair market value at the time the option is exercised. The plan does not violate the equal rights and privileges requirement of this paragraph (f) merely because the exercise price of options granted under one offering is less than the exercise price of options granted under a separate offering.

Example 6. Corporation Y maintains an employee stock purchase plan. Employee T is employed by Y. T is granted an option under the current offering to purchase a maximum of 100 shares of Y stock at an option price equal to 85 percent of the fair market value of the stock at exercise. The plan permits the carry forward of withheld but unused amounts from an earlier offering. Prior to the exercise date, $2000 of T's salary has been withheld and is available to be applied toward the purchase of Y stock. On the exercise date, the fair market value of Y stock is $20 per share. T is able to purchase 100 shares of Y stock at $17 per share for an aggregate purchase price of $1700. T can carry forward $300 to the subsequent offering. Each employee in the subsequent offering other than T will be permitted to make direct payments toward the purchase of shares under the subsequent offering in a maximum amount of $300 less any amount the employee has carried forward from an earlier offering. The plan does not violate the equal rights and privileges requirement of this paragraph (f).

(g) *Option price*—(1) An employee stock purchase plan or offering must, by its terms, provide that the option price will not be less than the lesser of—

(i) An amount equal to 85 percent of the fair market value of the stock at the time the option is granted, or

(ii) An amount that under the terms of the option may not be less than 85 percent of the fair market value of the stock at the time the option is exercised.

(2) For purposes of determining the option price, the fair market value of the stock may be determined in any reasonable manner, including the valuation methods permitted under § 20.2031–2. However, the option price must meet the minimum pricing requirements of this paragraph (g). For general rules relating to the option price, see § 1.421–1(e). For rules relating to the determination of when an option

is granted, *see* §§1.421–1(c) and 1.423–2(h)(2). Any option that does not meet the minimum pricing requirements of this paragraph (g) will not be treated as an option granted under an employee stock purchase plan irrespective of whether the plan or offering satisfies those requirements. If an option that does not meet the minimum pricing requirements is granted to an employee who is entitled to the grant of an option under the terms of the plan or offering, and the employee is not granted an option under such offering that qualifies as an option granted under an employee stock purchase plan, the offering will not meet the requirements of paragraph (e) of this section. Accordingly, none of the options granted under the offering will be eligible for the special tax treatment of section 421.

(3) The option price may be stated either as a percentage or as a dollar amount. If the option price is stated as a dollar amount, then the requirement of this paragraph (g) can only be met by a plan or offering in which the price is fixed at not less than 85 percent of the fair market value of the stock at the time the option is granted. If the fixed price is less than 85 percent of the fair market value of the stock at grant, then the option cannot meet the requirement of this paragraph (g) even if a decline in the fair market value of the stock results in such fixed price being not less than 85 percent of the fair market value of the stock at the time the option is exercised, because that result was not certain to occur under the terms of the option.

(4) *Examples*. The following examples illustrate the principles of this paragraph (g):

Example 1. Corporation Z has an employee stock purchase plan that provides that the option price will be 85 percent of the fair market value of the stock on the first day of the offering (which is the date of grant in this case), or 85 percent of the fair market value of the stock at exercise, whichever amount is the lesser. Upon the exercise of an option issued under Z's plan, Z agrees to accept an option price that is less than the minimum amount allowable under the terms of such plan. Notwithstanding that the option was issued under an employee stock purchase plan, the transfer of stock pursuant to the exercise of such option does not satisfy the requirement of this paragraph (g) and cannot qualify for the special tax treatment of section 421.

Example 2. Corporation AA has an employee stock purchase plan that provides that the option price is set at 85 percent of the fair market value of AA stock at exercise, but not less than $80 per share. On the first day of the offering (which is the date of grant in this case), the fair market value of AA stock is $100 per share. The option satisfies the requirement of this paragraph (g), and can qualify for the special tax treatment of section 421.

Example 3. Assume the same facts as in *Example 2*, except that the option price is set at 85 percent of the fair market value of AA stock at exercise, but not more than $80 per share. This option cannot satisfy the requirement of this paragraph (g) irrespective of whether, at the time the option is exercised, 85 percent of the fair market value of AA stock is $80 or less.

(h) *Option period*—(1) An employee stock purchase plan or offering must, by its terms, provide that options granted under the plan cannot be exercised after the expiration of 27 months from the date of grant unless, under the terms of the plan or offering, the option price is not less than 85 percent of the fair market value of the stock at the time of the exercise of the option. If the option price is not less than 85 percent of the fair market value of the stock at the time the option is exercised, then the option period provided under the plan must not exceed five years from the date of grant. If the requirements of this paragraph (h) are not met by the terms of the plan or offering, then options issued under such plan or offering will not be treated as options granted under an employee stock purchase plan irrespective of whether the options, by their terms, are exercisable beyond the period allowable under this paragraph (h). An option that provides that the option price is not less than 85 percent of the fair market value of the stock at exercise may have an option period of 5 years irrespective of whether the fair market value of the stock at exercise is more or less than the fair market value of the stock at grant. However, if the option provides that the option price is 85 percent of the fair market value of the stock at exercise, but not more

than some other fixed amount determined in accordance with the provisions of paragraph (g) of this section, then irrespective of the price paid on exercise, the option period must not be more than 27 months.

(2) Section 1.421–1(c) provides that, for purposes of §§ 1.421–1 through 1.424–1, the language ''the date of the granting of the option'' and the ''time such option is granted,'' and similar phrases refer to the date or time when the granting corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option. With respect to options granted under an employee stock purchase plan, the principles of § 1.421–1(c) shall be applied without regard to the requirement that the minimum option price must be fixed or determinable in order for the corporate action constituting an offer of stock to be considered complete.

(3) The date of grant will be the first day of an offering if the terms of an employee stock purchase plan or offering designate a maximum number of shares that may be purchased by each employee during the offering. Similarly, the date of grant will be the first day of an offering if the terms of the plan or offering require the application of a formula to establish, on the first day of the offering, the maximum number of shares that may be purchased by each employee during the offering. It is not required that an employee stock purchase plan or offering designate a maximum number of shares that may be purchased by each employee during the offering or incorporate a formula to establish a maximum number of shares that may be purchased by each employee during the offering. If the maximum number of shares that can be purchased under an option is not fixed or determinable until the date the option is exercised, then the date of exercise will be the date of grant of the option.

(4) *Examples*. The following examples illustrate the principles of this paragraph (h):

Example 1. (i) Corporation BB has an employee stock purchase plan that provides that the option price will be the lesser of 85 percent of the fair market value of the stock on the first day of an offering or 85 percent of the fair market value of the stock on the last day of the offering. Options are exercised on the last day of the offering. One million shares of BB stock are reserved for issuance under the plan. The plan provides that no employee may be permitted to purchase stock under the plan at a rate that exceeds $25,000 in fair market value of the BB stock (determined on the date of grant) for each calendar year during which an option granted to the employee is outstanding. The terms of each option granted under an offering provide that a maximum of 500 shares may be purchased by the option recipient during the offering. Because the maximum number of shares that can be purchased under the option is fixed and determinable on the first day of the offering, the date of grant for the option is the first day of the offering.

(ii) Assume the same facts as in paragraph (i) of *Example 1*, except that BB's plan excludes all employees who have been employed less than 18 months. The plan provides that employees who have not yet met the minimum service requirements on the first day of an offering will be granted an option on the date the 18-month service requirement has been attained. With respect to those employees who have been employed less than 18 months on the first day of an offering, the date of grant for the option is the date the 18-month service requirement has been attained.

Example 2. Assume the same facts as in paragraph (i) of *Example 1*, except that the terms of each option granted do not provide that a maximum of 500 shares may be purchased by the option recipient during the offering. Notwithstanding the fixed number of shares reserved for issuance under the plan and the $25,000 limitation set forth in the plan, the maximum number of shares that can be purchased under the option is not fixed or determinable until the last day of the offering when the option is exercised. Therefore the date of grant for the option is the last day of the offering when the option is exercised.

Example 3. Corporation CC has an employee stock purchase plan that provides that the option price will be 85 percent of the fair market value of the stock on the last day of the offering. Options are exercised on the last day of the offering. Each offering under the plan begins on January 1 and ends on December 31 of the same calendar year. The terms of each option granted under an offering provide that the maximum number of shares that may be purchased by any employee during the offering equals $25,000 divided by the fair market value of the stock on the first day of the offering. The maximum number of shares that can be purchased under the option is fixed and determinable on the first day of the offering and

therefore the date of grant for the option is the first day of the offering.

Example 4. Assume the same facts as in *Example 3* except that the terms of each option granted under an offering provide that the maximum number of shares that may be purchased by any employee during the offering equals 10 percent of the employee's annual salary (determined as of January 1 of the year in which the offering commences) divided by the fair market value of the stock on the first day of the offering. The maximum number of shares that can be purchased under the option is fixed and determinable on the first day of the offering and therefore the date of grant for the option is the first day of the offering.

(i) *Annual $25,000 limitation*—(1) An employee stock purchase plan or offering must, by its terms, provide that no employee may be permitted to purchase stock under all the employee stock purchase plans of the employer corporation and its related corporations at a rate that exceeds $25,000 in fair market value of the stock (determined at the time the option is granted) for each calendar year in which any option granted to the employee is outstanding at any time. In applying the foregoing limitation—

(i) The right to purchase stock under an option accrues when the option (or any portion thereof) first becomes exercisable during the calendar year;

(ii) The right to purchase stock under an option accrues at the rate provided in the option, but in no case may such rate exceed $25,000 of fair market value of such stock (determined at the time such option is granted) for any one calendar year; and

(iii) A right to purchase stock that has accrued under one option granted pursuant to the plan may not be carried over to any other option.

(2) If an option is granted under an employee stock purchase plan that satisfies the requirement of this paragraph (i), but the option gives the optionee the right to buy stock in excess of the maximum rate allowable under this paragraph (i), then no portion of the option will be treated as having been granted under an employee stock purchase plan. Furthermore, if the option was granted to an employee entitled to the grant of an option under the terms of the plan or offering, and the employee is not granted an option under the offering that qualifies as an option granted under an employee stock purchase plan, then the offering will not meet the requirements of paragraph (e) of this section. Accordingly, none of the options granted under the offering will be eligible for the special tax treatment of section 421.

(3) The limitation of this paragraph (i) applies only to options granted under employee stock purchase plans and does not limit the amount of stock that an employee may purchase under incentive stock options (as defined in section 422(b)) or any other stock options except those to which section 423 applies. Stock purchased under options to which section 423 does not apply will not limit the amount that an employee may purchase under an employee stock purchase plan, except for purposes of the 5-percent stock ownership provision of paragraph (d) of this section.

(4) Under the limitation of this paragraph (i), an employee may purchase up to $25,000 of stock (based on the fair market value of the stock at the time the option was granted) in each calendar year during which an option granted to the employee under an employee stock purchase plan is outstanding. Alternatively, an employee may purchase more than $25,000 of stock (based on the fair market value of such stock at the time the option was granted) in a calendar year, so long as the total amount of stock that the employee purchases does not exceed $25,000 in fair market value of the stock (determined at the time the option was granted) for each calendar year in which any option was outstanding. If, in any calendar year, the employee holds two or more outstanding options granted under employee stock purchase plans of the employer corporation, or a related corporation, then the employee's purchases of stock attributable to that year under all options granted under employee stock purchase plans must not exceed $25,000 in fair market value of the stock (determined at the time the options were granted). Under an employee stock purchase plan, an employee may not purchase stock in anticipation that the option will be outstanding in some future year. Thus, the employee may purchase only the amount of stock that does not exceed

the limitation of this paragraph (i) for the year of the purchase and for preceding years during which the option was outstanding. Thus, the amount of stock that may be purchased under an option depends on the number of years in which the option is actually outstanding. The amount of stock that may be purchased under an employee stock purchase plan may not be increased by reason of the failure to grant an option in an earlier year under such plan, or by reason of the failure to exercise an earlier option. For example, if an option is granted to an individual and expires without having been exercised at all, then the failure to exercise the option does not increase the amount of stock which such individual may be permitted to purchase under an option granted in a year following the year of such expiration. If an option granted under an employee stock purchase plan is outstanding in more than one calendar year, then stock purchased pursuant to the exercise of such an option will be applied first, to the extent allowable under this paragraph (i), against the $25,000 limitation for the earliest year in which the option was outstanding, then, against the $25,000 limitation for each succeeding year, in order.

(5) *Examples*. The following examples illustrate the principles of this paragraph (i):

Example 1. Assume that Corporation DD maintains an employee stock purchase plan and that Employee S is employed by DD. On June 1, 2010, DD grants S an option under the plan to purchase a total of 750 shares of DD stock at $85 per share. On that date, the fair market value of DD stock is $100 per share. The option provides that it may be exercised at any time but cannot be exercised after May 31, 2012. Under this paragraph (i), the option must not permit S to purchase more than 250 shares of DD stock during the calendar year 2010, because 250 shares are equal to $25,000 in fair market value of DD stock determined at the time of grant. During the calendar year 2011, S may purchase under the option an amount of DD stock equal to the difference between $50,000 in fair market value of DD stock (determined at the time the option was granted) and the fair market value of DD stock (determined at the time of grant of the option) purchased during the year 2010. During the calendar year 2012, S may purchase an amount of DD stock equal to the difference between $75,000 in fair market value of the stock (determined at the time of grant of the option) and the total amount of the fair market value of the stock (determined at the time of grant of the option) purchased under the option during the calendar years 2010 and 2011. S may purchase $25,000 of stock for the year 2010, and $25,000 of stock for the year 2012, although the option was outstanding for only a part of each of such years. However, S may not be granted another option under an employee stock purchase plan of DD or a related corporation to purchase stock of DD or a related corporation during the calendar years 2010, 2011, and 2012, so long as the option granted June 1, 2010, is outstanding.

Example 2. Assume the same facts as in *Example 1*, except that the option granted to S in 2010 is terminated in 2011 without any part of the option having been exercised, and that subsequent to the termination and during 2011, S is granted another option under DD's employee stock purchase plan. Under that option, S may be permitted to purchase $25,000 of stock for 2011. The failure of S to exercise the option granted to S in 2010, does not increase the amount of stock that S may be permitted to purchase under the option granted to S in 2011.

Example 3. Assume the same facts as in *Example 1*, except that, on May 31, 2012, S exercised the option granted to S in 2010, and purchased 600 shares of DD stock. Five hundred shares, the maximum amount of stock that could have been purchased in 2011, under the option, are treated as having been purchased for the years 2010 and 2011. Only 100 shares of the stock are treated as having been purchased for 2012. After S's exercise of the option on May 31, 2012, S is granted another option under DD's employee stock purchase plan. S may be permitted under the new option to purchase for 2012 stock having a fair market value of no more than $15,000 at the time the new option is granted.

Example 4. Corporation EE maintains an employee stock purchase plan and Employee R is employed by EE. On August 1, 2010, EE grants R an option under the plan to purchase 150 shares of EE stock at $85 per share during each of the calendar years 2010, 2011, and 2012. On that date, the fair market value of EE stock is $100 per share. The option provides that it may be exercised at any time during years 2010, 2011, and 2012. Because this option permits R to purchase only $15,000 of EE's stock for each year the option is outstanding, R could be granted another option by EE, or by a related corporation, in year 2010, permitting R to purchase an additional $10,000 of stock during each of the calendar years 2010, 2011, and 2012.

Example 5. Corporation FF maintains an employee stock purchase plan and Employee Q is employed by FF. On September 1, 2010, FF grants Q an option under the plan that will be automatically exercised on August 31, 2011, and August 31, 2012. The terms of the

option provide that no more than 150 shares may be purchased on each date that the option is automatically exercised. On August 31, 2011, Q may purchase under the option an amount of FF stock equal to $50,000 in fair market value of FF stock (determined at the time the option was granted). On August 31, 2012, Q may purchase under the option an amount of FF stock equal to the difference between $75,000 in fair market value of FF stock (determined at the time the option was granted) and the fair market value of FF stock (determined at the time of grant of the option) purchased during year 2011.

(j) *Restriction on transferability.* An employee stock purchase plan or offering must, by its terms, provide that options granted under the plan are not transferable by the optionee other than by will or the laws of descent and distribution, and must be exercisable, during the optionee's lifetime, only by the optionee. For general rules relating to the restriction on transferability required by this paragraph (j), *see* § 1.421–1(b)(2). For a limited exception to the requirement of this paragraph (j), see section 424(h)(3).

(k) *Special rule where option price is between 85 percent and 100 percent of value of stock*—(1)(i) If all the conditions necessary for the application of section 421(a) exist, this paragraph (k) provides additional rules that are applicable in cases where, at the time the option is granted, the option price per share is less than 100 percent (but not less than 85 percent) of the fair market value of the share. In that case, upon the disposition of the share by the employee after the expiration of the two-year and the one-year holding periods, or upon the employee's death while owning the share (whether occurring before or after the expiration of such periods), there shall be included in the employee's gross income as compensation (and not as gain upon the sale or exchange of a capital asset) the lesser of—

(A) The amount, if any, by which the price paid under the option was exceeded by the fair market value of the share at the time the option was granted, or

(B) The amount, if any, by which the price paid under the option was exceeded by the fair market value of the share at the time of such disposition or death.

(ii) For purposes of applying the rules of this paragraph (k), if the option price is not fixed or determinable at the time the option is granted, the option price will be computed as if the option had been exercised at such time. The amount of compensation resulting from the application of this paragraph (k) shall be included in the employee's gross income for the taxable year in which the disposition occurs, or for the taxable year closing with the employee's death, whichever event results in the application of this paragraph (k).

(iii) The application of the special rules provided in this paragraph (k) shall not affect the rules provided in section 421(a) with respect to the employee exercising the option, the employer corporation, or a related corporation. Thus, notwithstanding the inclusion of an amount as compensation in the gross income of an employee, as provided in this paragraph (k), no income results to the employee at the time the stock is transferred to the employee, and no deduction under section 162 is allowable at any time to the employer corporation or a related corporation with respect to such amount.

(iv) If, during the employee's lifetime, the employee exercises an option granted under an employee stock purchase plan, but the employee dies before the stock is transferred to the employee pursuant to the exercise of the option, then for the purpose of sections 421 and 423, on the employee's death, the stock is deemed to be transferred immediately to the employee, and immediately thereafter, the employee is deemed to have transferred the stock to the employee's executor, administrator, trustee, beneficiary by operation of law, heir, or legatee, as the case may be.

(2) If the special rules provided in this paragraph (k) are applicable to the disposition of a share of stock by an employee, then the basis of the share in the employee's hands at the time of the disposition, determined under section 1011, shall be increased by an amount equal to the amount includible as compensation in the employee's gross income under this paragraph (k). However, the basis of a share of stock

acquired after the death of an employee by the exercise of an option granted to the employee under an employee stock purchase plan shall be determined in accordance with the rules of section 421(c) and § 1.421–2(c). If the special rules provided in this paragraph (k) are applicable to a share of stock upon the death of an employee, then the basis of the share in the hands of the estate or the person receiving the stock by bequest or inheritance shall be determined under section 1014, and shall not be increased by reason of the inclusion upon the decedent's death of any amount in the decedent's gross income under this paragraph (k). See *Example (9)* of this paragraph (k) with respect to the determination of basis of the share in the hands of a surviving joint owner.

(3) *Examples*. The following examples illustrate the principles of this paragraph (k):

Example 1. On June 1, 2010, Corporation GG grants to Employee P, an employee of GG, an option under GG's employee stock purchase plan to purchase a share of GG stock for $85. The fair market value of GG stock on such date is $100 per share. On June 1, 2011, P exercises the option and on that date GG transfers the share of stock to P. On January 1, 2013, P sells the share for $150, its fair market value on that date. P's income tax return is filed on the basis of the calendar year. The income tax consequences to P and GG are as follows—

(i) Compensation in the amount of $15 is includible in P's gross income for the year 2013, the year of the disposition of the share. The $15 represents the difference between the option price ($85) and the fair market value of the share on the date the option was granted ($100), because the value is less than the fair market value of the share on the date of disposition ($150). For the purpose of computing P's gain or loss on the sale of the share, P's cost basis of $85 is increased by $15, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $100. Because the share was sold for $150, P realizes a gain of $50, which is treated as long-term capital gain; and

(ii) GG is not entitled to any deduction under section 162 at any time with respect to the share transferred to P.

Example 2. Assume the same facts as in *Example 1*, except that P sells the share of GG stock on January 1, 2014, for $75, its fair market value on that date. Because $75 is less than the option price ($85), no amount in respect of the sale is includible as compensation in P's gross income for the year 2014. P's basis for determining gain or loss on the sale is $85. Because P sold the share for $75, P realized a loss of $10 on the sale that is treated as a long-term capital loss.

Example 3. Assume the same facts as in *Example 1*, except that the option provides that the option price shall be 90 percent of the fair market value of the stock on the day the option is exercised. On June 1, 2011, when the option is exercised, the fair market value of the stock is $120 per share so that P pays $108 for the share of the stock. Compensation in the amount of $10 is includible in P's gross income for the year 2013, the year of the disposition of the share. This is determined in the following manner: The excess of the fair market value of the stock at the time of the disposition ($150) over the price paid for the share ($108) is $42; and the excess of the fair market value of the stock at the time the option was granted ($100) over the option price, computed as if the option had been exercised at such time ($90), is $10. Accordingly, $10, the lesser, is includible in gross income. In this situation, P's cost basis of $108 is increased by $10, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $118. Because the share was sold for $150, P realizes a gain of $32 that is treated as long-term capital gain.

Example 4. Assume the same facts as in *Example 1*, except that the option provides that the option price shall be the lesser of 95 percent of the fair market value of the stock on the first day of the offering period and 95 percent of the fair market value of the stock on the day the option is exercised. On June 1, 2011, when the option is exercised, the fair market value of the stock is $120 per share. P pays $95 for the share of the stock. Compensation in the amount of $5 is includible in P's gross income for the year 2013, the year of the disposition of the share. This is determined in the following manner: The excess of the fair market value of the stock at the time of the disposition ($150) over the price paid for the share ($95) is $55; and the excess of the fair market value of the stock at the time the option was granted ($100) over the option price, computed as if the option had been exercised at such time ($95), is $5. Accordingly, $5, the lesser, is includible in gross income. In this situation, P's cost basis of $95 is increased by $5, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $100. Because the share was sold for $150, P realizes a gain of $50 that is treated as long-term capital gain.

Example 5. Assume the same facts as in *Example 1*, except that instead of selling the share on January 1, 2013, P makes a gift of the share on that day. In that case $15 is includible as compensation in P's gross income for 2013. P's cost basis of $85 is increased by

$15, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $100, which becomes the donee's basis, as of the time of the gift, for determining gain or loss.

Example 6. Assume the same facts as in *Example 2*, except that instead of selling the share on January 1, 2014, P makes a gift of the share on that date. Because the fair market value of the share on that day ($75) is less than the option price ($85), no amount in respect of the disposition by way of gift is includible as compensation in P's gross income for 2014. P's basis for the share is $85, which becomes the donee's basis, as of the time of the gift, for the purpose of determining gain. The donee's basis for the purpose of determining loss, determined under section 1015(a), is $75 (fair market value of the share at the date of gift).

Example 7. Assume the same facts as in *Example 1*, except that after acquiring the share of stock on June 1, 2011, P dies on August 1, 2012, at which time the share has a fair market value of $150. Compensation in the amount of $15 is includible in P's gross income for the taxable year closing with P's death, $15 being the difference between the option price ($85) and the fair market value of the share when the option was granted ($100), because such value is less than the fair market value at date of death ($150). The basis of the share in the hands of P's estate is determined under section 1014 without regard to the $15 includible in the decedent's gross income.

Example 8. Assume the same facts as in *Example 7*, except that P dies on August 1, 2011, at which time the share has a fair market value of $150. Although P's death occurred within one year after the transfer of the share to P, the income tax consequences are the same as in *Example 7*.

Example 9. Assume the same facts as in *Example 1*, except that the share of stock was issued in the names of P and P's spouse jointly with right of survivorship, and that P and P's spouse sold the share on June 15, 2012, for $150, its fair market value on that date. Compensation in the amount of $15 is includible in P's gross income for the year 2012, the year of the disposition of the share. The basis of the share in the hands of P and P's spouse for the purpose of determining gain or loss on the sale is $100, that is, the cost of $85 increased by the amount of $15 includible as compensation in P's gross income. The gain of $50 on the sale is treated as long-term capital gain, and is divided equally between P and P's spouse.

Example 10. Assume the same facts as in *Example 1*, except that the share of stock was issued in the names of P and P's spouse jointly with right of survivorship, and that P predeceased P's spouse on August 1, 2012, at which time the share had a fair market value of $150. Compensation in the amount of $15 is includible in P's gross income for the taxable year closing with his death. See *Example 7*. The basis of the share in the hands of P's spouse as survivor is determined under section 1014 without regard to the $15 includible in the decedent's gross income.

Example 11. Assume the same facts as in *Example 10*, except that P's spouse predeceased P on July 1, 2012. Section 423(c) does not apply in respect of the death of P's spouse. Upon the subsequent death of P on August 1, 2012, the income tax consequences in respect of P's taxable year closing with the date of P's death, and in respect of the basis of the share in the hands of P's estate, are the same as in *Example 7*. If P had sold the share on July 15, 2012 (after the death of P's spouse), for $150, its fair market value at that time, the income tax consequences would be the same as in *Example 1*.

(l) *Effective/applicability date.* The regulations under this section are effective on November 17, 2009. The regulations under this section apply to options granted under an employee stock purchase plan on or after January 1, 2010.

[T.D. 9471, 74 FR 59078, Nov. 17, 2009; 74 FR 67973, Dec. 22, 2009]

§ 1.424–1 Definitions and special rules applicable to statutory options.

(a) *Substitutions and assumptions of options*—(1) *In general.* (i) This paragraph (a) provides rules under which an *eligible corporation* (as defined in paragraph (a)(2) of this section) may, by reason of a *corporate transaction* (as defined in paragraph (a)(3) of this section), substitute a new statutory option (new option) for an outstanding statutory option (old option) or assume an old option without such substitution or assumption being considered a modification of the old option. For the definition of *modification*, see paragraph (e) of this section.

(ii) For purposes of §§ 1.421–1 through 1.424–1, the phrase ''substituting or assuming a stock option in a transaction to which section 424 applies,'' ''substituting or assuming a stock option in a transaction to which § 1.424–1(a) applies,'' and similar phrases means a substitution of a new option for an old option or an assumption of an old option that meets the requirements of this paragraph (a). For a substitution or assumption to qualify under this

paragraph (a), the substitution or assumption must meet all of the requirements described in paragraphs (a)(4) and (a)(5) of this section.

(2) *Eligible corporation*. For purposes of this paragraph (a), the term *eligible corporation* means a corporation that is the employer of the optionee or a related corporation of such corporation. For purposes of this paragraph (a), the determination of whether a corporation is the employer of the optionee or a related corporation of such corporation is based upon all of the relevant facts and circumstances existing immediately after the corporate transaction. See §1.421–1(h) for rules concerning the employment relationship.

(3) *Corporate transaction*. For purposes of this paragraph (a), the term *corporate transaction* includes—

(i) A corporate merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation;

(ii) A distribution (excluding an ordinary dividend or a stock split or stock dividend described in §1.424–1(e)(4)(v)) or change in the terms or number of outstanding shares of such corporation; and

(iii) Such other corporate events prescribed by the Commissioner in published guidance.

(4) *By reason of*. (i) For a change in an option or issuance of a new option to qualify as a substitution or assumption under this paragraph (a), the change must be made by an *eligible corporation* (as defined in paragraph (a)(2) of this section) and occur by reason of a *corporate transaction* (as defined in paragraph (a)(3) of this section).

(ii) Generally, a change in an option or issuance of a new option is considered to be by reason of a corporate transaction, unless the relevant facts and circumstances demonstrate that such change or issuance is made for reasons unrelated to such corporate transaction. For example, a change in an option or issuance of a new option will be considered to be made for reasons unrelated to a corporate transaction if there is an unreasonable delay between the corporate transaction and such change in the option or issuance of a new option, or if the corporate transaction serves no substantial corporate business purpose independent of the change in options. Similarly, a change in the number or price of shares purchasable under an option merely to reflect market fluctuations in the price of the stock purchasable under an option is not by reason of a corporate transaction.

(iii) A change in an option or issuance of a new option is by reason of a distribution or change in the terms or number of the outstanding shares of a corporation (as described in paragraph (a)(3)(ii) of this section) only if the option as changed, or the new option issued, is an option on the same stock as under the old option (or if such class of stock is eliminated in the change in capital structure, on other stock of the same corporation).

(5) *Other requirements*. For a change in an option or issuance of a new option to qualify as a substitution or assumption under this paragraph (a), all of the requirements described in this paragraph (a)(5) must be met.

(i) In the case of an issuance of a new option (or a portion thereof) in exchange for an old option (or portion thereof), the optionee's rights under the old option (or portion thereof) must be canceled, and the optionee must lose all rights under the old option (or portion thereof). There cannot be a substitution of a new option for an old option within the meaning of this paragraph (a) if the optionee may exercise both the old option and the new option. It is not necessary to have a complete substitution of a new option for the old option. However, any portion of such option which is not substituted or assumed in a transaction to which this paragraph (a) applies is an outstanding option to purchase stock or, to the extent paragraph (e) of this section applies, a modified option.

(ii) The excess of the aggregate fair market value of the shares subject to the new or assumed option immediately after the change in the option or issuance of a new option over the aggregate option price of such shares must not exceed the excess of the aggregate fair market value of all shares subject to the old option (or portion thereof) immediately before the change in the option or issuance of a new option over the aggregate option price of such shares.

(iii) On a share by share comparison, the ratio of the option price to the fair market value of the shares subject to the option immediately after the change in the option or issuance of a new option must not be more favorable to the optionee than the ratio of the option price to the fair market value of the stock subject to the old option (or portion thereof) immediately before the change in the option or issuance of a new option. The number of shares subject to the new or assumed option may be adjusted to compensate for any change in the aggregate spread between the aggregate option price and the aggregate fair market value of the shares subject to the option immediately after the change in the option or issuance of the new option as compared to the aggregate spread between the option price and the aggregate fair market value of the shares subject to the option immediately before the change in the option or issuance of the new option.

(iv) The new or assumed option must contain all terms of the old option, except to the extent such terms are rendered inoperative by reason of the corporate transaction.

(v) The new option or assumed option must not give the optionee additional benefits that the optionee did not have under the old option.

(6) *Obligation to substitute or assume not necessary*. For a change in the option or issuance of a new option to meet the requirements of this paragraph (a), it is not necessary to show that the corporation changing an option or issuing a new option is under any obligation to do so. In fact, this paragraph (a) may apply even when the option that is being replaced or assumed expressly provides that it will terminate upon the occurrence of certain corporate transactions. However, this paragraph (a) cannot be applied to revive a statutory option which, for reasons not related to the corporate transaction, expires before it can properly be replaced or assumed under this paragraph (a).

(7) *Issuance of stock without meeting the requirements of this paragraph (a)*. A change in the terms of an option resulting in a modification of such option occurs if an optionee's new employer (or a related corporation of the new employer) issues its stock (or stock of a related corporation) upon exercise of such option without satisfying all of the requirements described in paragraphs (a)(4) and (5) of this section.

(8) *Date of grant*. For purposes of applying the rules of this paragraph (a), a substitution or assumption is considered to occur on the date that the optionee would, but for this paragraph (a), be considered to have been granted the option that the eligible corporation is substituting or assuming. A substitution or an assumption that occurs by reason of a corporate transaction may occur before or after the corporate transaction.

(9) Any reasonable methods may be used to determine the fair market value of the stock subject to the option immediately before the assumption or substitution and the fair market value of the stock subject to the option immediately after the assumption or substitution. Such methods include the valuation methods described in § 20.2031–2 of this chapter (the Estate Tax Regulations). In the case of stock listed on a stock exchange, the fair market value may be based on the last sale before and the first sale after the assumption or substitution if such sales clearly reflect the fair market value of the stock, or may be based upon an average selling price during a longer period, such as the day or week before, and the day or week after, the assumption or substitution. If the stocks are not listed, or if they are newly issued, it will be reasonable to base the determination on experience over even longer periods. In the case of a merger, consolidation, or other reorganization which is arrived at by arm's-length negotiations, the fair market value of the stocks subject to the option before and after the assumption or substitution may be based upon the values assigned to the stock for purposes of the reorganization. For example, if in the case of a merger the parties treat each share of the merged company as being equal in value to a share of the surviving company, it will be reasonable to assume that the stocks are of equal value so that the substituted option may permit the employee to purchase at the same price

one share of the surviving company for each share he could have purchased of the merged company.

(10) *Examples*. The principles of this paragraph (a) are illustrated by the following examples:

Example 1. Eligible corporation. X Corporation acquires a new subsidiary, Y Corporation, and transfers some of its employees to Y. Y Corporation wishes to grant to its new employees and to the employees of X Corporation new options for Y shares in exchange for old options for X shares that were previously granted by X Corporation. Because Y Corporation is an employer with respect to its own employees and a related corporation of X Corporation, Y Corporation is an eligible corporation under paragraph (a)(2) of this section with respect to both the employees of X and Y Corporations.

Example 2. Corporate transaction. (i) On January 1, 2004, Z Corporation grants E, an employee of Z, an option to acquire 100 shares of Z common stock. At the time of grant, the fair market value of Z common stock is $200 per share. E's option price is $200 per share. On July 1, 2005, when the fair market value of Z common stock is $400, Z declares a stock dividend of preferred stock distributed on common stock that causes the fair market value of Z common stock to decrease to $200 per share. On the same day, Z grants to E a new option to acquire 200 shares of Z common stock in exchange for E's old option. The new option has an exercise price of $100 per share.

(ii) A stock dividend other than that described in §1.424–1(e)(4)(v) is a corporate transaction under paragraph (a)(3)(ii) of this section. Generally, the issuance of a new option is considered to be by reason of a corporate transaction. None of the facts in this *Example 2* indicate that the new option is not issued by reason of the stock dividend. In addition, the new option is issued on the same stock as the old option. Thus, the substitution occurs by reason of the corporate transaction. Assuming the other requirements of this section are met, the issuance of the new option is a substitution that meets the requirements of this paragraph (a) and is not a modification of the option.

(iii) Assume the same facts as in paragraph (i) of this *Example 2*. Assume further that on December 1, 2005, Z declares an ordinary cash dividend. On the same day, Z grants E a new option to acquire Z stock in substitution for E's old option. Under paragraph (a)(3)(ii) of this section, an ordinary cash dividend is not a corporate transaction. Thus, the exchange of the new option for the old option does not meet the requirements of this paragraph (a) and is a modification of the option.

Example 3. Corporate transaction. On March 15, 2004, A Corporation grants E, an employee of A, an option to acquire 100 shares of A stock at $50 per share, the fair market value of A stock on the date of grant. On May 2, 2005, A Corporation transfers several employees, including E, to B Corporation, a related corporation. B Corporation arranges to purchase some assets from A on the same day as E's transfer to B. Such purchase is without a substantial business purpose independent of making the exchange of E's old options for the new options appear to be by reason of a corporate transaction. The following day, B Corporation grants to E, one of its new employees, an option to acquire shares of B stock in exchange for the old option held by E to acquire A stock. Under paragraph (a)(3)(i) of this section, the purchase of assets is a corporate transaction. Generally, the substitution of an option is considered to occur by reason of a corporate transaction. However, in this case, the relevant facts and circumstances demonstrate that the issuance of the new option in exchange for the old option occurred by reason of the change in E's employer rather than a corporate transaction and that the sale of assets is without a substantial corporate business purpose independent of the change in the options. Thus, the exchange of the new option for the old option is not by reason of a corporate transaction that meets the requirements of this paragraph (a) and is a modification of the old option.

Example 4. Corporate transaction. (i) E, an employee of Corporation A, holds an option to acquire 100 shares of Corporation A stock. On September 1, 2006, Corporation A has one class of stock outstanding and declares a stock dividend of one share of common stock for each outstanding share of common stock. The rights associated with the common stock issued as a dividend are the same as the rights under existing shares of stock. In connection with the stock dividend, E's option is exchanged for an option to acquire 200 shares of Corporation A stock. The per-share exercise price is equal to one half of the per-share exercise price of the original option. The stock dividend merely changes the number of shares of Corporation A outstanding and effects no other change to the stock of Corporation A. The option is proportionally adjusted and the aggregate exercise price remains the same and therefore satisfies the requirements described in §1.424–1(e)(4)(v).

(ii) The stock dividend is not a corporate transaction under paragraph (a)(3) of this section, and the declaration of the stock dividend is not a modification of the old option under paragraph (a) of this section. Pursuant to §1.424–1(e)(4)(v), the exercise price of the old option may be adjusted proportionally with the change in the number of outstanding shares of Corporation A such that the ratio of the aggregate exercise price of the option to the number of shares covered by the option is the same both before and

after the stock dividend. The adjustment of E's option is not treated as a modification of the option.

Example 5. Additional benefit. On June 1, 2004, P Corporation acquires 100 percent of the shares of S Corporation and issues a new option to purchase P shares in exchange for an old option to purchase S shares that is held by E, an employee of S. On the date of the exchange, E's old option is exercisable for 3 more years, and, after the exchange, E's new option is exercisable for 5 years. Because the new option is exercisable for an additional period of time beyond the time allowed under the old option, the effect of the exchange of the new option for the old option is to give E an additional benefit that E did not enjoy under the old option. Thus, the requirements of paragraph (a)(5) of this section are not met, and this paragraph (a) does not apply to the exchange of the new option for the old option. Therefore, the exchange is a modification of the old options.

Example 6. Spread and ratio tests. E is an employee of S Corporation. E holds an old option that was granted to E by S to purchase 60 shares of S at $12 per share. On June 1, 2005, S Corporation is merged into P Corporation, and on such date P issues a new option to purchase P shares in exchange for E's old option to purchase S shares. Immediately before the exchange, the fair market value of an S share is $32; immediately after the exchange, the fair market value of a P share is $24. The new option entitles E to buy P shares at $9 per share. Because, on a share-by-share comparison, the ratio of the new option price ($9 per share) to the fair market value of a P share immediately after the exchange ($24 per share) is not more favorable to E than the ratio of the old option price ($12 per share) to the fair market value of an S share immediately before the exchange ($32 per share) ($9/24 = 12/32$), the requirements of paragraph (a)(5)(iii) of this section are met. The number of shares subject to E's option to purchase P stock is set at 80. Because the excess of the aggregate fair market value over the aggregate option price of the shares subject to E's new option to purchase P stock, $1,200 (80 × $24 minus 80 × $9), is not greater than the excess of the aggregate fair market value over the aggregate option price of the shares subject to E's old option to purchase S stock, $1,200 (60 × $32 minus 60 × $12), the requirements of paragraph (a)(5)(ii) of this section are met.

Example 7. Ratio test and partial substitution. Assume the same facts as in *Example 6*, except that the fair market value of an S share immediately before the exchange of the new option for the old option is $8, that the option price is $10 per share, and that the fair market value of a P share immediately after the exchange is $12. P sets the new option price at $15 per share. Because, on a share-by-share comparison, the ratio of the new option price ($15 per share) to the fair market value of a P share immediately after the exchange ($12) is not more favorable to E than the ratio of the old option price ($10 per share) to the fair market value of an S share immediately before the substitution ($8 per share) ($15/12 = 10/8$), the requirements of paragraph (a)(5)(iii) of this section are met. Assume further that the number of shares subject to E's P option is set at 20, as compared to 60 shares under E's old option to buy S stock. Immediately after the exchange, 2 shares of P are worth $24, which is what 3 shares of S were worth immediately before the exchange (2 × $12 = 3 × $8). Thus, to achieve a complete substitution of a new option for E's old option, E would need to receive a new option to purchase 40 shares of P (*i.e.*, 2 shares of P for each 3 shares of S that E could have purchased under the old option ($2/3 = 40/60$)). Because E's new option is for only 20 shares of P, P has replaced only ½ of E's old option, and the other ½ is still outstanding.

Example 8. Partial substitution. X Corporation forms a new corporation, Y Corporation, by a transfer of certain assets and, in a spin-off, distributes the shares of Y Corporation to the stockholders of X Corporation. E, an employee of X Corporation, is thereafter an employee of Y. Y wishes to substitute a new option to purchase some of its stock for E's old option to purchase 100 shares of X. E's old option to purchase shares of X, at $50 a share, was granted when the fair market value of an X share was $50, and an X share was worth $100 just before the distribution of the Y shares to X's stockholders. Immediately after the spin-off, which is also the time of the substitution, each share of X and each share of Y is worth $50. Based on these facts, a new option to purchase 200 shares of Y at an option price of $25 per share could be granted to E in complete substitution of E's old option. In the alternative, it would also be permissible in connection with the spin off, to grant E a new option to purchase 100 shares of Y, at an option price of $25 per share, and for E to retain an option to purchase 100 shares of X under the old option, with the option price adjusted to $25. However, because X is no longer a related corporation with respect to Y, E must exercise the option for 100 shares of X within three months from the date of the spin off for the option to be treated as a statutory option. See §1.421–1(h). It would also be permissible to grant E a new option to purchase 100 shares of Y, at an option price of $25 per share, in substitution for E's right to purchase 50 of the shares under the old option.

Example 9. Stockholder approval requirements. (i) X Corporation, a publicly traded corporation, adopts an incentive stock option plan that meets the requirements of §1.422–2. Under the plan, options to acquire X

stock are granted to X employees. X Corporation is acquired by Y Corporation and becomes a subsidiary corporation of Y Corporation. After the acquisition, X employees remain employees of X. In connection with the acquisition, Y Corporation substitutes new options to acquire Y stock for the old options to acquire X stock previously granted to the employees of X. As a result of this substitution, on exercise of the new options, X employees receive Y Corporation stock.

(ii) Because the requirements of §1.422–2 were met on the date of grant, the substitution of the new Y options for the old X options does not require new stockholder approval. If the other requirements of paragraphs (a)(4) and (5) of this section are met, the issuance of new options for Y stock in exchange for the old options for X stock meets the requirements of this paragraph (a) and is not a modification of the old options.

(iii) Assume the same facts as in paragraphs (i) and (ii) of this *Example 9*. Assume further that as part of the acquisition, X amends its plan to allow future grants under the plan to be grants to acquire Y stock. Because the amendment of the plan to allow options on a different stock is considered the adoption of a new plan under §1.422–2(b)(2)(iii), the stockholders of X (in this case, Y) must approve the plan within 12 months before or after the date of the amendment of the plan. If the stockholders of X (in this case, Y) timely approve the plan, the future grants to acquire Y stock will be incentive stock options (assuming the other requirements of §1.422–2 have been met).

Example 10. Modification. X Corporation merges into Y Corporation. Y Corporation retains employees of X who hold old options to acquire X Corporation stock. When the former employees of X exercise the old options, Y Corporation issues Y stock to the former employees of X. Under paragraph (a)(7) of this section, because Y issues its stock on exercise of the old options for X stock, there is a change in the terms of the old options for X stock. Thus, the issuance of Y stock on exercise of the old options is a modification of the old options.

Example 11. Eligible corporation. (i) D Corporation grants an option to acquire 100 shares of D Corporation stock to E, an employee of D Corporation. S Corporation is a subsidiary of D Corporation. On March 1, 2005, D Corporation spins off S Corporation. E remains an employee of D Corporation. In connection with the spin off, D Corporation substitutes a new option to acquire D Corporation stock and a new option to acquire S Corporation stock for the old option in a manner that meets the requirements of paragraph (a) of this section.

(ii) The substitution of the new option to acquire S and D stock for the old option to acquire D stock is not a modification of the old option. However, because S is no longer a related corporation with respect to D Corporation, E must exercise the option for S stock within three months from March 1, 2005, for the option to be treated as a statutory option. See §1.421–1(h).

(iii) Assume the same facts as in paragraph (i) of this *Example 11* except that E's employment with D Corporation is terminated on February 20, 2005. The substitution of the new option to acquire S and D stock for the old option to acquire D stock is not a modification of the old option. However, because the employment relationship between E and D Corporation terminated on February 20, 2005, E must exercise the option for the D and S stock within three months from February 20, 2005, for the option to be treated as a statutory option. See §1.421–1(h).

(b) *Acquisition of new stock.* (1) Section 424(b) provides that the rules provided by sections 421 through 424 which are applicable with respect to stock transferred to an individual upon his exercise of an option, shall likewise be applicable with respect to stock acquired by a distribution or an exchange to which section 305, 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies. Stock so acquired shall, for purposes of sections 421 through 424, be considered as having been transferred to the individual upon his exercise of the option. A similar rule shall be applied in the case of a series of such acquisitions. With respect to such acquisitions, section 424(b) does not make inapplicable any of the provisions of section 305, 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036).

(2) The application of this paragraph may be illustrated by the following example:

Example. If, with respect to stock transferred pursuant to the timely exercise of a statutory option, there is a distribution of new stock to which section 305(a) is applicable, and if there is a disposition of such new stock before the expiration of the applicable holding period required with respect to the stock originally acquired pursuant to the exercise of such option, such disposition makes section 421 inapplicable to the transfer of the original stock pursuant to the exercise of the option to the extent that the disposition effects a reduction of the individual's total interest in the old and new stock. However, if the new stock, as well as the old stock, is not disposed of before the expiration of the holding period required with respect to the original stock acquired pursuant to the exercise

of the option, the special tax treatment provided by section 421 is applicable to both the original shares and the shares acquired by virtue of the distribution to which section 305(a) applies.

(c) *Disposition of stock.* (1) For purposes of sections 421 through 424, the term ''disposition of stock'' includes a sale, exchange, gift, or any transfer of legal title, but does not include—

(i) A transfer from a decedent to his estate or a transfer by bequest or inheritance; or

(ii) An exchange to which is applicable section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036); or

(iii) A mere pledge or hypothecation. However, a disposition of the stock pursuant to a pledge or hypothecation is a disposition by the individual, even though the making of the pledge or hypothecation is not such a disposition.

(iv) A transfer between spouses or incident to divorce (described in section 1041(a)). The special tax treatment of §1.421–2(a) with respect to the transferred stock applies to the transferee. However, see §1.421–1(b)(2) for the treatment of the transfer of a statutory option incident to divorce.

(2) A share of stock acquired by an individual pursuant to the exercise of a statutory option is not considered disposed of by the individual if such share is taken in the name of the individual and another person jointly with right of survivorship, or is subsequently transferred into such joint ownership, or is retransferred from such joint ownership to the sole ownership of the individual. However, any termination of such joint ownership (other than a termination effected by the death of a joint owner) is a disposition of such share, except to the extent the individual reacquires ownership of the share. For example, if such individual and his joint owner transfer such share to another person, the individual has made a disposition of such share. Likewise, if a share of stock held in the joint names of such individual and another person is transferred to the name of such other person, there is a disposition of such share by the individual. If an individual exercises a statutory option and a share of stock is transferred to another or is transferred to such individual in his name as trustee for another, the individual has made a disposition of such share. However, a termination of joint ownership resulting from the death of one of the owners is not a disposition of such share. For determination of basis in the hands of the survivor where joint ownership is terminated by the death of one of the owners, see section 1014.

(3) If an optionee exercises an incentive stock option with statutory option stock and the applicable holding period requirements (under §1.422–1(a) or §1.423–1(a)) with respect to such statutory option stock are not met before such transfer, then sections 354, 355, 356, or 1036 (or so much of 1031 as relates to 1036) do not apply to determine whether there is a disposition of those shares. Therefore, there is a disposition of the statutory option stock, and the special tax treatment of §1.421–2(a) does not apply to such stock.

(4) The application of this paragraph may be illustrated by the following examples:

Example 1. On June 1, 2004, the X Corporation grants to E, an employee, a statutory option to purchase 100 shares of X Corporation stock at $100 per share, the fair market value of X Corporation stock on that date. On June 1, 2005, while employed by X Corporation, E exercises the option in full and pays X Corporation $10,000, and on that day X Corporation transfers to E 100 shares of its stock having a fair market value of $12,000. Before June 1, 2006, E makes no disposition of the 100 shares so purchased. E realizes no income on June 1, 2005, with respect to the transfer to him of the 100 shares of X Corporation stock. X Corporation is not entitled to any deduction at any time with respect to its transfer to E of the stock. E's basis for such 100 shares is $10,000.

Example 2. Assume the same facts as in example (1), except assume that on August 1, 2006, three years and two months after the transfer of the shares to him, E sells the 100 shares of X Corporation stock for $13,000 which is the fair market value of the stock on that date. For the taxable year in which the sale occurs, E realizes a gain of $3,000 ($13,000 minus E's basis of $10,000), which is treated as capital gain.

Example 3. Assume the same facts as in example (2), except assume that on August 1, 2006, E makes a gift of the 100 shares of Y Corporation stock to his son. Such disposition results in no realization of gain to E either for the taxable year in which the option is exercised or the taxable year in which the

gift is made. E's basis of $10,000 becomes the donee's basis for determining gain or loss.

Example 4. Assume the same facts as in example (1), except assume that on May 1, 2006, E sells the 100 shares of X Corporation stock for $13,000. The special rules of section 421(a) are not applicable to the transfer of the stock by X Corporation to E, because disposition of the stock was made by E within two years from the date the options were granted and within one year of the date that the shares were transferred to him.

Example 5. Assume the same facts as in example (1), except assume that E dies on September 1, 2005, owning the 100 shares of X Corporation stock acquired by him pursuant to his exercise on June 1, 2005, of the statutory option. On the date of death, the fair market value of the stock is $12,500. No income is realized by E by reason of the transfer of the 100 shares to his estate. If the stock is valued as of the date of E's death for estate tax purposes, the basis of the 100 shares in the hands of the executor is $12,500.

Example 6. Assume the same facts as in example (1), except assume that on June 1, 2005, when the option is exercised by E the 100 shares are transferred by X to E and his wife W, as joint owners with right of survivorship, and that E dies on July 1, 2005. Neither the transfer into joint ownership nor the termination of such joint ownership by E's death is a disposition. Because E has made no disqualifying disposition of the shares, section 421(a) is applicable and E realizes no compensation income at death with respect to the shares even though he held the stock less than 2 years after the transfer of the shares to him pursuant to his exercise of the option. See §1.421–2(b)(2).

Example 7. On January 1, 2004, X Corporation grants to E, an employee of X Corporation, an incentive stock option to purchase 100 shares of X Corporation stock at $100 per share (the fair market value of an X Corporation share on that date). On January 1, 2005, when the fair market value of a share of X Corporation stock is $200, E exercises half of the option, pays X Corporation $5,000 in cash, and is transferred 50 shares of X Corporation stock with an aggregate fair market value of $10,000. E makes no disposition of the shares before January 2, 2006. Under §1.421–2(a), no income is recognized by E on the transfer of shares pursuant to the exercise of the incentive stock option, and X Corporation is not entitled to any deduction at any time with respect to its transfer of the shares to E. E's basis in the shares is $5,000.

Example 8. Assume the same facts as in *Example 7*, except that on December 1, 2005, one year and 11 months after the grant of the option and 11 months after the transfer of the 50 shares to E, E uses 25 of those shares, with a fair market value of $5,000, to pay for the remaining 50 shares purchasable under the option. On that day, X Corporation transfers 50 of its shares, with an aggregate fair market value of $10,000, to E. Because E disposed of the 25 shares before the expiration of the applicable holding periods, §1.421–2(a) does not apply to the January 1, 2005, transfer of the 25 shares used by E to exercise the remainder of the option. As a result of the disqualifying disposition of the 25 shares, E recognizes compensation income under the rules of §1.421–2(b).

Example 9. On January 1, 2005, X Corporation grants an incentive stock option to E, an employee of X Corporation. The exercise price of the option is $10 per share. On June 1, 2005, when the fair market value of an X Corporation share is $20, E exercises the option and purchases 5 shares with an aggregate fair market value of $100. On January 1, 2006, when the fair market value of an X Corporation share is $50, X Corporation is acquired by Y Corporation in a section 368(a)(1)(A) reorganization. As part of the acquisition, all X Corporation shares are converted into Y Corporation shares. After the conversion, if an optionee holds a fractional share of Y Corporation stock, Y Corporation will purchase the fractional share for cash equal to its fair market value. After applying the conversion formula to the shares held by E, E has 10 ½ Y Corporation shares. Y Corporation purchases E's one-half share for $25, the fair market value of one-half of a Y Corporation share on the conversion date. Because E sells the one-half share prior to expiration of the holding periods described in §1.422–1(a), the sale is a disqualifying disposition of the one-half share. Thus, in 2006, E must recognize compensation income of $5 (one-half of the fair market value of an X Corporation share on the date of exercise of the option, or $10, less one-half of the exercise price per share, or $5). For purposes of computing any additional gain, E's basis in the one-half share increases to $10 (reflecting the $5 included in income as compensation). E recognizes an additional gain of $15 ($25, the fair market value of the one-half share, less $10, the basis in such share). The extent to which the additional $15 of gain is treated as a redemption of Y Corporation stock is determined under section 302.

(d) *Attribution of stock ownership.* To determine the amount of stock owned by an individual for purposes of applying the percentage limitations relating to certain stockholders described in §§1.422–2(f) and 1.423–2(d), shares of the employer corporation or of a related corporation that are owned (directly or indirectly) by or for the individual's brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants, are considered to be owned by the individual. Also, for

such purposes, if a domestic or foreign corporation, partnership, estate, or trust owns (directly or indirectly) shares of the employer corporation or of a related corporation, the shares are considered to be owned proportionately by or for the stockholders, partners, or beneficiaries of the corporation, partnership, estate, or trust. The extent to which stock held by the optionee as a trustee of a voting trust is considered owned by the optionee is determined under all of the facts and circumstances.

(e) *Modification, extension, or renewal of option.* (1) This paragraph (e) provides rules for determining whether a share of stock transferred to an individual upon the individual's exercise of an option after the terms of the option have been changed is transferred pursuant to the exercise of a statutory option.

(2) Any modification, extension, or renewal of the terms of an option to purchase shares is considered the granting of a new option. The new option may or may not be a statutory option. To determine the date of grant of the new option for purposes of section 422 or 423, see §1.421–1(c).

(3) If section 423(c) applies to an option then, in case of a modification, extension, or renewal of an option, the highest of the following values shall be considered to be the fair market value of the stock at the time of the granting of such option for purposes of applying the rules of sections 423(b)(6)—

(i) The fair market value on the date of the original granting of the option,

(ii) The fair market value on the date of the making of such modification, extension, or renewal, or

(iii) The fair market value at the time of the making of any intervening modification, extension, or renewal.

(4)(i) For purposes of §§1.421–1 through 1.424–1 the term *modification* means any change in the terms of the option (or change in the terms of the plan pursuant to which the option was granted or in the terms of any other agreement governing the arrangement) that gives the optionee additional benefits under the option regardless of whether the optionee in fact benefits from the change in terms. In contrast, for example, a change in the terms of the option shortening the period during which the option is exercisable is not a modification. However, a change providing an extension of the period during which an option may be exercised (such as after termination of employment) or a change providing an alternative to the exercise of the option (such as a stock appreciation right) is a modification regardless of whether the optionee in fact benefits from such extension or alternative right. Similarly, a change providing an additional benefit upon exercise of the option (such as the payment of a cash bonus) or a change providing more favorable terms for payment for the stock purchased under the option (such as the right to tender previously acquired stock) is a modification.

(ii) If an option is not immediately exercisable in full, a change in the terms of the option to accelerate the time at which the option (or any portion thereof) may be exercised is not a modification for purposes of this section. Additionally, no modification occurs if a provision accelerating the time when an option may first be exercised is removed prior to the year in which it would otherwise be triggered. For example, if an acceleration provision is timely removed to avoid exceeding the $100,000 limitation described in §1.422–4, a modification of the option does not occur.

(iii) A change to an option which provides, either by its terms or in substance, that the optionee may receive an additional benefit under the option at the future discretion of the grantor, is a modification at the time that the option is changed to provide such discretion. In addition, the exercise of discretion to provide an additional benefit is a modification of the option. However, it is not a modification for the grantor to exercise discretion specifically reserved under an option with respect to the payment of a cash bonus at the time of exercise, the availability of a loan at exercise, the right to tender previously acquired stock for the stock purchasable under the option, or the payment of employment taxes and/or required withholding taxes resulting from the exercise of a statutory option. An option is not modified merely because an optionee is offered a change in

the terms of an option if the change to the option is not made. An offer to change the terms of an option that remains open less than 30 days is not a modification of the option. However, if an offer to change the terms of an option remains outstanding for 30 days or more, there is a modification of the option as of the date the offer to change the option is made.

(iv) A change in the terms of the stock purchasable under the option that increases the value of the stock is a modification of such option, except to the extent that a new option is substituted for such option by reason of the change in the terms of the stock in accordance with paragraph (a) of this section.

(v) If an option is amended solely to increase the number of shares subject to the option, the increase is not considered a modification of the option but is treated as the grant of a new option for the additional shares. Notwithstanding the previous sentence, if the exercise price and number of shares subject to an option are proportionally adjusted to reflect a stock split (including a reverse stock split) or stock dividend, and the only effect of the stock split or stock dividend is to increase (or decrease) on a pro rata basis the number of shares owned by each shareholder of the class of stock subject to the option, then the option is not modified if it is proportionally adjusted to reflect the stock split or stock dividend and the aggregate exercise price of the option is not less than the aggregate exercise price before the stock split or stock dividend.

(vi) Any change in the terms of an option made in an attempt to qualify the option as a statutory option grants additional benefits to the optionee and is, therefore, a modification. However, if the terms of an option are changed to provide that the optionee cannot transfer the option except by will or by the laws of descent and distribution in order to meet the requirements of section 422(b)(5) or 423(b)(9) such change is not a modicication.

(vii) An extension of an option refers to the granting by the corporation to the optionee of an additional period of time within which to exercise the option beyond the time originally prescribed. A renewal of an option is the granting by the corporation of the same rights or privileges contained in the original option on the same terms and conditions. The rules of this paragraph apply as well to successive modifications, extensions, and renewals.

(viii) Any inadvertent change to the terms of an option (or change in the terms of the plan pursuant to which the option was granted or in the terms of any other agreement governing the arrangement) that is treated as a modification under this paragraph (e) is not considered a modification of the option to the extent the change in the terms of the option is removed by the earlier of the date the option is exercised or the last day of the calendar year during which such change occurred. Thus, for example, if the terms of an option are inadvertently changed on March 1 to extend the exercise period and the change is removed on November, then if the option is not exercised prior to November 1, the option is not considered modified under this paragraph (e).

(5) A statutory option may, as a result of a modification, extension, or renewal, thereafter cease to be a statutory option, or any option may, by modification, extension, or renewal, thereafter become a statutory option.

(6) [Reserved]

(7) The application of this paragraph may be illustrated by the following examples:

Example 1. On June 1, 2004, the X Corporation grants to an employee an option under X's employee stock purchase plan to purchase 100 shares of the stock of X Corporation at $90 per share, such option to be exercised on or before June 1, 2006. At the time the option is granted, the fair market value of the X Corporation stock is $100 per share. On February 1, 2005, before the employee exercises the option, X Corporation modifies the option to provide that the price at which the employee may purchase the stock shall be $80 per share. On February 1, 2005, the fair market value of the X Corporation stock is $90 per share. Under section 424(h), the X Corporation is deemed to have granted an option to the employee on February 1, 2005. Such option shall be treated as an option to purchase at $80 per share 100 shares of stock having a fair market value of $100 per share, that is, the higher of the fair market value of the stock on June 1, 2004, or on February 1, 1965. Because the requirements of §1.424–1(e)(3) and §1.423–2(g) have not been met, the

exercise of such option by the employee after February 1, 2005, is not the exercise of a statutory option.

Example 2. On June 1, 2004, the X Corporation grants to an employee an option under X's employee stock purchase plan to purchase 100 shares of X Corporation stock at $90 per share, exercisable after December 31, 2005, and on or before June 1, 2006. On June 1, 2004, the fair market value of X Corporation's stock is $100 per share. On February 1, 2005, X Corporation modifies the option to provide that the option shall be exercisable on or before September 1, 2006. On February 1, 2005, the fair market value of X Corporation stock is $110 per share. Under section 424(h), X Corporation is deemed to have granted an option to the employee on February 1, 2005, to purchase at $90 per share 100 shares of stock having a fair market value of $110 per share, that is, the higher of the fair market value of the stock on June 1, 2004, or on February 1, 2005. Because the requirements of §1.424–1(e)(3) and §1.423–2(g) have not been met, the exercise of such option by the employee is not the exercise of a statutory option.

Example 3. The facts are the same as in example (1), except that the employee exercised the option to the extent of 50 shares on January 15, 2005, before the date of the modification of the option. Any exercise of the option after February 1, 2005, the date of the modification, is not the exercise of a statutory option. See example (1) in this subparagraph. The exercise of the option on January 15, 2005, pursuant to which 50 shares were acquired, is the exercise of a statutory option.

(f) *Definitions.* The following definitions apply for purposes of §§1.421–1 through 1.424–1:

(1) *Parent corporation.* The term *parent corporation*, or *parent*, means any corporation (other than the employer corporation) in an unbroken chain of corporations ending with the employer corporation if, at the time of the granting of the option, each of the corporations other than the employer corporation owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(2) *Subsidiary corporation.* The term *subsidiary corporation*, or *subsidiary*, means any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in an unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(g) *Effective/applicability date*—(1) *In general.* Except for §1.424–1(a)(10) *Example 9* (iii), the regulations under this section are effective on August 3, 2004. Section 1.424–1(a)(10) *Example 9* (iii) is effective on November 17, 2009. Section 1.424–1(a)(10) *Example 9* (iii) applies to statutory options granted on or after January 1, 2010.

(2) *Reliance and transition period.* For statutory options granted on or before June 9, 2003, taxpayers may rely on the 1984 proposed regulations LR–279–81 (49 FR 4504), the 2003 proposed regulations REG–122917–02 (68 FR 34344), or this section until the earlier of January 1, 2006, or the first regularly scheduled stockholders meeting of the granting corporation occurring 6 months after August 3, 2004. For statutory options granted after June 9, 2003, and before the earlier of January 1, 2006, or the first regularly scheduled stockholders meeting of the granting corporation occurring at least 6 months after August 3, 2004, taxpayers may rely on either REG–122917–02 or this section. Taxpayers may not rely on LR–279–81 or REG–122917–02 after December 31, 2005. Reliance on LR–279–81, REG–122917–02, or this section must be in its entirety, and all statutory options granted during the reliance period must be treated consistently.

[T.D. 6887, 31 FR 8808, June 24, 1966, as amended by T.D. 9144, 69 FR 46419, Aug. 3, 2004; 69 FR 61310, 61311, Oct. 18, 2004; 69 FR 70551, Dec. 7, 2004; T.D. 9471, 74 FR 59087, Nov. 17, 2009]

EDITORIAL NOTE: By T.D. 9144, 69 FR 46420, Aug. 3, 2004, §1.424–1 (c)(4)(vi) and (viii) were amended; however, because of the inaccurate amendatory language, the amendments could not be incorporated.

§§ 1.425–1.429 [Reserved]

§ 1.430(a)–1 Determination of minimum required contribution.

(a) *In general*—(1) *Overview.* This section sets forth rules for determining a plan's minimum required contribution for a plan year under section 430(a). Section 430 and this section apply to single-employer defined benefit plans (including multiple employer plans as

defined in section 413(c)) that are subject to section 412 but do not apply to multiemployer plans (as defined in section 414(f)). Paragraph (b) of this section defines a plan's minimum required contribution for a plan year. Paragraph (c) of this section provides rules for determining shortfall amortization installments. Paragraph (d) of this section provides rules for determining waiver amortization installments. Paragraph (e) of this section provides for early deemed amortization of shortfall and waiver amortization bases for fully funded plans. Paragraph (f) of this section provides definitions that apply for purposes of this section. Paragraph (g) of this section provides examples that illustrate the application of this section. Paragraph (h) of this section provides effective/applicability dates and transition rules.

(2) *Special rules for multiple employer plans*—(i) *In general.* In the case of a multiple employer plan to which section 413(c)(4)(A) applies, the rules of section 430 and this section are applied separately for each employer under the plan, as if each employer maintained a separate plan. Thus, the minimum required contribution is computed separately for each employer under such a multiple employer plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), the rules of section 430 and this section are applied as if all participants in the plan were employed by a single employer.

(ii) *CSEC plans.* A CSEC plan (that is, a plan that fits within the definition of a CSEC plan in section 414(y) for plan years beginning on or after January 1, 2014 and for which the election under section 414(y)(3)(A) has not been made) is not subject to the rules of section 430. See section 433 for the minimum funding rules that apply to CSEC plans.

(b) *Definition of minimum required contribution*—(1) *In general.* In the case of a defined benefit plan that is subject to section 430, except as offset under section 430(f) and § 1.430(f) 1, the minimum required contribution for a plan year is determined as the applicable amount determined under paragraph (b)(2) of this section or paragraph (b)(3) of this section, reduced by the amount of any funding waiver under section 412(c) that is granted for the plan year. See paragraph (b)(4) of this section for special rules for a plan maintained by a commercial passenger airline (or other eligible employer) for which an election under section 402 of the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780), as amended (PPA '06), has been made, and see section 430(j) and § 1.430(j) 1(b) for rules regarding the required interest adjustment for a contribution that is paid on a date other than the valuation date for the plan year. See also § 1.430(j)–1(d)(3)(iv)(B) for rules regarding an increase to the minimum required contribution in certain circumstances for a plan with an unpaid liquidity amount.

(2) *Plan assets less than funding target*—(i) *General rule.* For any plan year in which the value of plan assets (as reduced to reflect the subtraction of certain funding balances as provided under § 1.430(f)–1(c), but not below zero) is less than the funding target for the plan year, the minimum required contribution for that plan year is equal to the sum of—

(A) The target normal cost for the plan year;

(B) The total (not less than zero) of the shortfall amortization installments as described in paragraph (c) of this section determined with respect to any shortfall amortization base for the plan year and for each preceding plan year for which the shortfall amortization base has not been fully taken into account (generally, the 6 preceding plan years); and

(C) The total of the waiver amortization installments as described in paragraph (d) of this section determined with respect to any waiver amortization base for all preceding plan years for which the waiver amortization base has not been fully taken into account (generally, the 5 preceding plan years).

(ii) *Special rule for short plan years*—(A) *Proration of amortization installments.* In determining the minimum required contribution in the case of a plan year that is shorter than 12 months (and is not a 52-week plan year of a plan that uses a 52–53 week plan

year), the shortfall amortization installments and waiver amortization installments that are taken into account under paragraphs (b)(2)(i)(B) and (C) of this section are determined by multiplying the amount of those installments that would be taken into account for a 12-month plan year by a fraction, the numerator of which is the duration of the short plan year and the denominator of which is 1 year.

(B) *Effect on subsequent years.* In plan years after the short plan year, installments with respect to a shortfall amortization base or waiver amortization base continue to be taken into account under paragraphs (b)(2)(i)(B) and (C) of this section until the total amount of those installments, as originally determined when the base was established, has been taken into account. Thus, in the case of a plan that has a short plan year, an additional partial installment will be taken into account under paragraphs (b)(2)(i)(B) and (C) of this section for the plan year that ends after the end of the original amortization period (generally 7 years for shortfall amortization bases and 5 years for waiver amortization bases) in an amount determined so that the total of the amortization installments (including the prorated installment payable for the short plan year and the additional partial installment) is equal to the total of the amortization installments as originally determined.

(3) *Plan assets equal or exceed funding target.* For any plan year in which the value of plan assets (as reduced to reflect the subtraction of certain funding balances as provided under §1.430(f)–1(c), but not below zero) equals or exceeds the funding target for the plan year, the minimum required contribution for that plan year is equal to the target normal cost for the plan year reduced (but not below zero) by that excess.

(4) *Special rules for commercial passenger airlines*—(i) *In general.* This paragraph (b)(4) provides special rules for a plan maintained by a commercial passenger airline (or an employer whose principal business is providing catering services to a commercial passenger airline) for which an election under section 402(a)(1) of PPA '06 has been made. See paragraph (c)(4) of this section for special rules for a plan maintained by a commercial passenger airline (or an employer whose principal business is providing catering services to a commercial passenger airline) for which an election under section 402(a)(2) of PPA '06 has been made.

(ii) *Determinations during 17-year amortization period.* If an election described in section 402(a)(1) of PPA '06 applies for the plan year with respect to an eligible plan described in section 402(c)(1) of PPA '06, then the plan's minimum required contribution for purposes of section 430 of the Internal Revenue Code (Code) for the plan year is equal to the amount necessary to amortize (at an interest rate of 8.85 percent) the unfunded liability of the plan in equal installments over the remaining amortization period. For this purpose, the unfunded liability means the excess of the accrued liability under the plan determined using the unit credit funding method and an interest rate of 8.85 percent over the value of assets (as determined under section 430(g)(3) and §1.430(g)–1(c)), and the remaining amortization period is the 17-plan-year period beginning with the first plan year for which the election was made, reduced by 1 year for each plan year after the first plan year for which the election was made. In addition, the section 430(f)(3) election to apply funding balances against the minimum required contribution does not apply to a plan to which the election described in section 402(a)(1) of PPA '06 applies for the plan year.

(iii) *Determinations following the election period.* If an election described in section 402(a)(1) of PPA '06 applied to the plan for any preceding plan year but does not apply for the current plan year, then the plan's minimum required contribution for purposes of section 430 of the Code for the plan year is determined without regard to that election. For the first plan year for which that election no longer applies to the plan, any prefunding balance or funding standard carryover balance is reduced to zero.

(5) *Terminated plans*—(i) *Short plan year.* If a plan's termination date occurs during a plan year but before the last day of a plan year, then, for purposes of section 430, the plan is treated

as having a short plan year that ends on the termination date.

(ii) *Valuation date.* If a plan's termination date is before the date that would otherwise have been the valuation date for a plan year, then the valuation date for the plan year must be changed so that it falls within the short plan year pursuant to §1.430(g)–1(b)(2)(i). See §1.430(g)–1(b)(2)(iv) for a rule providing automatic approval of changes in the valuation date that are required by section 430.

(c) *Shortfall amortization installments*—(1) *In general.* Except as otherwise provided in paragraphs (c)(3) and (4) of this section, the shortfall amortization installments with respect to a shortfall amortization base established for a plan year are the annual amounts necessary to amortize that shortfall amortization base in level annual installments over the 7-year period beginning with that plan year. See §1.430(h)(2)–1(e) and (f) for rules regarding interest rates used for determining shortfall amortization installments and the date within each plan year on which the installments are assumed to be paid. The shortfall amortization installments are determined using the interest rates that apply for the plan year for which the shortfall amortization base is established and are not redetermined in subsequent plan years to reflect any changes in the valuation date or changes in interest rates under section 430(h)(2) for those subsequent plan years.

(2) *Shortfall amortization base*—(i) *In general.* Unless the value of plan assets (as reduced to reflect the subtraction of certain funding balances as provided under §1.430(f)–1(c)(2), but not below zero) is equal to or greater than the funding target for the plan year, a shortfall amortization base is established for the plan year equal to—

(A) The funding shortfall for the plan year; minus

(B) The amount attributable to future installments determined under paragraph (c)(2)(ii) of this section.

(ii) *Amount attributable to future installments.* The amount attributable to future installments is equal to the sum of the present values (determined in accordance with §1.430(h)(2)–1(e) and (f) using the interest rates that apply for the current plan year) of—

(A) The shortfall amortization installments that have been determined for the plan year and any succeeding plan year with respect to the shortfall amortization bases for any plan year preceding the plan year; and

(B) The waiver amortization installments that have been determined for the plan year and any succeeding plan year with respect to the waiver amortization bases for any plan year preceding the plan year.

(iii) *Timing assumption for installments after change in valuation date.* For purposes of determining the present value in paragraph (c)(2)(ii) of this section, the shortfall amortization installments and waiver amortization installments are assumed to be paid on the valuation date for the current plan year and anniversaries thereof even if the valuation date for a subsequent plan year is not the same as the valuation date for the plan year for which a shortfall amortization base or waiver amortization base was established. For example, assume that a plan has a July 1 to June 30 plan year and a valuation date that is the first day of the plan year, and that the plan year for the plan is changed to the calendar year, so that the plan has a short plan year beginning July 1, 2017 and ending December 31, 2017 and a calendar plan year thereafter. In this case—

(A) For the July 1, 2017 actuarial valuation, the shortfall amortization payments with respect to shortfall amortization bases established for all prior plan years are assumed to be paid on July 1, 2017 and anniversaries thereof; and

(B) For the January 1, 2018 actuarial valuation, the shortfall amortization payments with respect to shortfall amortization bases established for all prior plan years are assumed to be paid on January 1, 2018 and anniversaries thereof.

(iv) *Transition rule.* See paragraph (h)(4) of this section for a transition rule under which only a portion of the funding target is taken into account in determining whether a shortfall amortization base is established under this paragraph (c)(2).

(3) *Election of funding relief for certain plans*—(i) *Funding relief under the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010.* See section 430(c)(2)(D) and section 430(c)(7) for special rules that apply to determine the amount of shortfall amortization installments with respect to shortfall amortization bases established for plan years ending on or after October 10, 2009 and beginning before January 1, 2012, for which the relief under section 430(c)(2)(D) is elected.

(ii) *Funding relief related to eligible charity plans.* See section 104(d)(3)(B) through (F) of PPA '06, which reflects amendments made by section 103(b)(2) of the Cooperative and Small Employer Charity Pension Flexibility Act of 2014, Public Law 113–97 (128 Stat. 1137), for special rules that apply to determine the amount of shortfall amortization installments with respect to plan years beginning on or after January 1, 2014, in the case of an eligible charity plan for which the relief under section 104(d)(3)(A) of PPA '06 is elected.

(iii) *Election by commercial passenger airline under section 402(a)(2) of PPA '06.* If an election described in section 402(a)(2) of PPA '06 has been made for an eligible plan described in section 402(c)(1) of PPA '06, then the minimum required contribution for purposes of section 430 is determined under generally applicable rules, except that the shortfall amortization base for the first plan year for which section 430 applies to the plan is amortized over 10 years (rather than over 7 years as provided in paragraph (c)(1) of this section) in accordance with §1.430(h)(2)–1(e) and (f) using the interest rates that apply for purposes of determining the target normal cost for the first plan year for which section 430 applies to the plan. In such a case, the shortfall amortization installments with respect to the shortfall amortization base for that plan year will continue to be included in determining the minimum required contribution for 10 years rather than 7 years. See also §1.430(h)(2)–1(b)(6) for a special rule for determining the funding target in the case of a plan for which an election under section 402(a)(2) of PPA '06 has been made.

(d) *Waiver amortization installments*—(1) *In general.* For purposes of this section, the waiver amortization installments with respect to a waiver amortization base established for a plan year are the annual amounts necessary to amortize that waiver amortization base in level annual installments over the 5-year period beginning with the following plan year. See §1.430(h)(2)–1(e) and (f) for rules regarding interest rates used for determining waiver amortization installments and the date within each plan year on which the installments are assumed to be paid. The waiver amortization installments established with respect to a waiver amortization base are determined using the interest rates that apply for the plan year for which the waiver is granted (even though the first installment with respect to the waiver amortization base is not due until the subsequent plan year) and are not redetermined in subsequent plan years to reflect any changes in the valuation date or changes in interest rates under section 430(h)(2) for those subsequent plan years.

(2) *Waiver amortization base*—(i) *In general.* For purposes of this section, a waiver amortization base is established for each plan year for which a waiver of the minimum funding standard has been granted in accordance with section 412(c). The amount of the waiver amortization base is equal to the waived funding deficiency under section 412(c)(3) for the plan year.

(ii) *Transition rule.* See paragraph (h)(3) of this section for the treatment of funding waivers granted for plan years beginning before 2008.

(e) *Early deemed amortization upon attainment of funding target.* In any case in which the funding shortfall for a plan year is zero, for purposes of determining the minimum required contribution for that plan year and subsequent plan years—

(1) The shortfall amortization bases for all preceding plan years (and all shortfall amortization installments determined with respect to those bases) are reduced to zero; and

(2) The waiver amortization bases for all preceding plan years (and all waiver amortization installments determined

with respect to those bases) are reduced to zero.

(f) *Definitions*—(1) *In general*. The definitions set forth in this paragraph (f) apply for purposes of this section.

(2) *Funding shortfall*. The term *funding shortfall* means the excess (if any) of—

(i) The funding target for a plan year; over

(ii) The value of plan assets for the plan year (as reduced to reflect the subtraction of the funding standard carryover balance and prefunding balance to the extent provided under §1.430(f)–1(c), but not below zero).

(3) *Funding target*. The term *funding target* means the plan's funding target for a plan year determined under §1.430(d)–1(b)(2), §1.430(i)–1(c), or §1.430(i)–1(e)(1), whichever applies to the plan for the plan year.

(4) *Target normal cost*. The term *target normal cost* means the plan's target normal cost for a plan year determined under §1.430(d)–1(b)(1), §1.430(i)–1(d), or §1.430(i)–1(e)(2), whichever applies to the plan for the plan year.

(5) *Termination date*—(i) *Plans subject to Title IV of ERISA*. In the case of a plan subject to Title IV of the Employee Retirement Income Security Act of 1974, as amended (ERISA), the termination date means the plan's termination date established under section 4048(a) of ERISA.

(ii) *Other plans*—(A) *In general*. In the case of a plan not subject to Title IV of ERISA, the termination date means the plan's termination date established by the plan administrator, provided that the termination date may be no earlier than the date on which all actions necessary to effect the plan termination (other than the distribution of plan assets) are taken.

(B) *Requirement for prompt distribution*. A plan is not treated as terminated on the applicable date described in paragraph (f)(5)(ii)(A) of this section if the assets are not distributed as soon as administratively feasible after that date. Whether distribution of plan assets is made as soon as administratively feasible is to be determined under all the relevant facts and circumstances. In general, distribution of plan assets is deemed to have been made as soon as administratively feasible to the extent that any delay in distribution was because of circumstances outside the control of the plan administrator. However, distribution of plan assets that was delayed merely for the purpose of obtaining a higher value than current market value is generally not deemed to have been made as soon as administratively feasible.

(C) *Presumption applicable to prompt distribution requirement*. Except as provided in paragraph (f)(5)(ii)(D) of this section, distribution of plan assets which is not completed within one year following the applicable date described in paragraph (f)(5)(ii)(A) of this section is presumed not to have been made as soon as administratively feasible.

(D) *Exception to prompt distribution presumption for obtaining determination letter from Commissioner*. A plan is not treated as failing to meet the requirement to distribute plan assets as soon as administratively feasible after the proposed termination date if the delay is attributable to the period of time necessary to obtain a determination letter from the Commissioner on the plan's qualified status upon its termination, provided that the request for a determination letter is timely and the distribution of plan assets is made as soon as administratively feasible after the letter is obtained.

(6) *Transition funding shortfall*—(i) *In general*. The term *transition funding shortfall* means the excess, if any, of—

(A) The applicable percentage of the funding target for a plan year; over

(B) The value of plan assets for the plan year (as reduced to reflect the subtraction of the funding standard carryover balance and prefunding balance to the extent provided under §1.430(f)–1(c), but not below zero).

(ii) *Applicable percentage*. For purposes of this paragraph (f)(6), the applicable percentage is determined in accordance with the following table:

Calendar year in which the plan year begins	Applicable percentage
2008	92
2009	94
2010	96

(g) *Examples*. The following examples illustrate the rules of this section. Unless otherwise indicated, these examples are based on the following assumptions: Section 430 applies to determine the minimum required contribution for plan years beginning on or after January 1, 2008; the plan year is the calendar year; the valuation date is January 1; the plan's prefunding balance and funding standard carryover balance are equal to $0; the plan sponsor did not elect any funding relief under section 430(c)(2)(D) for any plan year; and the plan has not received any funding waivers for any relevant time periods.

Example 1. (i) Plan A has a funding target of $2,500,000 and assets totaling $1,800,000 as of January 1, 2016. For purposes of this example, the segment interest rates used for the January 1, 2016 valuation are assumed to be 5.26% for the first segment interest rate and 5.82% for the second segment interest rate. No shortfall or waiver amortization bases have been established for prior plan years.

(ii) A $700,000 shortfall amortization base is established for 2016, which is equal to the $2,500,000 funding target less $1,800,000 of assets.

(iii) With respect to the new shortfall amortization base of $700,000, there is a shortfall amortization installment of $116,852 (which is the amount necessary to amortize the $700,000 shortfall amortization base over 7 years) for each year from 2016 through 2022. The amount of this shortfall amortization installment is determined by discounting the first five installments using the first segment interest rate of 5.26%, and by discounting the sixth and seventh installments using the second segment rate of 5.82%.

Example 2. (i) The facts are the same as in *Example 1*, except that the plan was granted a funding waiver for 2014, resulting in five annual waiver amortization installments of $70,000 each, beginning with the 2015 plan year.

(ii) As of January 1, 2016, the present value of the remaining waiver amortization installments is $259,702, which is determined by discounting the remaining four waiver amortization installments of $70,000 each to January 1, 2016, using the first segment rate of 5.26%. See paragraph (c)(2)(ii) of this section.

(iii) A $440,298 shortfall amortization base is established for 2016, which is equal to the $2,500,000 funding target, less $1,800,000 of assets, less $259,702 (which is the present value of the remaining four waiver amortization installments).

(iv) With respect to this shortfall amortization base of $440,298, there is a shortfall amortization installment of $73,500 (which is equal to the $440,298 shortfall amortization base amortized over 7 years) for each year from 2016 through 2022.

Example 3. (i) The facts are the same as in *Example 2*. Plan A has a $100,000 target normal cost for the 2016 plan year and was granted a funding waiver for 2016 to the largest extent permitted under section 412(c).

(ii) If the funding waiver for 2016 had not been granted, the minimum required contribution for 2016 would have been $243,500. This is equal to the $100,000 target normal cost, plus the $70,000 waiver amortization installment from the 2014 waiver, plus the $73,500 January 1, 2016 shortfall amortization installment.

(iii) In accordance with section 412(c)(1)(C), the portion of the minimum required contribution attributable to the amortization of the 2014 funding waiver cannot be waived. Therefore, the maximum amount of the January 1, 2016 minimum required contribution that can be waived is $173,500.

(iv) In accordance with paragraph (d) of this section, a waiver amortization base of $173,500 is established as of January 1, 2016 to be amortized over 5 years beginning with the 2017 plan year. Although the waiver amortization installments for the 2016 funding waiver are not included in the minimum required contribution until 2017, the amount of those installments is determined based on the interest rates used for the 2016 plan year.

(v) The waiver amortization installments with respect to the 2016 funding waiver are calculated using the first segment interest rate of 5.26% for the first four installments (calculated as of January 1, 2017 through January 1, 2020) and the second segment interest rate of 5.82% for the final installment payable as of January 1, 2021. Accordingly, the waiver amortization installments with respect to the 2016 funding waiver are $40,554 each, payable beginning January 1, 2017.

Example 4. (i) The facts are the same as in *Example 3*. As of January 1, 2017, Plan A has a funding target of $2,750,000 and assets totaling $1,900,000. For purposes of this example, the first segment rate used for the 2017 valuation is assumed to be 5.50%, the second segment rate is assumed to be 6.00%, and the third segment rate is assumed to be 6.50%.

(ii) As of January 1, 2017, the present value of the remaining three waiver amortization installments with respect to the 2014 waiver is $199,242, which is determined using the first segment rate of 5.50%.

(iii) As of January 1, 2017, the present value of the remaining five waiver amortization installments with respect to the 2016 waiver is $182,701, which is determined using the first segment rate of 5.50%.

(iv) As of January 1, 2017, the present value of the remaining six shortfall amortization installments with respect to the 2016 shortfall amortization base is $386,052, which is determined using the first segment rate of

5.50% for the first five installments and the second segment rate of 6.00% for the sixth installment.

(v) A shortfall amortization base of $82,005 is established for 2017, which is equal to the $2,750,000 funding target, reduced by the sum of $1,900,000 of assets, $199,242 (the present value of the remaining waiver amortization installments with respect to the 2014 waiver), $182,701 (the present value of the remaining waiver amortization installments with respect to the 2016 waiver), and $386,052 (the present value of the remaining installments with respect to the 2016 shortfall amortization base).

(vi) With respect to this shortfall amortization base of $82,005, there is a shortfall amortization installment of $13,766 (which is the amount necessary to amortize the $82,005 shortfall amortization base over 7 years) for each year from 2017 through 2023.

Example 5. (i) As of January 1, 2016, a plan has a funding target of $2,500,000, a target normal cost of $175,000, and assets totaling $2,450,000. As of January 1, 2016, there are six remaining installments of $60,000 each with respect to the only shortfall amortization base for the plan, which was established for the 2015 plan year. Also as of January 1, 2016, there are five remaining installments of $25,000 each with respect to the only waiver amortization base for the plan, which was established for the 2015 plan year. For purposes of this example, the segment interest rates used for the January 1, 2016, valuation are assumed to be 5.26% for the first segment interest rate and 5.82% for the second segment interest rate.

(ii) A shortfall amortization base of −$379,812 is established for 2016, which is equal to the $2,500,000 funding target, reduced by the sum of $2,450,000 of assets, $316,696 (the present value of the remaining installments with respect to the 2015 shortfall amortization base) and $113,116 (the present value of the remaining installments with respect to the 2015 funding waiver).

(iii) The shortfall amortization installment for the 2016 shortfall amortization base is −$63,403, which is the amount necessary to amortize the −$379,812 shortfall amortization base over seven years. The first five shortfall amortization installments are discounted using the first segment rate of 5.26% and the sixth and seventh shortfall amortization installments are discounted using the second segment rate of 5.82%.

(iv) The sum of the shortfall amortization installments is equal to −$3,403 ($60,000 plus −$63,403). However, in accordance with paragraph (b)(2)(i)(B) of this section, for purposes of determining the minimum required contribution for a plan year, the total of the shortfall amortization installments for a plan year is limited so that it is not less than zero.

(v) The minimum required contribution as of January 1, 2016 is $200,000. This is equal to the sum of the target normal cost of $175,000, the total of the shortfall amortization installments (as limited) of $0, and the waiver amortization installment of $25,000.

(vi) The shortfall amortization bases are not set to zero as of January 1, 2016, even though the sum of the shortfall amortization installments was set to zero for the 2016 plan year. Therefore, as of January 1, 2017 (unless the plan has a funding shortfall of zero as of that date), the shortfall amortization base established as of January 1, 2015 will have five remaining installments of $60,000 each and the shortfall amortization base established as of January 1, 2016 will have six remaining installments of −$ 63,403 each. Similarly, the waiver amortization base will have four remaining installments of $25,000 each.

Example 6. (i) The facts are the same as in *Example 5*, except that Plan A has assets totaling $2,550,000 as of January 1, 2016.

(ii) Because the assets of $2,550,000 exceed the funding target of $2,500,000, no new shortfall amortization base is established under paragraph (c)(2) of this section.

(iii) Furthermore, under paragraph (e) of this section, all shortfall amortization bases and waiver amortization bases (and all shortfall amortization installments and waiver amortization installments associated with those bases) are reduced to zero as of January 1, 2016.

(iv) The minimum required contribution for the 2016 plan year is $125,000, which is equal to the $175,000 target normal cost less the excess of the assets over the funding target ($2,550,000 minus $2,500,000).

Example 7. (i) The actuarial valuation for Plan B as of January 1, 2016, based on a 12-month plan year, results in a target normal cost of $110,000 and a shortfall amortization installment for 2016 of $185,000, attributable to a shortfall amortization base established January 1, 2016. There are no other shortfall or waiver amortization bases for Plan B as of January 1, 2016. The plan year for Plan B is changed to April 1 through March 31, effective April 1, 2016, resulting in a short plan year beginning January 1, 2016 and ending March 31, 2016.

(ii) The target normal cost for the short plan year is redetermined in order to reflect the fact that there is a short plan year. An actuarial valuation shows that the target normal cost is $25,000 for the short plan year based on the accruals for that short plan year (determined in accordance with 29 CFR 2530.204–2(e)).

(iii) In accordance with paragraph (b)(2)(ii)(A) of this section, the shortfall amortization base is prorated to reflect the three months covered by the short plan year.

Accordingly, the shortfall amortization installment for the short plan year is $46,250 (that is, $185,000 multiplied by 3/12).

(iv) The total minimum required contribution for the short plan year is $71,250 (that is, the sum of the target normal cost of $25,000 plus the shortfall amortization installment of $46,250).

Example 8. (i) The facts are the same as in *Example 7.* For purposes of this example, assume that the first segment rate for the plan year beginning April 1, 2016 is 5.30%, and the second segment rate is 5.80%.

(ii) The present value of the remaining shortfall amortization installments with respect to the January 1, 2016 shortfall amortization base is equal to $1,074,937. This is determined by discounting the remaining installments (6 full-year installments of $185,000 each due April 1, 2016 through April 1, 2021, and a final 9-month installment of $138,750 due April 1, 2022) using the first segment rate of 5.30% for the first five installments and the second segment rate of 5.80% for the remaining installments.

Example 9. (i) As of January 1, 2016, Plan C has a funding target of $1,100,000, a target normal cost of $20,000, and an actuarial value of assets of $1,150,000. Prior to establishing any shortfall amortization base for 2016, the total of the shortfall amortization installments for 2016 is $30,000 and the present value of the remaining shortfall amortization installments (including installments for the 2016 plan year) is $150,000. Based on the segment rates used for the 2016 plan year, the 7-year amortization factor for any shortfall amortization base established for 2016 is 5.9887. The funding standard carryover balance as of January 1, 2016 is $40,000 and the prefunding balance is $60,000. The plan sponsor intends to use both balances to offset the minimum required contribution for 2016.

(ii) In accordance with sections 430(c) and 430(f)(4)(A), the test to determine whether Plan C is exempt from establishing a new shortfall amortization base for 2016 is initially applied based on assets reduced by the prefunding balance, because the plan sponsor intends to use the prefunding balance to offset the minimum required contribution. Therefore, the actuarial value of assets used for this purpose is $1,150,000 minus $60,000, or $1,090,000. This is less than the funding target of $1,100,000, so a new shortfall amortization base is established for 2016.

(iii) The funding shortfall as of January 1, 2016 is the difference between the funding target and the actuarial value of assets, where the actuarial value of assets is reduced by both the funding standard carryover balance and the prefunding balance. Accordingly, the value of assets used for this calculation is $1,050,000 (that is, $1,150,000 − $40,000 − $60,000), and the funding shortfall is $50,000 (that is, $1,100,000 − $1,050,000).

(iv) The shortfall amortization base established as of January 1, 2016 is the difference between the funding shortfall of $50,000 and the $150,000 present value of remaining shortfall amortization installments for bases established in prior years (that is, −$100,000). The shortfall amortization installment attributable to this base is −$100,000 ÷ 5.9887, or −$16,698.

(v) The preliminary minimum required contribution is the sum of the target normal cost, the shortfall amortization installments for bases established prior to 2016, and the shortfall amortization installment for the new base established for 2016, or $33,302 (that is, $20,000 + $30,000 − $16,698). However, this amount is less than the funding standard carryover balance. Because section 430(f)(3)(B) and § 1.430(f)–1(d)(2) require that the funding standard carryover balance be used before using the prefunding balance, this means that the full minimum required contribution will be offset without using the prefunding balance. Accordingly, the plan sponsor will not be electing to use any portion of the prefunding balance to offset the minimum required contribution for 2016.

(vi) Because the plan sponsor is not using the prefunding balance to offset the minimum required contribution, the test to determine whether Plan C is exempt from establishing a new shortfall amortization base for 2016 must be applied without subtracting the prefunding balance from the actuarial value of plan assets. Because the full actuarial value of assets of $1,150,000 is higher than the funding target of $1,100,000, the plan is exempt from establishing a new shortfall amortization base for 2016. However, the actuarial value of plan assets is reduced by both balances when determining the funding shortfall, which is used to determine whether the shortfall amortization bases established prior to 2016 are reduced to zero. Because the funding shortfall is greater than zero as of January 1, 2016 (as calculated in paragraph (iii) of this *Example 9*), the shortfall amortization bases established before the 2016 plan year are retained.

(vii) The minimum required contribution for 2016 is the sum of the target normal cost and the shortfall amortization installments, or $50,000 ($20,000 + $30,000). Because this is larger than the funding standard account carryover balance of $40,000, the plan sponsor can only offset $40,000 of the minimum required contribution and must contribute $10,000 to meet the minimum funding requirements. The prefunding balance cannot be used to offset the remaining $10,000 minimum funding requirement because doing so would require recalculating the minimum required contribution as illustrated in paragraphs (ii) through (v) of this *Example 9* and the minimum required contribution would be too small to use the prefunding balance.

Example 10. (i) The facts are the same as in *Example 9*, except that, in lieu of making the cash contribution required in *Example 9*, the plan sponsor elects to reduce the funding standard carryover balance by $9,000.

(ii) Because the plan sponsor intends to use the prefunding balance to offset the minimum required contribution, the test to determine whether Plan C is exempt from establishing a shortfall amortization base for 2016 is based on the actuarial value of assets reduced by the prefunding balance. The actuarial value of assets reduced for the prefunding balance ($1,090,000) is less than the funding target ($1,100,000), so a new shortfall amortization base is established for 2016.

(iii) The remaining funding standard carryover balance is $31,000 (that is, $40,000 minus the elected reduction of $9,000). The funding shortfall as of January 1, 2016 is the difference between the funding target and the actuarial value of assets, where the actuarial value of assets is reduced by both the remaining funding standard carryover balance and the prefunding balance. Accordingly, the value of assets used for this calculation is $1,059,000 (that is, $1,150,000 − $31,000 − $60,000), and the funding shortfall is $41,000 (that is, $1,100,000 − $1,059,000).

(iv) The shortfall amortization base established as of January 1, 2016 is the difference between the funding shortfall of $41,000 and the $150,000 present value of remaining shortfall amortization installments for bases established in prior years (that is, −$109,000). The shortfall amortization installment attributable to this base is −$109,000 ÷ 5.9887, or −$18,201.

(v) The minimum required contribution is the sum of the target normal cost, the shortfall amortization installments for bases established prior to 2016, and the shortfall amortization installment for the new base established for 2016, or $31,799 (that is, $20,000 + $30,000 − $18,201). This amount is larger than the remaining funding standard carryover balance of $31,000. Therefore, the plan sponsor can offset the full minimum required contribution using the remaining $31,000 of the funding standard carryover balance and $799 of the prefunding balance. Because a portion of the prefunding balance is used to offset the minimum required contribution, the test under section 430(c)(5) is applied by subtracting the prefunding balance from the actuarial value of assets as illustrated in paragraph (ii) of this *Example 10*, and no further adjustments are required to the minimum required contribution.

Example 11. (i) An amendment to Plan D was adopted during 2015, scheduled to be effective February 1, 2016. The actuary determines that, as of January 1, 2016, the amendment would increase Plan D's funding target by $300,000, if the amendment is permitted to take effect. As of February 1, 2016, prior to taking into account the amendment, the presumed adjusted funding target attainment percentage (AFTAP) for Plan D is less than 80% but not less than 60%. Plan D's sponsor makes a section 436 contribution (under section 436(c)(2)(A)) of $300,000, adjusted for interest as required under § 1.436–1(f)(2)(i)(A)(*2*), to allow the amendment to take effect.

(ii) Because the plan amendment was adopted prior to the valuation date for 2016 and becomes effective during the 2016 plan year, under § 1.430(d)–1(d)(1)(i), the plan amendment must be taken into account in the funding target as of January 1, 2016. However, because the section 436 contribution is made for the 2016 plan year, it is not included in Plan D's actuarial value of assets as of January 1, 2016.

(iii) The funding shortfall as of January 1, 2016 is calculated as the amount of the funding target (taking into account the plan amendment) minus the actuarial value of assets, where the value of assets is reduced by any funding standard carryover balance and prefunding balance as of that date. Because the funding target takes into account the increase of $300,000 attributable to the plan amendment but the actuarial value of assets does not include the section 436 contribution, the funding shortfall is $300,000 higher than it would have been had the plan amendment not been allowed to take effect.

(iv) The funding shortfall as of January 1, 2017 will reflect both the cost of the plan amendment and the value of the section 436 contribution made during 2016. Therefore, in the absence of any other factors affecting the shortfall amortization base, it is expected that a negative shortfall amortization base will be established as of January 1, 2017 as a result of the section 436 contribution made during 2016.

Example 12. (i) Plan E has a calendar year plan year and in 2015 had 97 participants. Plan E has a valuation date of July 1. A shortfall amortization base of $300,000 was established with the July 1, 2016 valuation. The plan had no other shortfall or waiver amortization bases. For purposes of this example, assume that the first segment rate for the 2016 plan year is 5.50% and the second segment rate is 6.00%. Accordingly, the shortfall amortization installments are determined as seven annual installments of $50,358 each, payable as of each July 1 beginning July 1, 2016.

(ii) Sometime after January 1, 2016, the number of participants in Plan E increased to over 100 during 2016, and therefore the valuation date was changed to January 1 effective with the 2017 plan year. As of January 1, 2017, Plan E has a funding target of $2,000,000, plan assets of $1,600,000, and a zero funding standard carryover balance and prefunding balance. For purposes of this example, assume that as of January 1, 2017, the

first segment rate is 5.75% and the second segment rate is 6.25%.

(iii) In accordance with paragraph (c)(1) of this section, the amount of the shortfall amortization installments for the base established July 1, 2016 is not adjusted for the change in valuation date. As of January 1, 2017, the outstanding balance of the shortfall amortization base established as of July 1, 2016 is $263,047, determined as the present value of the remaining shortfall amortization installments, calculated as if the shortfall amortization installments of $50,358 are payable annually on January 1 instead of July 1.

(iv) A new shortfall amortization base of $136,953 is established effective January 1, 2017 equal to the difference between the funding shortfall of $400,000 and the outstanding balance of the shortfall amortization base established as of July 1, 2016 ($263,047). The shortfall amortization installment for this base is calculated as $23,139.

(v) The total shortfall amortization installment for the 2017 plan year is $73,497, equal to the sum of the installments for the shortfall amortization base established July 1, 2016 ($50,358) and the base established January 1, 2017 ($23,139). The total amortization installment is determined as an amount payable as of January 1 regardless of the fact that the installment for the first base was initially calculated as an amount payable on July 1.

Example 13. (i) A funding waiver of $300,000 was granted for Plan F for the 2006 plan year. The valuation interest rate for the January 1, 2007 actuarial valuation is 8.50% (which exceeds 150% of the applicable federal midterm rate). The first segment rate for the January 1, 2008 valuation of Plan F is 5.26%.

(ii) The waiver amortization charge for the plan year beginning January 1, 2007 is $70,166, which is equal to the $300,000 funding waiver base amortized over 5 years at the valuation interest rate of 8.50%.

(iii) The annual waiver amortization installment for 2008 and later years is equal to the amortization charge for the 2007 plan year, or $70,166. As of January 1, 2008, the present value of the remaining waiver amortization installments is $260,318, which is determined by discounting the remaining four waiver amortization installments of $70,166 to January 1, 2008, using the first segment rate of 5.26%.

Example 14. (i) As of January 1, 2008, Plan G has a funding target of $2,500,000, plan assets of $1,800,000 and a funding standard carryover balance of $100,000. Plan G has not received a funding waiver for any past plan year. Plan G was in existence during 2007, and in the 2007 plan year was not subject to the deficit reduction contribution in section 412(l) of the Code as it existed prior to PPA '06.

(ii) Plan G qualifies for the transition rule in section 430(c)(5) of the Code (as in effect prior to amendments made by the Tax Increase Prevention Act of 2014, Public Law 113–295, 128 Stat. 4010) and paragraph (h)(4) of this section. Because Plan G's assets are less than 92% of its funding target, a shortfall amortization base must be established as of January 1, 2008.

(iii) Under the transition rule in paragraph (h)(4) of this section, the shortfall amortization base for 2008 is determined using only 92% of Plan G's funding target, or $2,300,000. For purposes of this calculation, the value of assets is reduced by the funding standard carryover balance for a net asset figure of $1,700,000 (that is, $1,800,000 minus $100,000). Accordingly, the shortfall amortization base as of January 1, 2008 is equal to $600,000.

(h) *Effective/applicability dates and transition rules*—(1) *Statutory effective date/applicability date.* Section 430 generally applies to plan years beginning on or after January 1, 2008. The applicability of section 430 for purposes of determining the minimum required contribution is delayed for certain plans in accordance with sections 104 through 106 of PPA '06.

(2) *Effective date/applicability date of regulations.* This section applies to plan years beginning on or after January 1, 2016. For plan years beginning before January 1, 2016, plans are permitted to rely on the provisions set forth in this section for purposes of satisfying the requirements of section 430(a).

(3) *Treatment of pre-PPA '06 funding waivers.* In the case of a plan that has received a funding waiver under section 412 for a plan year for which section 430 was not yet effective with respect to the plan for purposes of determining the minimum required contribution, the waiver is treated as giving rise to a waiver amortization base and the amortization charges with respect to that funding waiver are treated as waiver amortization installments as described in paragraph (d) of this section. With respect to such a pre-existing funding waiver, the amount of the waiver amortization installment is equal to the amortization charge with respect to that waiver determined using the interest rate or rates that applied for the pre-effective plan year.

(4) *Transition rule for determining shortfall amortization base*—(i) *In general.* Except as provided in paragraph (h)(4)(ii) of this section, in the case of

plan years beginning after December 31, 2007 and before January 1, 2011, for purposes of applying the rules of paragraph (c)(2) of this section—

(A) The applicable percentage (as described in paragraph (f)(6)(ii) of this section) of the funding target is substituted for the funding target; and

(B) The transition funding shortfall is substituted for the funding shortfall.

(ii) *Transition rule not available for new plans or deficit reduction plans.* The transition rule of paragraph (h)(4)(i) of this section does not apply to a plan—

(A) That was not in effect for a plan year beginning in 2007; or

(B) That was subject to section 412(l) for the last plan year beginning during 2007, determined after the application of sections 412(l)(6) and (9) (regardless of whether the deficit reduction contribution for that plan year was equal to zero).

(5) *Pre-effective plan year*—(i) *In general.* For purposes of this section, the pre-effective plan year for a plan is the last plan year beginning before section 430 applies to the plan to determine the minimum required contribution. Thus, except for plans with a delayed effective date as described in paragraph (h)(1) of this section, the pre-effective plan year for a plan is the last plan year beginning before January 1, 2008.

(ii) *Eligible charity plans.* An eligible charity plan (as described in section 104(d) of PPA '06, which reflects amendments made by section 202(b)(2) of PRA 2010, Public Law 111–192, 124 Stat. 1280 (June 25, 2010)) that applies section 430 to the first plan year beginning on or after January 1, 2008 has a pre-effective plan year that is the last plan year beginning before January 1, 2008 and a second pre-effective plan year that is the last plan year that precedes the plan year for which section 430 again applies to the plan. (Section 430 does not apply to such a plan for plan years beginning on or after January 1, 2009 and before January 1, 2017, unless the plan ceases to be an eligible charity plan, or an election under section 104(d)(2) or 104(d)(4) of PPA '06 is made for the plan not to be treated as an eligible charity plan, as of an earlier date.)

[T.D. 9732, 80 FR 54383, Sept. 9, 2015]

§ 1.430(d)–1 Determination of target normal cost and funding target.

(a) *In general*—(1) *Overview.* This section sets forth rules for determining a plan's target normal cost and funding target under sections 430(b) and 430(d), including guidance relating to the rules regarding actuarial assumptions under sections 430(h)(1), 430(h)(4), and 430(h)(5). Section 430 and this section apply to single employer defined benefit plans (including multiple employer plans as defined in section 413(c)) that are subject to section 412, but do not apply to multiemployer plans (as defined in section 414(f)). For further guidance on actuarial assumptions, *see* § 1.430(h)(2)–1 (relating to interest rates) and §§ 1.430(h)(3)–1 and 1.430(h)(3)–2 (relating to mortality tables). *See* also § 1.430(i)–1 for the determination of the funding target and the target normal cost for a plan that is in at-risk status.

(2) *Organization of regulation.* Paragraph (b) of this section sets forth certain definitions that apply for purposes of section 430. Paragraph (c) of this section provides rules regarding which benefits are taken into account in determining a plan's target normal cost and funding target. Paragraph (d) of this section sets forth the rules regarding the plan provisions that are taken into account in making these determinations, and paragraph (e) of this section provides rules on the plan population that is taken into account for this purpose. Paragraph (f) of this section provides rules relating to the actuarial assumptions and the plan's funding method that are used to determine present values. Paragraph (g) of this section contains effective/applicability dates and transition rules.

(3) *Special rules for multiple employer plans.* In the case of a multiple employer plan to which section 413(c)(4)(A) applies, the rules of section 430 and this section are applied separately for each employer under the plan, as if each employer maintained a separate plan. Thus, the plan's funding target and target normal cost are computed separately for each employer under such a multiple employer plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not

apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), the rules of section 430 and this section are applied as if all participants in the plan were employed by a single employer.

(b) *Definitions*—(1) *Target normal cost*—(i) *In general.* For a plan that is not in at-risk status under section 430(i) for a plan year, subject to the adjustments described in paragraph (b)(1)(iii) of this section, the *target normal cost* of the plan for the plan year is the present value (determined as of the valuation date) of all benefits under the plan that accrue during, are earned during, or are otherwise allocated to service for the plan year under the applicable rules of this section, including paragraph (c)(1)(ii)(B), (C), or (D) of this section. *See* §1.430(i)–1(d) and (e)(2) for the determination of the target normal cost for a plan that is in at-risk status.

(ii) *Benefits allocated to a plan year.* The benefits that accrue, are earned, or are otherwise allocated to service for the plan year are based on the actual benefits accrued, earned, or otherwise allocated to service for the plan year through the valuation date and benefits expected to accrue, be earned, or be otherwise allocated to service for the plan year for the period from the valuation date through the end of the plan year. The benefits that are allocated to the plan year under the rules of paragraph (c) of this section include any increase in benefits during the plan year that is attributable to increases in compensation for the current plan year even if that increase in benefits is with respect to benefits attributable to service performed in a preceding plan year. In addition, the benefits that are allocated to the plan year under the rules of paragraph (c) of this section include any increase in benefits during the plan year that arises on account of mandatory employee contributions (within the meaning of §1.411(c)–1(c)(4)) that are made during the plan year.

(iii) *Special adjustments*—(A) *In general.* The target normal cost of the plan for the plan year (determined under paragraph (b)(1)(i) of this section) is adjusted (not below zero) by adding the amount of plan-related expenses expected to be paid from plan assets during the plan year and subtracting the amount of mandatory employee contributions (within the meaning of §1.411(c)–1(c)(4)) that are expected to be made during the plan year.

(B) *Plan-related expenses.* [Reserved]

(2) *Funding target.* For a plan that is not in at-risk status under section 430(i) for a plan year, the funding target of the plan for the plan year is the present value (determined as of the valuation date) of all benefits under the plan that have been accrued, earned, or otherwise allocated to years of service prior to the first day of the plan year under the applicable rules of this section, including paragraph (c)(1)(ii)(B), (C), or (D) of this section. *See* §1.430(i)–1(c) and (e)(1) for the determination of the funding target for a plan that is in at-risk status.

(3) *Funding target attainment percentage*—(i) *In general.* Except as otherwise provided in this paragraph (b)(3), the funding target attainment percentage of a plan for a plan year is a fraction (expressed as a percentage)—

(A) The numerator of which is the value of plan assets for the plan year (determined under the rules of §1.430(g)–1) after subtraction of the prefunding balance and the funding standard carryover balance under section 430(f)(4)(B) and §1.430(f)–1(c); and

(B) The denominator of which is the funding target of the plan for the plan year (determined without regard to the at-risk rules of section 430(i) and §1.430(i)–1).

(ii) *Determination of funding target attainment percentage for plans with delayed effective dates.* If section 430 does not apply for purposes of determining the plan's minimum required contribution for a plan year that begins on or after January 1, 2008 (as is the case for a plan described in section 104, 105, or 106 of the Pension Protection Act of 2006 (PPA '06), Public Law 109–280 (120 Stat. 780)), then the funding target attainment percentage is determined for that plan year in accordance with the rules of paragraph (b)(3)(i) of this section in the same manner as for a plan to which section 430 applies to determine the plan's minimum required contribution, except that the value of plan assets that forms the numerator under

paragraph (b)(3)(i)(A) of this section is determined without subtraction of the funding standard carryover balance or the credit balance under the funding standard account.

(iii) *Special rule for plans with zero funding target.* If the funding target of the plan is equal to zero for a plan year, then the funding target attainment percentage under this paragraph (b)(3) is equal to 100 percent for the plan year.

(4) *Present value.* The present value of a benefit (including a portion of a benefit) with respect to a participant that is taken into account under the rules of paragraph (c) of this section is determined as of the valuation date by multiplying the amount of that benefit by the probability that the benefit will be paid at a future date and then discounting the resulting product using the appropriate interest rate under §1.430(h)(2)–1. The probability that the benefit will be paid with respect to the participant at such future date is determined using the actuarial assumptions that satisfy the standards of paragraph (f) of this section as to the probability of future service, advancement in age, and other events (such as death, disability, termination of employment, and selection of optional form of benefit) that affect whether the participant or beneficiary will be eligible for the benefit and whether the benefit will be paid at that future date.

(c) *Benefits taken into account*—(1) *In general*—(i) *Benefits earned or accrued.* The benefits taken into account in determining the target normal cost and the funding target under paragraph (b) of this section are all benefits earned or accrued under the plan that have not yet been paid as of the valuation date, including retirement-type and ancillary benefits (within the meaning of §1.411(d)–3(g)). The benefits taken into account are based on the participant's or beneficiary's status (such as active employee, vested or partially vested terminated employee, or disabled participant) as of the valuation date, and those benefits are allocated to the funding target or the target normal cost under paragraph (c)(1)(ii) of this section.

(ii) *Allocation of benefits*—(A) *In general.* To the extent that the amount of a participant's benefit that is expected to be paid is a function of the accrued benefit, the allocation of the benefit for purposes of determining the funding target and the target normal cost is made using the rules of paragraph (c)(1)(ii)(B) of this section. To the extent that the amount of a participant's benefit that is expected to be paid is not a function of the accrued benefit, but is a function of the participant's years of service (or is the excess of a function of the participant's years of service over a function of the participant's accrued benefit), the allocation of the benefit for purposes of determining the funding target and the target normal cost is made using the rules of paragraph (c)(1)(ii)(C) of this section. To the extent that the amount of a participant's benefit that is expected to be paid is not allocated under the rules of paragraph (c)(1)(ii)(B) or (C) of this section, the allocation of the benefit for purposes of determining the funding target and the target normal cost is made using the rules of paragraph (c)(1)(ii)(D) of this section.

(B) *Benefits that are based on accrued benefits.* If the allocation of the benefit for purposes of determining the funding target and the target normal cost is made under this paragraph (c)(1)(ii)(B), then the portion of a participant's benefit that is taken into account in the funding target for a plan year is determined by applying the function to the accrued benefit as of the first day of the plan year, and the portion of the benefit that is taken into account in determining the target normal cost for the plan year is determined by applying that function to the increase in the accrued benefit during the plan year. For example, a benefit that is assumed to be payable at a particular early retirement age in the amount of 90 percent of the accrued benefit is taken into account in the funding target in the amount of 90 percent of the accrued benefit as of the beginning of the plan year, and that benefit is taken into account in the target normal cost in the amount of 90 percent of the increase in the accrued benefit during the plan year.

(C) *Benefits that are based on service.* If the allocation of the benefit for purposes of determining the funding target

and the target normal cost is made under this paragraph (c)(1)(ii)(C), then the portion of a participant's benefit that is taken into account in determining the funding target for a plan year is determined by applying the function to the participant's years of service as of the first day of the plan year, and the portion of the benefit that is taken into account in determining the target normal cost for the plan year is determined by applying that function to the increase in the participant's years of service during the plan year. For example, if a plan provides a post-retirement death benefit of $500 per year of service, then the funding target is determined based on a death benefit of $500 multiplied by a participant's years of service at the beginning of the year, and if the participant earns or is expected to earn a full year of service during the plan year, the target normal cost is based on the additional $500 in death benefits attributable to that additional year of service.

(D) *Other benefits*. If the allocation of the benefit for purposes of determining the funding target and the target normal cost is made under this paragraph (c)(1)(ii)(D), then the portion of a participant's benefit that is taken into account in determining the funding target for a plan year is equal to the total benefit multiplied by the ratio of the participant's years of service as of the first day of the plan year to the years of service the participant will have at the time of the event that causes the benefit to be payable (whether the benefit is expected to be paid at the time of that decrement or at a future time), and the portion of the benefit that is taken into account in determining the target normal cost for the plan year is the increase in the proportionate benefit attributable to the increase in the participant's years of service during the plan year. For example, if a plan provides a Social Security supplement for a participant who retires after 30 years of service that is equal to a participant's Social Security benefit, the funding target with respect to the benefit payable beginning at a particular age (which reflects the probability of retirement at that age) is determined based on the projected Social Security benefit payable at the particular age multiplied by a fraction, the numerator of which is the participant's years of service as of the first day of the plan year and the denominator of which is the participant's projected years of service at the particular age. In such a case, if the participant earns or is expected to earn a full year of service during the plan year, the target normal cost is determined based on the projected Social Security benefit payable at the particular age multiplied by a fraction, the numerator of which is one and the denominator of which is the participant's projected years of service at the particular age.

(iii) *Application of section 436 limitations to funding target and target normal cost determination*—(A) *Effect of limitation on unpredictable contingent event benefits*. The determination of the funding target and the target normal cost of a plan for a plan year must take into account any limitation on unpredictable contingent event benefits under section 436(b) with respect to unpredictable contingent events which occurred before the valuation date, but must not take into account anticipated funding-based limitations on unpredictable contingent event benefits under section 436(b) with respect to unpredictable contingent events which are expected to occur on or after the valuation date.

(B) *Effect of limitation on applicability of plan amendments*. See paragraph (d) of this section for rules regarding the treatment of plan amendments that take effect during the plan year taking into account the restrictions under section 436(c).

(C) *Effect of limitation on prohibited payments*. The determination of the funding target and the target normal cost of a plan for a plan year must take into account any limitation on prohibited payments under section 436(d) with respect to any annuity starting date that was before the valuation date, but must not take into account any limitation on prohibited payments under section 436(d) for any annuity starting date on or after the valuation date (however, the determination must take into account benefit distributions under plan provisions that allow new annuity starting dates with respect to

distributions that were limited under section 436(d)).

(D) *Effect of limitation on benefit accruals.* Except as otherwise provided in this paragraph (c)(1)(iii)(D), the determination of the funding target of a plan for a plan year must take into account any limitation on benefit accruals under section 436(e) applicable before the valuation date. However, if the plan terms provide for the automatic restoration of benefit accruals as permitted under §1.436–1(a)(4)(ii)(B), and the restoration of benefits as of the valuation date will not be treated as resulting from a plan amendment under the rules of §1.436–1(c)(3) (because the period of limitation as of the valuation date does not exceed 12 months and the adjusted funding target attainment percentage for the plan would not be less than 60 percent taking into account the restored benefit accruals), then the determination of the funding target of a plan for a plan year must not take into account the limitation on benefit accruals under section 436(e) for that period. The determination of the target normal cost of a plan for a plan year must not take into account any limitation on benefit accruals under section 436(e). Thus, if an employer wishes to take a plan freeze into account in determining the target normal cost, the plan must be specifically amended to cease accruals.

(iv) *Effect of other limitations of benefits*—(A) *Liquidity shortfalls.* The determination of the funding target and the target normal cost of a plan for a plan year must take into account any restrictions on payments under section 401(a)(32) on account of a liquidity shortfall (as defined in section 430(j)(4)) for periods preceding the valuation date. The determination of the funding target and the target normal cost must not take into account any restrictions on payments under section 401(a)(32) on account of a liquidity shortfall or possible liquidity shortfall for any period on or after the valuation date.

(B) *High 25 limitation.* The determination of the funding target and the target normal cost of a plan for a plan year must take into account any restrictions on payments under §1.401(a)(4)–5(b) to highly compensated employees to the extent that benefits were not paid or will not be paid because of a limitation that applied prior to the valuation date. If a benefit that was otherwise restricted was paid prior to the valuation date but with suitable security (such as an escrow account) provided to the plan in the event of a plan termination, the benefit is treated as distributed for purposes of section 430 and this section. Accordingly, the funding target does not include any liability for the benefit and the plan assets do not include the security. The determination of the funding target and the target normal cost of a plan for a plan year must not take into account any restrictions on payments under §1.401(a)(4)–5(b) to highly compensated employees that are anticipated with respect to annuity starting dates on or after the valuation date on account of the funded status of the plan.

(2) *Benefits provided by insurance*—(i) *General rule.* A plan generally is required to reflect in the plan's funding target and target normal cost the liability for benefits that are funded through insurance contracts held by the plan, and to include the corresponding insurance contracts in plan assets. Paragraph (c)(2)(ii) of this section sets forth an alternative to this general approach. A plan's treatment of benefits funded through insurance contracts pursuant to this paragraph (c)(2) is part of the plan's funding method. Accordingly, that treatment can be changed only with the consent of the Commissioner.

(ii) *Separate funding of insured benefits.* As an alternative to the treatment described in paragraph (c)(2)(i) of this section, in the case of benefits that are funded through insurance contracts, the liability for benefits provided under such contracts is permitted to be excluded from the plan's funding target and target normal cost, provided that the corresponding insurance contracts are excluded from plan assets. This treatment is only available with respect to insurance purchased from an insurance company licensed under the laws of a State and only to the extent that a participant's or beneficiary's right to receive those benefits is an irrevocable contractual right under the insurance contracts, based on premiums paid to the insurance company

prior to the valuation date. For example, in the case of a retired participant receiving benefits from an annuity contract in pay status under which no premiums are required on or after the valuation date, the liability for benefits provided by the contract is permitted to be excluded from the plan's funding target provided that the value of the contract is also excluded from the value of plan assets. Similarly, in the case of an active or deferred vested participant whose benefits are funded by a life insurance or annuity contract under which further premiums are required on or after the valuation date, the liability for benefits, if any, that would be paid from the contract if no further premiums were to be paid (for example, if the contract were to go on reduced paid-up status) is permitted to be excluded from the plan's funding target and target normal cost, provided that the value of the contract is excluded from the value of plan assets. By contrast, if the plan trustee can surrender a contract to the insurer for its cash value, then the participant's or beneficiary's right to receive those benefits is not an irrevocable contractual right and, therefore, the liability for benefits provided under the contract must be taken into account in determining the plan's funding target and target normal cost and the contracts cannot be excluded from plan assets.

(d) *Plan provisions taken into account*—(1) *General rule*—(i) *Plan provisions adopted by valuation date.* Except as otherwise provided in this paragraph (d), a plan's funding target and target normal cost for a plan year are determined based on plan provisions that are adopted no later than the valuation date for the plan year and that take effect on or before the last day of the plan year. For example, in the case of a plan amendment adopted on or before the valuation date for the plan year that has an effective date occurring in the current plan year, the plan amendment is taken into account in determining the funding target and the target normal cost for the current plan year if it is permitted to take effect under the rules of section 436(c) for the current plan year, but the amendment is not taken into account for the current plan year if it does not take effect until a future plan year.

(ii) *Plan provisions adopted after valuation date.* If a plan administrator makes the election described in section 412(d)(2) with respect to a plan amendment, then the plan amendment is treated as having been adopted on the first day of the plan year for purposes of this paragraph (d). Section 412(d)(2) applies to any plan amendment adopted no later than 2½ months after the close of the plan year, including an amendment adopted during the plan year. Thus, if an amendment is adopted after the valuation date for a plan year (and no later than 2½ months after the close of the plan year), but takes effect by the last day of the plan year, the amendment is taken into account in determining the plan's funding target and target normal cost for the plan year if the plan administrator makes the election described in section 412(d)(2) with respect to such amendment.

(iii) *Determination of when an amendment takes effect.* For purposes of this paragraph (d)(1), the determination of whether an amendment that increases benefits takes effect and when it takes effect is determined in accordance with the rules of section 436(c) and § 1.436–1(c)(5). For purposes of this paragraph (d)(1), in the case of an amendment that decreases benefits, the amendment takes effect under a plan on the first date on which the benefits of any individual who is or could be a participant or beneficiary under the plan would be less than those benefits would be under the pre-amendment plan provisions if the individual were on that date to satisfy the applicable conditions for the benefits. In either case, the determination of when an amendment takes effect is unaffected by an election under section 412(d)(2).

(2) *Special rule for certain amendments increasing liabilities.* In the case of a plan amendment that is not required to be taken into account under the rules of paragraph (d)(1) of this section because it is adopted after the valuation date for the plan year, the plan amendment must be taken into account in determining a plan's funding target and target normal cost for the plan year if the plan amendment—

(i) Takes effect by the last day of the plan year;

(ii) Increases the liabilities of the plan by reason of increases in benefits, establishment of new benefits, changing the rate of benefit accrual, or changing the rate at which benefits become nonforfeitable; and

(iii) Would not be permitted to take effect under the rules of section 436(c) if those rules were applied—

(A) By treating the increase in the target normal cost for the plan year attributable to the amendment (and all other amendments that must be taken into account solely because of the application of the rules in this paragraph (d)(2)) as if the increase were an increase in the funding target for the plan year; and

(B) By taking into account all unpredictable contingent event benefits permitted to be paid for unpredictable contingent events that occurred during the current plan year and all plan amendments that took effect in the current plan year (including all amendments to which this paragraph (d)(2) applies for the plan year).

(3) *Allocation of benefits attributable to plan amendments.* If a plan amendment is taken into account for a plan year under the rules of this paragraph (d), then the allocation of benefits that is used to determine the funding target and the target normal cost for that plan year is based on the plan as amended. Thus, if an amendment that is taken into account for a plan year increases a participant's accrued benefit for service prior to the beginning of the plan year, then the present value of that increase is included in the funding target for the plan year.

(e) *Plan population taken into account*—(1) *In general.* In making any determination of the funding target or target normal cost under paragraph (b) of this section, the plan population is determined as of the valuation date. The plan population must include three classes of individuals—

(i) Participants currently employed in the service of the employer;

(ii) Participants who are retired under the plan or who are otherwise no longer employed in the service of the employer; and

(iii) All other individuals currently entitled to benefits under the plan.

(2) *Assumption regarding rehiring of former employees*—(i) *Special exclusion for ''rule of parity'' cases.* Certain individuals may be excluded from the class of individuals described in paragraph (e)(1)(ii) of this section. The excludable individuals are those former employees who, prior to the valuation date for the plan year, have terminated service with the employer without vested benefits and whose service might be taken into account in future years because the ''rule of parity'' of section 411(a)(6)(D) does not permit that service to be disregarded. However, if the plan's experience as to separated employees returning to service has been such that the exclusion described in this paragraph (e)(2) would be unreasonable, then no such exclusion is permitted.

(ii) *Application to partially vested participants.* Whether former employees who are terminated with partially vested benefits are assumed to return to service is determined under the same rules that apply to former employees without vested benefits under paragraph (e)(2)(i) of this section.

(3) *Anticipated future participants.* In making any determination of the funding target or target normal cost under paragraph (b) of this section, the actuarial assumptions and funding method used for the plan must not anticipate the affiliation with the plan of future participants not employed in the service of the employer on the plan's valuation date. However, any such determination may anticipate the affiliation with the plan of current employees who have not yet satisfied the participation (age and service) requirements of the plan as of the valuation date.

(f) *Actuarial assumptions and funding method used in determination of present value*—(1) *Selection of actuarial assumptions and funding method*—(i) *General rules.* The determination of any present value or other computation under section 430 and this section must be made on the basis of actuarial assumptions and a funding method. Except as otherwise specifically provided (for example, in §1.430(h)(2)–1(b)(6) or section

4006(a)(3)(E)(iv) of the Employee Retirement Income Security Act of 1974, as amended (ERISA)), the same actuarial assumptions and funding method must be used for all computations under sections 430 and 436. For example, the actuarial assumptions and the funding method used in making a certification of the adjusted funding target attainment percentage for a plan year must be the same as those disclosed on the actuarial report under section 6059 (Schedule SB, ''Single-Employer Defined Benefit Plan Actuarial Information'' of Form 5500, ''Annual Return/Report of Employee Benefit Plan'').

(ii) *Changes in actuarial assumptions and funding method.* Actuarial assumptions established for a plan year cannot subsequently be changed for that plan year unless the Commissioner determines that the assumptions that were used are unreasonable. Similarly, a funding method established for a plan year cannot subsequently be changed for that plan year unless the Commissioner determines that the use of that funding method for that plan year is impermissible.

(iii) *Procedures for establishing actuarial assumptions and funding method.* For purposes of this paragraph (f)(1), in the case of a plan for which an actuarial report under section 6059 (Schedule SB of Form 5500) is required to be filed for a plan year, actuarial assumptions and the funding method are established by the filing of the actuarial report if it is filed no later than the due date (with extensions) for the report. In the case of a plan for which an actuarial report for a plan year is not required to be filed, actuarial assumptions and the funding method are established by the delivery of the completed report to the employer if it is delivered no later than what would be the due date (with extensions) for filing the actuarial report were such a filing required. If the actuarial report is not filed or delivered by the applicable date described in the two preceding sentences, then the same actuarial assumptions (such as the same interest rate and mortality table elections) and funding method as were used for the preceding plan year apply for all computations under sections 430 and 436 for the current plan year, unless the Commissioner permits or requires other actuarial assumptions or another funding method permitted under section 430 to be used for the current plan year.

(iv) *Scope of funding method.* A plan's funding method includes not only the overall funding method used by the plan but also each specific method of computation used in applying the overall method. However, the choice of which actuarial assumptions are appropriate to the overall method or to the specific method of computation is not a part of the funding method. The assumed earnings rate used for purposes of determining the actuarial value of assets under section 430(g)(3)(B) is treated as an actuarial assumption, rather than as part of the funding method.

(2) *Interest and mortality rates.* Section 430(h)(2) and § 1.430(h)(2)–1 set forth the interest rates, and section 430(h)(3) and §§ 1.430(h)(3)–1 and 1.430(h)(3)–2 set forth the mortality tables, that must be used for purposes of determining any present value under this section. However, notwithstanding the requirement to use the mortality tables, in the case of a plan which has fewer than 100 participants and beneficiaries who are not in pay status, the actuarial assumptions may assume no pre-retirement mortality, but only if that assumption would be a reasonable assumption.

(3) *Other assumptions.* In the case of actuarial assumptions other than those specified in sections 430(h)(2), 430(h)(3), and 430(i), each of those actuarial assumptions must be reasonable (taking into account the experience of the plan and reasonable expectations). In addition, the actuarial assumptions (other than those specified in sections 430(h)(2), 430(h)(3), and 430(i)) must, in combination, offer the plan's enrolled actuary's best estimate of anticipated experience under the plan based on information determined as of the valuation date. *See* paragraph (f)(4)(iii) of this section for special rules for determining the present value of a single-sum and similar distributions.

(4) *Probability of benefit payments in single sum or other optional forms*—(i) *In general.* This paragraph (f)(4) provides rules relating to the probability that benefit payments will be paid as single

sums or other optional forms under a plan and the impact of that probability on the determination of the present value of those benefit payments under section 430.

(ii) *General rules of application.* Any determination of present value or any other computation under this section must take into account—

(A) The probability that future benefit payments under the plan will be made in the form of any optional form of benefit provided under the plan (including single-sum distributions), determined on the basis of the plan's experience and other related assumptions, in accordance with paragraph (f)(3) of this section; and

(B) Any difference in the present value of future benefit payments that results from the use of actuarial assumptions in determining the amount of benefit payments in any such optional form of benefit that are different from those prescribed by section 430(h).

(iii) *Single-sum and similar distributions*—(A) *Distributions using section 417(e) assumptions.* In the case of a distribution that is subject to section 417(e)(3) and that is determined using the applicable interest rates and applicable mortality table under section 417(e)(3), for purposes of applying paragraph (f)(4)(ii) of this section, the computation of the present value of that distribution is treated as having taken into account any difference in present value that results from the use of actuarial assumptions that are different from those prescribed by section 430(h) (as required under paragraph (f)(4)(ii)(B) of this section) if and only if the present value of the distribution is determined in accordance with this paragraph (f)(4)(iii).

(B) *Substitution of annuity form.* Except as otherwise provided in this paragraph (f)(4)(iii), the present value of a distribution is determined in accordance with this paragraph (f)(4)(iii) if that present value is determined as the present value, using special actuarial assumptions, of the annuity (either the deferred or immediate annuity) which is used under the plan to determine the amount of the distribution. Under these special assumptions, for the period beginning with the expected annuity starting date for the distribution, the current applicable mortality table under section 417(e)(3) that would apply to a distribution with an annuity starting date occurring on the valuation date is substituted for the mortality table under section 430(h)(3) that would otherwise be used. In addition, under these special assumptions, the valuation interest rates under section 430(h)(2) are used for purposes of discounting the projected annuity payments from their expected payment dates to the valuation date (as opposed to the interest rates under section 417(e)(3) which the plan uses to determine the amount of the benefit).

(C) *Optional application of generational mortality and phase-in of interest rates.* In determining the present value of a distribution under this paragraph (f)(4)(iii), if a plan uses the generational mortality tables under §1.430(h)(3)–1(a)(4) or §1.430(h)(3)–2, the plan is permitted to use a 50–50 male-female blend of the annuitant mortality rates under the §1.430(h)(3)–1(a)(4) generational mortality tables in lieu of the applicable mortality table under section 417(e)(3) that would apply to a distribution with an annuity starting date occurring on the valuation date. Similarly, a plan is permitted to make adjustments to the interest rates in order to reflect differences between the phase-in of the section 430(h)(2) segment rates under section 430(h)(2)(G) and the adjustments to the segment rates under section 417(e)(3)(D)(iii).

(D) *Distributions subject to section 417(e)(3) using other assumptions.* In the case of a distribution that is subject to section 417(e)(3) but that is determined on a basis other than using the applicable interest rates and the applicable mortality table under section 417(e)(3), for purposes of applying paragraph (f)(4)(ii)(B) of this section, the computation of present value must take into account the extent to which the present value of the distribution is different from the present value determined using the rules of paragraph (f)(4)(iii)(B) of this section, based on actuarial assumptions that satisfy the requirements of paragraph (f)(3) of this section. If the plan provides that the amount of the benefit is based on a comparison of the section 417(e)(3) benefit (that is, the benefit determined

using the applicable interest rates and the applicable mortality table under section 417(e)(3)) with another benefit determined using some other basis, then paragraph (f)(4)(ii)(B) of this section is applied as of the valuation date by comparing the present value of the section 417(e)(3) benefit determined under the rules of paragraph (f)(4)(iii)(B) of this section with the present value of the other benefit. The rule of this paragraph (f)(4)(iii)(D) applies, for example, where a distribution that is subject to section 417(e)(3) is determined as the greater of the benefit determined using the applicable interest rates and the applicable mortality table under section 417(e)(3) and the benefit determined using some other basis, or where the amount of a distribution that is subject to section 417(e)(3) is determined using an interest rate other than the applicable interest rates as required under section 415(b)(2)(E)(ii) (*see* § 1.417(e)–1(d)(1)).

(5) *Distributions from applicable defined benefit plans under section 411(a)(13)(C)*—(i) *In general.* In the case of an applicable defined benefit plan described in section 411(a)(13)(C), if the amount of a future distribution is based on an interest adjustment applied to the current accumulated benefit, then the amount of that distribution is determined by projecting the future interest credits or equivalent amount under the plan's interest crediting rules using actuarial assumptions that satisfy the requirements of paragraph (f)(3) of this section. Thus, if a plan provides for a single-sum distribution equal to the balance of a participant's hypothetical account under a cash balance plan, then the amount of that future distribution is equal to the projected account balance at the expected date of payment determined using actuarial assumptions that satisfy the requirements of paragraph (f)(3) of this section.

(ii) *Annuity distributions*—(A) *General rule.* In the case of an applicable defined benefit plan described in section 411(a)(13)(C), if the amount of an annuity distribution is based on either the balance of a hypothetical account maintained for a participant or the accumulated percentage of a participant's final average compensation, then the amount of that annuity distribution is calculated by converting the projected account balance (or accumulated percentage of final average compensation), in accordance with paragraph (f)(5)(i) of this section, to an annuity by applying the plan's annuity conversion provisions using the rules of this paragraph (f)(5)(ii).

(B) *Use of current annuity factors.* Except as otherwise provided in paragraph (f)(5)(ii)(C) of this section, if the plan bases the conversion of the projected account balance (or accumulated percentage of final average compensation) to an annuity using the applicable interest rates and applicable mortality table under section 417(e)(3), then the amount of the annuity distribution is determined by dividing the projected account balance (or accumulated percentage of final average compensation) by an annuity factor corresponding to the assumed form of payment using, for the period beginning with the annuity starting date, the current applicable mortality table under section 417(e)(3) that would apply to a distribution with an annuity starting date occurring on the valuation date (in lieu of the mortality table under section 430(h)(3) that would otherwise be used) and the valuation interest rates under section 430(h)(2) (as opposed to the interest rates under section 417(e)(3) which the plan uses to determine the amount of the annuity).

(C) *Optional application of generational mortality and phase-in of segment rates.* In determining the amount of an annuity distribution under paragraph (f)(5)(ii)(B) of this section, a plan is permitted to apply the options described in paragraph (f)(4)(iii)(C) of this section.

(D) *Distributions using assumptions other than assumptions under section 417(e)(3).* In applying this paragraph (f)(5)(ii), in the case of a plan that determines an annuity using a basis other than the applicable interest rates and applicable mortality table under section 417(e)(3), the amount of the annuity distribution must be based on actuarial assumptions that satisfy the requirements of paragraph (f)(3) of this section.

(6) *Unpredictable contingent event benefits.* Any determination of present

value or any other computation under this section must take into account, based on information as of the valuation date, the probability that future benefits (or increased benefits) will become payable under the plan due to the occurrence of an unpredictable contingent event (as described in § 1.436–1(j)(9)). For this purpose, this probability with respect to an unpredictable contingent event may be assumed to be zero if there is not more than a de minimis likelihood that the unpredictable contingent event will occur.

(7) *Reasonable techniques permitted*—(i) *Determination of benefits to be paid during the plan year.* Any reasonable technique can be used to determine the present value of the benefits expected to be paid during a plan year, based on the interest rates and mortality assumptions applicable for the plan year. For example, the present value of a monthly retirement annuity payable at the beginning of each month can be determined—

(A) Using the standard actuarial approximation that reflects 13/24ths of the discounted expected payments for the year as of the beginning of the year and 11/24ths of the discounted expected payments for the year as of the end of the year;

(B) By assuming a uniform distribution of death during the year; or

(C) By assuming that the payment is made in the middle of the year.

(ii) *Determination of target normal cost.* In the case of a participant for whom there is a less than 100 percent probability that the participant will terminate employment during the plan year, for purposes of determining the benefits expected to accrue, be earned, or otherwise allocated to service during the plan year which are used to determine the target normal cost, it is permissible to assume the participant will not terminate during the plan year, unless using this method of calculation would be unreasonable.

(8) *Approval of significant changes in actuarial assumptions for large plans*—(i) *In general.* Except as otherwise provided in paragraph (f)(8)(iii) of this section, any actuarial assumptions used to determine the funding target of a plan for a plan year during which the plan is described in paragraph (f)(8)(ii) of this section cannot be changed from the actuarial assumptions that were used for the preceding plan year without the approval of the Commissioner if the changes in assumptions result in a decrease in the plan's funding shortfall (within the meaning of section 430(c)(4)) for the current plan year (disregarding the effect on the plan's funding shortfall resulting from changes in interest and mortality assumptions under sections 430(h)(2) and (h)(3)) that either exceeds $50,000,000, or exceeds $5,000,000 and is 5 percent or more of the funding target of the plan before such change.

(ii) *Affected plans.* A plan is described in this paragraph (f)(8)(ii) for a plan year if—

(A) The plan is a defined benefit plan (other than a multiemployer plan) to which title IV of ERISA applies; and

(B) The aggregate unfunded vested benefits used to determine variable-rate premiums for the plan year (as determined under section 4006(a)(3)(E)(iii) of ERISA) of the plan and all other plans maintained by the contributing sponsors (as defined in section 4001(a)(13) of ERISA) and members of such sponsors' controlled groups (as defined in section 4001(a)(14) of ERISA) which are covered by title IV of ERISA (disregarding multiemployer plans and disregarding plans with no unfunded vested benefits) exceed $50,000,000.

(iii) *Automatic approval to resume use of previously used assumptions upon exiting at-risk status during phase-in.* A plan that is not in at-risk status for the current plan year and that was in at-risk status for the prior plan year (but not for a period of 5 or more consecutive plan years) is granted automatic approval to use the actuarial assumptions that were applied before the plan entered at-risk status and that were used in combination with the required at-risk assumptions during the period the plan was in at-risk status.

(9) *Examples.* The following examples illustrate the rules of this section. Unless otherwise indicated, these examples are based on the following assumptions: The normal retirement age is 65, the minimum required contribution for the plan is determined under the rules of section 430 starting in 2008, the plan year is the calendar year, the valuation

date is January 1, no plan-related expenses are paid or expected to be paid from plan assets, and the plan does not provide for mandatory employee contributions. The examples are as follows:

Example 1. (i) Plan P provides an accrued benefit equal to 1.0% of a participant's highest 3-year average compensation for each year of service. Plan P provides that an early retirement benefit can be received at age 60 equal to the participant's accrued benefit reduced by 0.5% per month for early commencement. On January 1, 2010, Participant A is age 60 and has 12 years of past service. Participant A's compensation for the years 2007 through 2009 was $47,000, $50,000, and $52,000, respectively. Participant A's rate of compensation at December 31, 2009, is $54,000 and A's rate of compensation for 2010 is assumed not to increase at any point during 2010. Decrements are applied at the beginning of the plan year.

(ii) Participant A's annual accrued benefit as of January 1, 2010, is $5,960 [0.01 × 12 × ($47,000 + $50,000 + $52,000) ÷ 3]. Participant A's expected benefit accrual for 2010 is $800 [0.01 × 13 × ($50,000 + $52,000 + $54,000) ÷ 3 − $5,960], to the extent that Participant A is expected to continue in employment for the full 2010 plan year.

(iii) Because the early retirement benefit is a function of the participant's accrued benefit, the allocation of the benefit for purposes of determining the target normal cost and funding target is made under paragraph (c)(1)(ii)(B) of this section. Accordingly, for Participant A, the early retirement benefit that is taken into account with respect to the decrement at age 60 when determining the 2010 funding target is $4,172 [$5,960 accrued benefit × (1 − 0.005 × 60 months)]. The expected accrual of the early retirement benefit during 2010 that is taken into account for Participant A with respect to the decrement at age 60 when determining the 2010 target normal cost is zero, because in this example the age-60 decrement would be applied as of January 1, 2010, before Participant A would earn any additional benefits. (But see paragraph (f)(7)(ii) of this section for an alternative approach for determining the expected accrual with respect to the decrement at age 60.)

(iv) The early retirement benefit for Participant A with respect to the decrement at age 61 that is taken into account in determining the funding target for the 2010 plan year is $4,529.60 [$5,960 accrued benefit × (1 − 0.005 × 48 months)]. The portion of the early retirement benefit that is taken into account for Participant A with respect to the decrement at age 61 that is taken into account in determining the target normal cost for the 2010 plan year is $608 [$800 expected annual accrual × (1 − 0.005 × 48 months)].

Example 2. (i) The facts are the same as in *Example 1.* In addition, the plan offers a $500 temporary monthly supplement to participants who complete 15 years of service and retire from active employment after attaining age 60. The temporary supplement is payable until the participant turns age 62. In addition, the supplement is limited so that it does not exceed the participant's Social Security benefit payable at age 62. On January 1, 2010, Participant B is age 55 and has 20 years of past service, and Participant C is age 60 and has 14 years of past service. For Participants B and C, the projected Social Security benefit is greater than $500 per month.

(ii) Because the temporary supplement is not a function of the participant's accrued benefit or service, the allocation of the benefit for purposes of determining the target normal cost and funding target is made under paragraph (c)(1)(ii)(D) of this section. The portion of the annual temporary supplement for Participant B with respect to the early retirement decrement occurring at age 60 that is taken into account in determining the funding target for the 2010 plan year is $4,800 [($500 × 12 months) × 20 years of past service ÷ 25 years of service at assumed early retirement age]. The portion of the annual temporary supplement for Participant B with respect to the early retirement decrement occurring at age 61 that is taken into account in determining the funding target for the 2010 plan year is $4,615 [($500 × 12 months) × 20 years of past service ÷ 26 years of service at assumed early retirement age]. In each case, the allocable portion of the benefit is assumed to be payable until age 62 (or the participant's death, if earlier).

(iii) For Participant B, the portion of the annual temporary supplement with respect to the early retirement decrement occurring at age 60 that is taken into account in determining the target normal cost for the 2010 plan year is $240 [($500 × 12 months) × 1 year of service expected to be earned during the plan year ÷ 25 years of service at assumed early retirement age]. The portion of the annual temporary supplement with respect to the early retirement decrement occurring at age 61 that is taken into account in determining the target normal cost for the 2010 plan year is $230.77 [($500 × 12 months) × 1 year of service expected to be earned during the plan year ÷ 26 years of service at assumed early retirement age]. The present value of these amounts reflects a payment period beginning with the decrement at age 60 or 61, as applicable, until age 62 (or assumed death, if earlier).

(iv) For Participant C, the portion of the annual temporary supplement with respect to the early retirement decrement occurring at age 61 (when the participant is first eligible for the benefit) that is taken into account in determining the funding target for

the 2010 plan year is $5,600 [($500 × 12 months) × 14 years of past service ÷ 15 years of service at assumed early retirement age]. The present value of this amount reflects a payment period beginning with the decrement at age 61 until age 62 (or death if earlier).

Example 3. (i) The facts are the same as in *Example 1.* The plan also provides a single-sum death benefit (in addition to the qualified pre-retirement spouse's benefit) equal to the greater of the participant's annual accrued benefit at the time of death, or $10,000. The benefit is limited as necessary to ensure that the plan meets the incidental death benefit requirements of section 401(a).

(ii) The determination of the portion of the death benefit that is taken into account in determining the target normal cost and funding target is made under paragraph (c)(1)(ii)(B) of this section to the extent that it is a function of the participant's accrued benefit and under paragraph (c)(1)(ii)(D) of this section to the extent that it relates to the part of the death benefit that is not a function of the participant's accrued benefit.

(iii) The portion of the single-sum death benefit corresponding to the accrued benefit, or $5,960, is taken into account when determining the 2010 funding target for Participant A.

(iv) The excess of the death benefit over Participant A's accrued benefit is $4,040 (that is, $10,000 − $5,960). Because this part of the death benefit is not a function of the participant's accrued benefit nor is it a function of service, the determination of the corresponding portion of the death benefit taken into account in determining the target normal cost and funding target for 2010 is made under paragraph (c)(1)(ii)(D) of this section. For example, for Participant A, the portion of this benefit with respect to the death decrement occurring at age 64 that is taken into account for purposes of determining the funding target for the 2010 plan year is $3,030 ($4,040 × 12 years of past service ÷ 16 years of service at assumed age of death).

(v) The total single-sum death benefit for Participant A with respect to the death decrement at age 64 that is taken into account in determining the funding target for the 2010 plan year is $8,990 ($5,960 + $3,030).

(vi) Similarly, the portion of the single-sum death benefit for Participant A that is taken into account in determining the target normal cost for the 2010 plan year is equal to the sum of the expected increase in the accrued benefit during 2010, and the expected change in the allocable portion of the excess death benefit attributable to service during 2010 as determined in accordance with paragraph (c)(1)(ii)(D) of this section. As described in *Example 1,* the expected increase in Participant A's accrued benefit during 2010 is $800, to the extent that Participant A is expected to continue in employment for the full 2010 plan year.

(vii) At the end of 2010, Participant A's accrued benefit is expected to be $6,760 ($5,960 + $800). The excess portion of the single-sum death benefit to be allocated in accordance with paragraph (c)(1)(ii)(D) of this section is $3,240 ($10,000 − $6,760), and the allocable portion of the excess benefit for Participant A as of December 31, 2010, with respect to the death decrement at age 64, is $2,632.50 ($3,240 × 13 years of service as of December 31, 2010 ÷ 16 years of service at assumed age of death). The change in the allocable portion of Participant A's excess death benefit due to an additional year of service, with respect to the death decrement at age 64, is a decrease of $397.50. Therefore, the target normal cost for the 2010 plan year attributable to Participant A, with respect to the death decrement at age 64, will reflect a single-sum death benefit of $402.50 ($800 expected increase in Participant A's accrued benefit minus a $397.50 expected decrease in the allocable portion of the death benefit in excess of the accrued benefit).

Example 4. (i) The facts are the same as in *Example 3,* except that the plan provides a single-sum death benefit equal to the greater of the present value of the qualified pre-retirement survivor annuity or 100 times the amount of the participant's monthly retirement benefit with service projected to normal retirement age. The valuation is based on the assumption that all surviving spouses choose to receive their benefit in the form of a single sum. For Participant A, the value of the qualified pre-retirement survivor annuity is less than 100 times Participant A's projected monthly retirement benefit.

(ii) The allocation of the death benefit that is a function of Participant A's accrued benefit is based on service and compensation to the first day of the plan year for purposes of determining the funding target, and the allocation of the death benefit that is a function of the increase in Participant A's accrued benefit during the plan year for purposes of determining the target normal cost is made in accordance with paragraph (c)(1)(ii)(B) of this section. As described in *Example 1,* Participant A's accrued benefit based on service and compensation as of January 1, 2010, is $5,960, or $496.67 per month. Accordingly, the portion of the single-sum death benefit corresponding to the accrued benefit, or $49,667 (100 times $496.67), is taken into account when determining the 2010 funding target for Participant A.

(iii) In addition, the funding target and the target normal cost reflect a portion of Participant A's death benefit in excess of the amount based on Participant A's accrued benefit. Based on Participant A's average compensation as of the first day of the plan year, Participant A's accrued benefit with service projected to normal retirement is

$8,443 [.01 × 17 years of service at age 65 × ($47,000 + $50,000 + $52,000) ÷ 3], or $703.61 per month. The corresponding death benefit is $70,361.

(iv) The excess of the death benefit over Participant A's accrued benefit as of January 1, 2010, is $20,694 (that is, $70,361 − $49,667). Because this part of the death benefit is not a function of Participant A's accrued benefit or service, the portion that is taken into account in determining the funding target is determined under paragraph (c)(1)(ii)(D) of this section. For Participant A, the portion of this benefit with respect to the death decrement occurring at age 64 that is taken into account when determining the funding target for the 2010 plan year is $15,521 ($20,694 × 12 years of past service ÷ 16 years of service at assumed age of death). The total single-sum death benefit for Participant A with respect to the death decrement at age 64 reflected in the funding target for the 2010 plan year is $65,188 ($49,667 + $15,521).

(v) Similarly, the portion of the single-sum death benefit for Participant A that is taken into account when determining the target normal cost for 2010 is equal to the sum of the death benefit based on the expected increase in the accrued benefit during 2010 and the expected change in the allocable portion of the excess death benefit attributable to service during 2010 as determined in accordance with paragraph (c)(1)(ii)(D) of this section.

(vi) At the end of 2010, Participant A's accrued benefit is expected to be $6,760 ($5,960 + $800), or $563.33 per month, and the associated death benefit is $56,333. The expected increase in the amount of the death benefit attributable to the increase in Participant A's accrued benefit is therefore $6,666 ($56,333 − $49,667).

(vii) Participant A's projected accrued benefit at normal retirement based on average compensation as of the end of 2010 is $8,840 [.01 × 17 years of service at age 65 × ($50,000 + $52,000 + $54,000) ÷ 3], or $736.67 per month. The corresponding death benefit is $73,667. The excess portion of the single-sum death benefit to be allocated in accordance with paragraph (c)(1)(ii)(D) of this section is $17,334 ($73,667 − $56,333), and the allocable portion of the excess benefit for Participant A as of December 31, 2010, with respect to the death decrement at age 64, is $14,084 ($17,334 × 13 years of service as of December 31, 2010 ÷ 16 years of service at assumed age of death).

(viii) The change in the allocable portion of Participant A's excess death benefit during 2010, with respect to the death decrement at age 64, is a decrease of $1,437 ($14,084 − $15,521). Therefore, the target normal cost for the 2010 plan year attributable to Participant A, with respect to the death decrement at age 64, will reflect a single-sum death benefit of $5,229 ($6,666 expected increase in Participant A's death benefit based on the expected increase in the accrued benefit, minus an expected decrease of $1,437 in the amount of the death benefit in excess of the amount attributable to the accrued benefit).

Example 5. (i) The facts are the same as in *Example 1*. In addition, the plan provides a disability benefit to participants who become disabled after completing 15 years of service. The disability benefit is payable at normal retirement age or an earlier date if elected by a participant. For purposes of calculating the disability benefit, service continues to accrue until normal retirement age (unless recovery or commencement of retirement benefits occurs earlier). Further, compensation is deemed to continue at the same rate as when the disability began.

(ii) Participant A will be eligible for the disability benefit at age 63 after completion of 15 years of service. Participant A's annual disability benefit at normal retirement age is $9,180 (that is, 1% of highest 3-year average compensation of $54,000 multiplied by 17 years of deemed service at normal retirement age).

(iii) The portion of the disability benefit based on the participant's accrued benefit as of the valuation date that is taken into account in determining the target normal cost and funding target is determined in accordance with paragraph (c)(1)(ii)(B) of this section. Accordingly, the portion of the disability benefit corresponding to Participant A's accrued benefit as of January 1, 2010, or $5,960, is taken into account when determining the 2010 funding target.

(iv) The excess of Participant A's disability benefit over the accrued benefit as of January 1, 2010, is $3,220 ($9,180 − $5,960). Because this portion of the disability benefit is not based on Participant A's accrued benefit or service, the portion that is taken into account in determining the funding target is determined under paragraph (c)(1)(ii)(D) of this section. The portion of Participant A's excess disability benefit with respect to the disability decrement occurring at age 63 that is taken into account when determining the 2010 funding target is $2,576 [$3,220 × (12 years of past service ÷ 15 years of service at assumed date of disability)]. The total disability benefit for Participant A, with respect to the disability decrement occurring at age 63, that is taken into account in determining the funding target for the 2010 plan year is $8,536 ($5,960 + $2,576).

(v) The portion of Participant A's disability benefit with respect to the disability decrement occurring at age 64 that is taken into account when determining the 2010 funding target is $8,375 [$5,960 + $3,220 × (12 years of past service ÷ 16 years of service at assumed date of disability)].

(vi) If in fact Participant A becomes disabled at age 63, the funding target will reflect the full disability benefit to which Participant A will be entitled at normal retirement age, based on service projected to normal retirement age (17 years) and final average compensation reflecting compensation projected to normal retirement age at the rate Participant A was earning at the time of disablement.

Example 6. (i) The facts are the same as in *Example 5*, except that the disability benefit is based on the accrued benefit calculated using service and compensation earned to the date of disability.

(ii) Because the disability benefit is a function of the participant's accrued benefit, the portion of Participant A's disability benefit that is taken into account when determining the funding target for the 2010 plan year is Participant A's annual accrued benefit as of January 1, 2010, or $5,960, as determined in *Example 1*. This amount is taken into account for both the disability decrement occurring at age 63 and the disability decrement occurring at age 64.

(iii) Similarly, the benefit accrual for Participant A with respect to the disability decrements occurring at age 63 and age 64 that is taken into account when determining the target normal cost for the 2010 plan year is equal to Participant A's expected benefit accrual for 2010 determined in *Example 1*, or $800.

Example 7. (i) Retiree D, a participant in Plan P, is a male age 72 and is receiving a $100 monthly straight life annuity. The 2009 actuarial valuation is performed using the segment rates applicable for September 2008 (determined without regard to the transition rule of section 430(h)(2)(G)), and the 2009 annuitant and nonannuitant (male and female) mortality tables (published in Notice 2008–85). See §601.601(d)(2) relating to objectives and standards for publishing regulations, revenue rulings and revenue procedures in the Internal Revenue Bulletin.

(ii) The present value of Retiree D's straight life annuity on the valuation date is $10,535.79. This is equal to the sum of: $5,029.99, which is the present value of payments expected to be made during the first 5 years, using the first segment interest rate of 5.07%; $5,322.26, which is the present value of payments expected to be made during the next 15 years, using the second segment interest rate of 6.09%; and $183.54, which is the present value of payments expected to be made after 20 years, using the third segment interest rate of 6.56%.

Example 8. (i) The facts are the same as in *Example 7*. Plan P does not provide for early retirement benefits or single-sum distributions. The actuary assumes that no participants terminate employment prior to age 50 (other than by death), there is a 5% probability of withdrawal at age 50, and that those participants who withdraw receive a deferred annuity starting at age 65. Participant E is a male age 46 on January 1, 2009, and has an annual accrued benefit of $23,000 beginning at age 65.

(ii) Before taking into account the 5% probability of withdrawal, the funding target associated with Participant E's assumed age 50 withdrawal benefit in the 2009 actuarial valuation is $68,396.75. This is equal to the sum of: $6,925.29, which is the present value of payments expected to be made during the year the participant turns age 65 (the 20th year after the valuation date), using the second segment interest rate of 6.09%; and $61,471.46, which is the present value of payments expected to be made after the 20th year, using the third segment interest rate of 6.56%.

(iii) Taking the 5% probability of withdrawal into account, the funding target for the 2009 plan year associated with Participant E's assumed age 50 withdrawal benefit is $3,419.84 ($68,396.75 × 5%).

Example 9. (i) The facts are the same as in *Example 8*, except the plan offers a single-sum distribution payable at normal retirement age (age 65) determined based on the applicable interest rates and the applicable mortality table under section 417(e)(3). The actuary assumes that 70% of the participants will elect a single sum upon retirement and the remaining 30% will elect a straight life annuity.

(ii) Before taking into account the 5% probability of withdrawal or the 70% probability of electing a single-sum payment, the portion of the 2009 funding target that is attributable to Participant E's assumed single-sum payment, deferred to age 65, is $70,052.30. This is calculated in the same manner as the present value of annuity payments, except that, for the period after the annuity starting date, the 2009 applicable mortality rates are substituted for the 2009 male annuitant mortality rates. This portion of the funding target for the 2009 plan year is equal to the sum of: $6,929.00, which is the present value of annuity payments expected to be made between age 65 and 66 (during the 20th year after the valuation date), using the second segment interest rate of 6.09%; and $63,123.30, which is the present value of annuity payments expected to be made after the 20th year following the valuation date, using the third segment interest rate of 6.56%. These present value amounts reflect the 2009 male nonannuitant mortality rates prior to the assumed commencement of benefits at age 65 and the 100% probability of retiring at age 65.

(iii) Taking the 5% probability of withdrawal and the 70% probability of electing a single-sum payment into account, the portion of the 2009 funding target attributable to Participant E's assumed single-sum payment based on withdrawal at age 50 is

$2,451.83 ($70,052.30 × 5% × 70%). After taking into account the 5% probability of withdrawal and the 30% probability of electing a straight life annuity, the portion of the 2009 funding target that is attributable to Participant E's assumed straight life annuity (based on assumed withdrawal at age 50), deferred to age 65, is equal to 30% of the result obtained in *Example 8*.

Example 10. (i) The facts are the same as in *Example 9*, except the plan offers an immediate single sum upon withdrawal at age 50 determined based on the applicable interest rates and the applicable mortality table under section 417(e)(3). The actuary assumes that 70% of the participants will elect to receive a single-sum distribution upon withdrawal.

(ii) Before taking into account the 5% probability of withdrawal and the 70% probability of electing a single-sum payment, the portion of the funding target for the 2009 plan year that is attributable to Participant E's assumed single-sum payment based on withdrawal at age 50 is $68,908.39. This is calculated in the same manner as the present value of annuity payments, except that the 2009 applicable mortality rates are substituted for the 2009 male annuitant and non-annuitant mortality rates after the annuity starting date. This portion of the 2009 funding target is equal to the sum of $6,815.85, which is the present value of annuity payments expected to be made between age 65 and 66 (during the 20th year after the valuation date), using the second segment interest rate of 6.09%, and $62,092.54, which is the present value of annuity payments expected to be made after the 20th year following the valuation date, using the third segment interest rate of 6.56%. These present value amounts reflect the 2009 male nonannuitant mortality rates prior to the assumed single-sum distribution age of 50.

(iii) Applying the 5% probability of withdrawal at age 50 and the 70% probability of electing a single-sum payment, the portion of the funding target for the 2009 plan year that is attributable to Participant E's assumed single-sum payment (based on withdrawal at age 50) is $2,411.79 ($68,908.39 × 5% × 70%).

Example 11. (i) The facts are the same as in *Example 8*, except that the plan sponsor elects under section 430(h)(2)(D)(ii) to use the monthly corporate bond yield curve instead of segment rates. The enrolled actuary assumes payments are made monthly throughout the year and uses the interest rate from the middle of the monthly corporate bond yield curve because this mid-year yield rate most closely matches the average timing of benefits paid. In accordance with § 1.430(h)(2)–1(e)(4), the applicable monthly corporate bond yield curve is the yield curve derived from December 2008 rates.

(ii) Before taking into account the 5% probability of withdrawal, the funding target associated with Participant E's assumed age 50 withdrawal benefit in the 2009 actuarial valuation is $67,394.12. This reflects the sum of each year's expected payments, discounted at the yield rates described in paragraph (i) of this *Example 11*, as shown below:

Age	Maturity	Yield rate	Present value
65	19.5	6.97%	$5,897.88
66	20.5	6.90%	5,524.69
67	21.5	6.84%	5,164.63
68 and over	Varies	Varies	50,806.92
Total			67,394.12

(iii) Applying the 5% probability of withdrawal, the portion of the funding target for the 2009 plan year attributable to Participant E's assumed withdrawal at age 50 is $3,369.71 ($67,394.12 × 5%).

Example 12. (i) The facts are the same as in *Example 10*, except that the plan determines the amount of the immediate single-sum distribution upon withdrawal at age 50 based on the applicable interest rates under section 417(e)(3) or an interest rate of 6.25%, whichever produces the higher amount. The applicable mortality table under section 417(e)(3) is used for both calculations.

(ii) Before taking into account the 5% probability of withdrawal and the 70% probability of electing a single-sum payment, the present value of Participant E's single-sum distribution as of January 1, 2009, using an interest rate of 6.25%, based on withdrawal at age 50, is $77,391.88. This amount is determined by calculating the projected single-sum distribution at age 50 using the applicable mortality rate under section 417(e)(3) and an interest rate of 6.25%, or $94,789.10, and discounting the result to the January 1, 2009, valuation date using the first segment rate of 5.07% (because the single-sum distribution is assumed to be paid 4 years after the valuation date) and the male non-annuitant mortality rates for 2009.

(iii) Before taking into account the 5% probability of withdrawal and the 70% probability of electing a single-sum payment, the present value as of January 1, 2009, of Participant E's age-50 single-sum distribution using the applicable interest rates and applicable mortality table under section 417(e)(3)

is $68,908.39, as developed in *Example 10*. Corresponding to plan provisions, the present value reflected in the funding target is the larger of this amount or the present value of the amount based on a 6.25% interest rate, or $77,391.88.

(iv) Applying the 5% probability of withdrawal at age 50 and the 70% probability of electing a single-sum payment, the portion of the funding target for the 2009 plan year that is attributable to Participant E's assumed single-sum payment (based on withdrawal at age 50) is $2,708.72 ($77,391.88 × 5% × 70%).

Example 13. (i) Plan Q is a cash balance plan that permits an immediate payment of a single sum equal to the participant's hypothetical account balance upon termination of employment. Plan Q's terms provide that the hypothetical account is credited with interest at a market-related rate, based on a specified index. The January 1, 2009, actuarial valuation is performed using the 24-month average segment rates applicable for September 2008 (determined without regard to the transition rule of section 430(h)(2)(G)). Participant F is a male age 61 on January 1, 2009, and has a hypothetical account balance equal to $150,000 on that date. In the 2009 actuarial valuation, the enrolled actuary assumes that the hypothetical account balances will increase with annual interest credits of 7% until the participant commences receiving his or her benefit, corresponding to the actuary's best estimate of future interest rates credited under the terms of the plan. The actuary also assumes that all participants will retire on the first day of the plan year in which they attain age 65 (that is, no participant will terminate employment prior to age 65 other than by death), and that 100% of participants will elect a single sum upon retirement.

(ii) Participant F's hypothetical account balance projected to January 1, 2013 (the plan year in which F attains age 65) is $196,619.40 based on the assumed annual interest crediting rate of 7%. The funding target for the 2009 plan year attributable to Participant F's benefit at age 65 is $158,525.81, which is calculated by discounting the projected hypothetical account balance of $196,619.40 using the first segment rate of 5.07% and the male non-annuitant mortality rates.

Example 14. (i) The facts are the same as in *Example 13*, except that the actuary assumes that 10% of the participants will choose to collect their benefits in the form of a straight life annuity. The plan provides that the participant's account balance at retirement is converted to an annuity using the applicable interest rates and applicable mortality table under section 417(e)(3).

(ii) Participant F's hypothetical account balance projected to January 1, 2013 (the plan year in which F attains age 65) is $196,619.40, as outlined in *Example 13*. This amount is converted to an annuity payable commencing at age 65 by dividing the projected account balance by an annuity factor based on the applicable mortality table for 2009 under section 417(e)(3) (corresponding to the valuation date) and the interest rates used for the valuation. The resulting annuity factor is 10.8321, reflecting one year of interest at the first segment rate (5.07%) corresponding to the first year of the expected annuity payments (the fifth year after the valuation date), 15 years of interest at the second segment rate (6.09%) and all remaining years at the third segment rate (6.56%). The projected future annuity is therefore $196,619.40 divided by 10.8321, or $18,151.55 per year.

(iii) Before taking into account the 10% probability that the participant will elect to take the distribution in the form of a lifetime annuity, the funding target associated with the future annuity payout for Participant F is $149,120.41. This is equal to the sum of $14,242.79, which is the present value of the annuity payment expected to made during the year the participant turns age 65 (the 5th year after the valuation date), using the first segment interest rate of 5.07%; $116,321.72, which is the present value of payments expected to be made during the 6th through the 20th years following the valuation date, using the second segment interest rate of 6.09%; and $18,555.90, which is the present value of payments expected to be made after the 20th year following the valuation date, using the third segment interest rate of 6.56%.

(iv) Applying the 10% probability of electing a lifetime annuity, the portion of the 2009 funding target attributable to Participant F's assumed lifetime annuity payable at age 65 is $14,912.04. The portion of the 2009 funding target attributable to Participant F's assumed single-sum payment is 90% of the result obtained in *Example 13*.

Example 15. (i) Plan H provides a monthly benefit of $50 times service for all participants. Plan H has a funding target of $1,000,000 and an actuarial value of assets of $810,000 as of January 1, 2010. No annuity contracts have been purchased, and Plan H has no funding standard carryover balance or prefunding balance as of January 1, 2010. The enrolled actuary certifies that the January 1, 2010, AFTAP is 81%. Effective July 1, 2010, Plan H is amended on June 14, 2010, to increase the plan's monthly benefit to $55 for years of service earned on or after July 1, 2010. The present value of the increase in plan benefits during 2010 (reflecting benefit accruals attributable to the six months between July 1, 2010, and December 31, 2010) is $25,000.

(ii) The amendment increases benefits for future service only, and so the funding target is unaffected. Since section 436(c) only

restricts plan amendments that increase plan liabilities, the plan amendment can take effect.

(iii) If the $25,000 present value of the increase in plan benefits during 2010 were included in Plan H's funding target of $1,000,000, the total would be $1,025,000, and the AFTAP would be 79.02% (that is, $810,000/$1,025,000). Since this is less than 80%, the amendment would not have been permitted to take effect if the 2010 increase were included in the funding target instead of target normal cost.

(iv) Because the amendment was adopted after the January 1, 2010, valuation date, the plan sponsor would generally have the option of deciding whether to reflect this amendment in the January 1, 2010, valuation or defer recognition of the amendment to the January 1, 2011, valuation. However, under paragraph (d)(2) of this section, because the plan amendment would not have been permitted to take effect under the provisions of section 436 if the increase in the target normal cost for the plan year had been taken into account in the funding target, the actuary must take into account the amendment in the January 1, 2010, valuation for purposes of section 430. Thus, the target normal cost for the plan year includes the $25,000 that results from the plan amendment.

(g) *Effective/applicability dates and transition rules*—(1) *Statutory effective date/applicability date*—(i) *In general*. Section 430 generally applies to plan years beginning on or after January 1, 2008. The applicability of section 430 for purposes of determining the minimum required contribution is delayed for certain plans in accordance with sections 104 through 106 of PPA '06.

(ii) *Applicability of special adjustments*. The special adjustments of paragraph (b)(1)(iii) of this section (relating to adjustments to the target normal cost for plan-related expenses and mandatory employee contributions) apply to plan years beginning after December 31, 2008. In addition, a plan sponsor may elect to make the special adjustments of paragraph (b)(1)(iii) of this section for a plan year beginning in 2008. This election must take into account both adjustments described in paragraph (b)(1)(iii) of this section. This election is subject to the same rules that apply to an election to add an amount to the plan's prefunding balance pursuant to §1.430(f)–1(f), and it must be made in the same manner as the election made under §1.430(f)–1(f). Thus, the election can be made no later than the last day for making the minimum required contribution for the plan year to which the election relates.

(2) *Effective date/applicability date of regulations*. This section applies to plan years beginning on or after January 1, 2010, regardless of whether section 430 applies to determine the minimum required contribution for the plan year. For plan years beginning before January 1, 2010, plans are permitted to rely on the provisions set forth in this section for purposes of satisfying the requirements of section 430.

(3) *Approval for changes in funding method*—(i) *2008 plan year*. Any changes in a plan's funding method that are made for the first plan year beginning in 2008 that are not inconsistent with the requirements of section 430 are treated as having been approved by the Commissioner and do not require the Commissioner's specific prior approval.

(ii) *Application of this section*—(A) *First plan year for which regulations are effective*. Except as otherwise provided in paragraph (g)(3)(ii)(B) of this section, any change in a plan's funding method for the first plan year that begins on or after January 1, 2010, is treated as having been approved by the Commissioner and does not require the Commissioner's specific prior approval.

(B) *Optional earlier application of regulations*. For the first plan year that a plan applies all the provisions of this section, §§1.430(f)–1, 1.430(g)–1, 1.430(i)–1, and 1.436–1, any change in a plan's funding method for that plan year is treated as having been approved by the Commissioner and does not require the Commissioner's specific prior approval. For example, if the change in funding method includes a change in the valuation software, the change in the valuation software is treated as having been approved by the Commissioner and does not require the Commissioner's specific prior approval. If that plan year begins before January 1, 2010, the automatic approval for a change in funding method under paragraph (g)(3)(ii)(A) of this section does not apply to the plan.

(C) *Special rule for changes in allocation*. Any change in a plan's funding method for a plan year earlier than the first plan year beginning on or after January 1, 2010, that is necessary to

apply the rules of paragraph (c)(1)(ii) of this section is treated as having been approved by the Commissioner and does not require the Commissioner's specific prior approval.

(iii) *First plan year for which section 430 applies to determine minimum funding.* For a plan for which the minimum required contribution is not determined under section 430 for the first plan year that begins on or after January 1, 2008, pursuant to sections 104 through 106 of PPA '06, any change in a plan's funding method for the first plan year to which section 430 applies to determine the plan's minimum required contribution is treated as having been approved by the Commissioner and does not require the Commissioner's specific prior approval.

(4) *Approval for changes in actuarial assumptions.* The Commissioner's specific prior approval is not required with respect to any actuarial assumptions that are adopted for the first plan year for which section 430 applies to determine the minimum required contribution for the plan and that are not inconsistent with the requirements of section 430.

(5) *Transition rule for determining funding target attainment percentage for the 2007 plan year*—(i) *In general.* For purposes of the first plan year beginning on or after January 1, 2008, the funding target attainment percentage for the plan's prior plan year (the 2007 plan year) is determined as the fraction (expressed as a percentage), the numerator of which is the value of plan assets determined under paragraph (g)(5)(ii) of this section, and the denominator of which is the plan's current liability determined pursuant to section 412(l)(7) (as in effect prior to amendment by PPA '06) as of the valuation date for the 2007 plan year.

(ii) *Determination of value of plan assets*—(A) *In general.* The value of plan assets for the 2007 plan year under this paragraph (g)(5)(ii)(A) is determined as the value of plan assets as described in paragraph (g)(5)(ii)(B) of this section, reduced by the plan's funding standard account credit balance for the 2007 plan year as described in paragraph (g)(5)(iii)(A) of this section except to the extent provided in paragraph (g)(5)(iii)(B) of this section.

(B) *Value of plan assets.* The value of plan assets for the 2007 plan year under this paragraph (g)(5)(ii)(B) is determined under section 412(c)(2) as in effect for the 2007 plan year, except that the value of plan assets prior to subtracting the plan's funding standard account credit balance described in paragraph (g)(5)(iii)(A) of this section must be adjusted so that it is neither less than 90 percent of the fair market value of plan assets nor greater than 110 percent of the fair market value of plan assets on the valuation date for that plan year. If the value of plan assets prior to adjustment under this paragraph (g)(5)(ii)(B) is less than 90 percent of the fair market value of plan assets on the valuation date, then the value of plan assets under this paragraph (g)(5)(ii)(B) is equal to 90 percent of the fair market value of plan assets. If the value of plan assets determined under this paragraph (g)(5)(ii)(B) is greater than 110 percent of the fair market value of plan assets on the valuation date, then the value of plan assets under this paragraph (g)(5)(ii)(B) is equal to 110 percent of the fair market value of plan assets.

(iii) *Subtraction of credit balance*—(A) *In general.* If a plan has a funding standard account credit balance as of the valuation date for the 2007 plan year, then, except as described in paragraph (g)(5)(iii)(B) of this section, that balance is subtracted from the value of plan assets described in paragraph (g)(5)(ii)(B) of this section as of that valuation date to determine the value of plan assets for the 2007 plan year. However, the value of plan assets is not reduced below zero.

(B) *Effect of funding standard carryover balance reduction for the 2008 plan year.* Notwithstanding the rules of paragraph (g)(5)(iii)(A) of this section, for the first plan year beginning in 2008, if the employer has made an election to reduce some or all of the funding standard carryover balance as of the first day of that year in accordance with §1.430(f)–1(e), then the present value (determined as of the valuation date for the 2007 plan year using the valuation interest rate for that 2007 plan year) of the amount so reduced is not treated as part of the funding standard account credit balance when

that balance is subtracted from the value of plan assets pursuant to paragraph (g)(5)(iii)(A) of this section.

[T.D. 9467, 74 FR 53035, Oct. 15, 2009]

§ 1.430(f)–1 Effect of prefunding balance and funding standard carryover balance.

(a) *In general*—(1) *Overview*. This section provides rules relating to the application of prefunding and funding standard carryover balances under section 430(f). Section 430 and this section apply to single employer defined benefit plans (including multiple employer plans) that are subject to section 412, but do not apply to multiemployer plans (as defined in section 414(f)). Paragraph (b) of this section sets forth rules regarding a plan's prefunding balance and a plan sponsor's election to maintain a funding standard carryover balance. Paragraph (c) of this section provides rules under which those balances must be subtracted from plan assets. Paragraph (d) of this section describes a plan sponsor's election to use those balances to offset the minimum required contribution. Paragraph (e) of this section describes a plan sponsor's election to reduce those balances (which will affect the determination of the value of plan assets for purposes of sections 430 and 436). Paragraph (f) of this section sets forth rules regarding elections under this section. Paragraph (g) of this section contains examples. Paragraph (h) of this section contains effective/applicability dates and transition rules.

(2) *Special rules for multiple employer plans*. In the case of a multiple employer plan to which section 413(c)(4)(A) applies, the rules of this section are applied separately for each employer under the plan, as if each employer maintained a separate plan. Thus, each employer under such a multiple employer plan may have a separate funding standard carryover balance and a prefunding balance for the plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), the rules of this section are applied as if all participants in the plan were employed by a single employer.

(b) *Maintenance of balances*—(1) *Prefunding balance*—(i) *In general*. A plan sponsor is permitted to elect to maintain a prefunding balance for a plan. A prefunding balance maintained for a plan consists of a beginning balance of zero, increased by the amount of excess contributions to the extent the employer elects to do so as described in paragraph (b)(1)(ii) of this section, and decreased to the extent provided in paragraph (b)(1)(iii) of this section. The plan sponsor's initial election to add to the prefunding balance under paragraph (b)(1)(ii) of this section constitutes an election to maintain a prefunding balance. The prefunding balance is adjusted further for investment return and interest as provided in paragraphs (b)(3) and (b)(4) of this section.

(ii) *Increases*—(A) *In general*. If the plan sponsor of a plan elects to add to the plan's prefunding balance, as of the first day of a plan year following the first effective plan year for the plan, the prefunding balance is increased by the amount so elected by the plan sponsor for the plan year. The amount added to the prefunding balance cannot exceed the present value of the excess contributions for the preceding plan year determined under paragraph (b)(1)(ii)(B) of this section, increased for interest in accordance with paragraph (b)(1)(iv)(A) of this section.

(B) *Present value of excess contribution*. The present value of the excess contribution for the preceding plan year is the excess, if any, of—

(*1*) The present value (determined under the rules of paragraph (b)(1)(iv)(B) of this section) of the employer contributions (other than contributions to avoid or terminate benefit limitations described in § 1.436–1(f)(2)) to the plan for such preceding plan year; over

(*2*) The minimum required contribution for such preceding plan year.

(C) *Treatment of unpaid minimum required contributions*. For purposes of this paragraph (b)(1)(ii), a contribution made during a plan year to correct an unpaid minimum required contribution (within the meaning of section 4971(c)(4)) for a prior plan year is not

treated as a contribution for the current plan year.

(iii) *Decreases.* As of the first day of each plan year, the prefunding balance of a plan is decreased (but not below zero) by the sum of—

(A) Any amount of the prefunding balance that was used under paragraph (d) of this section to offset the minimum required contribution of the plan for the preceding plan year; and

(B) Any reduction in the prefunding balance under paragraph (e) of this section for the plan year.

(iv) *Adjustments for interest*—(A) *Adjustment of excess contribution.* The present value of the excess contribution for the preceding year (as determined under paragraph (b)(1)(ii)(B) of this section) is increased for interest accruing for the period between the valuation date for the preceding plan year and the first day of the current plan year. For this purpose, interest is determined by using the plan's effective interest rate under section 430(h)(2)(A) for the preceding plan year, except to the extent provided in paragraph (b)(3)(iii) of this section.

(B) *Determination of present value.* The present value of the contributions described in paragraph (b)(1)(ii)(B)(*1*) of this section is determined as of the valuation date for the preceding plan year, using the plan's effective interest rate under section 430(h)(2)(A) for the preceding plan year.

(2) *Funding standard carryover balance*—(i) *In general.* A funding standard carryover balance is automatically established for a plan that had a positive balance in the funding standard account under section 412(b) (as in effect prior to amendment by the Pension Protection Act of 2006 (PPA '06), Public Law 109–280 (120 Stat. 780)) as of the end of the pre-effective plan year for the plan. The funding standard carryover balance as of the beginning of the first effective plan year for the plan is the positive balance in the funding standard account under section 412(b) (as in effect prior to amendment by PPA '06) as of the end of the pre-effective plan year for the plan. After that date, the funding standard carryover balance is decreased to the extent provided in paragraph (b)(2)(ii) of this section and adjusted further for investment return and interest as provided in paragraphs (b)(3) and (b)(4) of this section.

(ii) *Decreases.* As of the first day of each plan year, the funding standard carryover balance of a plan is decreased (but not below zero) by the sum of—

(A) Any amount of the funding standard carryover balance that was used under paragraph (d) of this section to offset the minimum required contribution of the plan for the preceding plan year; and

(B) Any reduction in the funding standard carryover balance under paragraph (e) of this section for the plan year.

(3) *Adjustments for investment experience*—(i) *In general.* A plan's prefunding balance under paragraph (b)(1) of this section and a plan's funding standard carryover balance under paragraph (b)(2) of this section as of the first day of a plan year must be adjusted to reflect the actual rate of return on plan assets for the preceding plan year. For this purpose, the actual rate of return on plan assets for the preceding plan year is determined on the basis of fair market value and must take into account the amount and timing of all contributions, distributions, and other plan payments made during that period.

(ii) *Ordering rules for adjustments.* In general, the adjustment for actual rate of return on plan assets is applied to the balance after any reduction of prefunding and funding standard carryover balances for that preceding plan year under paragraph (e) of this section and after subtracting amounts used to offset the minimum required contribution for the preceding plan year pursuant to paragraph (d) of this section. However, see paragraph (d)(1)(ii)(D) of this section for a special ordering rule when adjusting for investment experience.

(iii) *Special rule for excess contributions attributable to use of funding balances.* Notwithstanding paragraph (b)(1)(iv)(A) of this section, to the extent that a contribution is included in the present value of excess contributions solely because the minimum required contribution has been offset under paragraph (d) of this section, the contribution is adjusted for investment

experience under the rules of this paragraph (b)(3).

(4) *Valuation date other than the first day of the plan year*—(i) *In general*. If a plan's valuation date is not the first day of the plan year, then, solely for purposes of applying paragraphs (c), (d), and (e) of this section, the plan's prefunding and funding standard carryover balances (if any) determined under this paragraph (b) are increased from the first day of the plan year to the valuation date using the plan's effective interest rate under section 430(h)(2)(A) for the plan year.

(ii) *Special rule for adjustments for investment experience*. In the case of a plan with a valuation date that is not the first day of the plan year, for purposes of applying the subtraction under paragraph (b)(3)(ii) of this section for amounts used to offset the minimum required contribution for the preceding plan year and the decreases under paragraphs (b)(1)(iii) and (b)(2)(ii) of this section, the amount of the prefunding balance or funding standard carryover balance that is used to offset the minimum required contribution under paragraph (d) of this section or reduced under paragraph (e) of this section is discounted from the valuation date to the first day of the plan year using the effective interest rate under section 430(h)(2)(A) for the plan year.

(5)*Special rule for quarterly contributions*. For purposes of applying a prefunding balance or funding standard carryover balance to required installments described in section 430(j)(3), the respective balances are increased from the beginning of the year to the date of the election (using the plan's effective interest rate for the plan year) to determine the amount available to offset the required quarterly installment. The amounts used to offset required quarterly installments are then discounted from that date to the first day of the plan year for purposes of the subtraction under paragraph (b)(3)(ii) of this section and the decreases under paragraphs (b)(1)(iii) and (b)(2)(ii) of this section, using the effective interest rate for the plan year. However, see paragraph (d)(1)(i)(B) of this section for a special rule regarding late quarterly installments when determining the amount that is used to offset the minimum required contribution for the plan year.

(c) *Effect of balances on the value of plan assets*—(1) *In general*. In the case of any plan with a prefunding balance or a funding standard carryover balance, the amount of those balances is subtracted from the value of plan assets for purposes of sections 430 and 436, except as otherwise provided in paragraphs (c)(2), (c)(3), and (d)(3) of this section and § 1.436–1(j)(1)(ii)(B).

(2) *Subtraction of balances in determining new shortfall amortization base*—(i) *Prefunding balance*. For purposes of determining whether a plan is exempt from the requirement to establish a new shortfall amortization base under section 430(c)(5), the amount of the prefunding balance is subtracted from the value of plan assets only if an election under paragraph (d) of this section to use the prefunding balance to offset the minimum required contribution is made for the plan year.

(ii) *Funding standard carryover balance*. For purposes of determining whether a plan is exempt from the requirement to establish a new shortfall amortization base under section 430(c)(5), the funding standard carryover balance is not subtracted from the value of plan assets regardless of whether any portion of either the funding standard carryover balance or the prefunding balance is used to offset the minimum required contribution for the plan year under paragraph (d) of this section.

(3) *Special rule for certain binding agreements with PBGC*. If there is in effect for a plan year a binding written agreement with the Pension Benefit Guaranty Corporation (PBGC) which provides that all or a portion of the prefunding balance or funding standard carryover balance (or both balances) is not available to offset the minimum required contribution for a plan year, that specified amount is not subtracted from the value of plan assets for purposes of determining the funding shortfall under section 430(c)(4). For example, if a plan has no prefunding balance and a $20 million funding standard carryover balance, a PBGC agreement provides that $5 million of a plan's funding standard carryover balance is unavailable to offset the minimum required

contribution for a plan year, and the plan's assets are $100 million, then the value of plan assets for purposes of determining the funding shortfall under section 430(c)(4) is reduced by $15 million ($20 million less $5 million) to $85 million. For purposes of this paragraph (c)(3), an agreement with the PBGC is taken into account with respect to a plan year only if the agreement was executed prior to the valuation date for the plan year.

(d) *Election to apply balances against minimum required contribution*—(1) *In general*—(i) *Amount of offset to minimum required contribution*—(A) *Effect of use of balances*. Subject to the limitations provided in this paragraph (d), in the case of any plan year with respect to which the plan sponsor elects to use all or a portion of the prefunding balance or the funding standard carryover balance to offset the minimum required contribution for the plan year, the minimum required contribution for the plan year (determined after taking into account any waiver under section 412(c)) is offset as of the valuation date for the plan year by the amount so used.

(B) *Special rule for late election with respect to quarterly contributions*. Notwithstanding paragraph (d)(1)(i)(A) of this section, if the plan sponsor elects to use all or a portion of the prefunding balance or the funding standard carryover balance to satisfy a required installment under section 430(j)(3), the amount used to offset the minimum required contribution for the plan year is the portion of the balance so used, adjusted in accordance with the rules of paragraph (b)(5) of this section, unless the date of the election is after the due date of the required installment. If the election to use all or a portion of the prefunding balance or the funding standard carryover balance to satisfy the required installments under section 430(j)(3) is made after the due date for the required installment, then the amount used to offset the minimum required contribution for the plan year is the portion of the balance so used, discounted from the date of the election to the due date of the required installment at the effective interest rate plus 5 percentage points, and then further adjusted from the installment due date to the valuation date at the effective interest rate. For example, if a quarterly installment of $20,250 is due on April 15 for a calendar year plan with a valuation date on January 1 and an effective interest rate of 6 percent, and the installment is satisfied by an election to apply the funding standard carryover balance that is made on July 1 (2½; months after the April 15 due date), then the amount used to offset the minimum required contribution under this paragraph (d)(1)(i) is $19,481 (that is, $20,250 ÷ $1.11^{(2.5/12)}$ ÷ $1.06^{(3.5/12)}$). However, the amount by which the funding standard carryover balance is reduced under paragraph (b)(2)(ii) of this section is $19,669 (that is, $20,250 ÷ $1.06^{(6/12)}$).

(ii) *Maximum amount of available balances and coordination of elections*—(A) *General requirement to follow chronology*. In general, the amount of prefunding and funding standard carryover balances that may be used to offset the minimum required contribution for a plan year must take into account any decrease in those balances which results from a prior election either to use the prefunding balance or funding standard carryover balance under section 430(f)(3) and this paragraph (d) or to reduce those balances under section 430(f)(5) and paragraph (e) of this section (including deemed elections under section 436(f)(3) and § 1.436–1(a)(5)). For example, for a calendar plan year with a January 1 valuation date, a deemed election under section 436(f)(3) and § 1.436–1(a)(5) on April 1, 2010 (the first day of the 4th month of the plan year) will reduce the available prefunding balance or funding standard carryover balance that can be used with respect to an election made after April 1, 2010.

(B) *Exception to chronological rule*. Notwithstanding the general rule of paragraph (d)(1)(ii)(A) of this section, all elections under section 430(f)(5) and paragraph (e) of this section to reduce the prefunding balance or funding standard carryover balance for the current plan year (including deemed elections under section 436(f)(3) and § 1.436–1(a)(5)) are deemed to occur on the valuation date for the plan year and before any election under section 430(f)(3) and this paragraph (d) to offset the minimum required contribution for

the current plan year. Accordingly, if an election to use the prefunding balance or funding standard carryover balance to offset the minimum required contribution for the plan year (including an election to satisfy the quarterly contribution requirement) has been made prior to the election to reduce the prefunding balance or funding standard carryover balance, then the amount available for use to offset the otherwise applicable minimum required contribution for the plan year under this paragraph (d) will be retroactively reduced. However, an election to reduce a prefunding balance or funding standard carryover balance for a plan year does not affect a prior election to use a prefunding balance or funding standard carryover balance to offset a minimum required contribution for a prior plan year.

(C) *Investment experience.* In addition to reflecting any decrease in the prefunding balance or the funding standard carryover balance which results from a prior election for the previous year either to use the prefunding balance or funding standard carryover balance under section 430(f)(3) and this paragraph (d) to offset the minimum required contribution for such prior plan year or to reduce those balances under section 430(f)(5) and paragraph (e) of this section (including deemed elections under section 436(f)(3) and §1.436–1(a)(5)), the prior plan year's prefunding and funding standard carryover balances must be adjusted under the rules of paragraph (b)(3) of this section for investment experience for that prior plan year before determining the amount of those balances available for such an election for the current plan year.

(D) *Special rule for current year elections that are made before prior year elections.* This paragraph (d)(1)(ii)(D) sets forth a special rule that applies if, for the current plan year, a plan sponsor makes an election under this paragraph (d) or paragraph (e) of this section (including a deemed election under section 436(f)(3) and §1.436–1(a)(5)), and then subsequently makes an election under this paragraph (d) to offset the minimum required contribution for the prior plan year. This special rule applies solely for purposes of determining the amount of prefunding and funding standard carryover balances available for that subsequent election. Under this special rule, in lieu of decreasing the funding standard carryover balance or prefunding balance as of the valuation date for the current year to take into account the current year election, the funding standard carryover balance or prefunding balance as of the valuation date for the prior plan year is decreased by the amount of the prior year equivalent of the current year election. The prior year equivalent of the current year election is determined by dividing the amount of the current year election (as of the first day of the current plan year) by a number equal to 1 plus the rate of investment return for the prior plan year determined under paragraph (b)(3) of this section. If this paragraph (d)(1)(ii)(D) applies for a plan year, then the funding standard carryover balance and prefunding balance are nonetheless adjusted in accordance with the rules of paragraph (b) of this section, after the application of the rules of this paragraph (d)(1)(ii)(D). Thus, the amount used to offset the minimum required contribution for the earlier plan year is subtracted from the prefunding balance or funding standard carryover balance as of the valuation date for that year prior to the adjustment for investment return under paragraph (b)(3) of this section for that plan year, and the amount by which the prefunding balance or funding standard carryover balance is decreased for the second year is based on the elections made for the second year.

(2) *Requirement to use funding standard carryover balance before prefunding balance.* To the extent that a plan has a funding standard carryover balance greater than zero, no amount of the plan's prefunding balance may be used to offset the minimum required contribution. Thus, a plan's funding standard carryover balance must be exhausted before the plan's prefunding balance may be applied under paragraph (d)(1) of this section to offset the minimum required contribution.

(3) *Limitation for underfunded plans*—(i) *In general.* An election to use the prefunding balance or funding standard

carryover balance to offset the minimum required contribution under this paragraph (d) is not available for a plan year if the plan's prior plan year funding ratio is less than 80 percent. For purposes of this paragraph (d)(3), except as otherwise provided in this paragraph (d)(3) or paragraph (h)(3) of this section, the plan's prior plan year funding ratio is the fraction (expressed as a percentage)—

(A) The numerator of which is the value of plan assets on the valuation date for the preceding plan year, reduced by the amount of any prefunding balance (but not the amount of any funding standard carryover balance); and

(B) The denominator of which is the funding target of the plan for the preceding plan year (determined without regard to the at-risk rules of section 430(i)(1)).

(ii) *Special rule for second year of a new plan with no past service.* In the case of a new plan that was neither the result of a merger nor involved in a spinoff, if the prior plan year was the first year of the plan and the funding target for the prior plan year was zero, then the plan's prior plan year funding ratio is deemed to be 80 percent for purposes of this paragraph (d)(3).

(iii) *Special rule for plans that are the result of a merger.* [Reserved]

(iv) *Special rules for plans that are involved in a spinoff.* [Reserved]

(e) *Election to reduce balances*—(1) *In general.* A plan sponsor may make an election for a plan year to reduce any portion of a plan's prefunding and funding standard carryover balances under this paragraph (e). If such an election is made, the amount of those balances that must be subtracted from the value of plan assets pursuant to paragraph (c)(1) of this section will be smaller and, accordingly, the value of plan assets taken into account for purposes of sections 430 and 436 will be larger. Thus, this election to reduce a plan's prefunding and funding standard carryover balances is taken into account in the determination of the value of plan assets for the plan year and applies for all purposes under sections 430 and 436, including for purposes of determining the plan's prior plan year funding ratio under paragraph (d)(3) of this section for the following plan year. *See also* section 436(f)(3) and §1.436–1(a)(5) for a rule under which the plan sponsor is deemed to make the election described in this paragraph (e). The rules of paragraph (d)(1)(ii) of this section also apply for purposes of determining the maximum amount of prefunding balance or funding standard carryover balance that is available for an election under this paragraph (e).

(2) *Requirement to reduce funding standard carryover balance before prefunding balance.* To the extent that a plan has a funding standard carryover balance greater than zero, no election under paragraph (e)(1) of this section is permitted to be made that reduces the plan's prefunding balance. Thus, a plan must exhaust its funding standard carryover balance before it is permitted to make an election under paragraph (e)(1) of this section with respect to its prefunding balance.

(f) *Elections*—(1) *Method of making elections*—(i) *In general.* Any election under this section by the plan sponsor must be made by providing written notification of the election to the plan's enrolled actuary and the plan administrator. The written notification must set forth the relevant details of the election, including the specific dollar amount involved in the election (except as provided in this paragraph (f)(1). Thus, except as provided in this paragraph (f)(1), a conditional or formula-based election generally does not satisfy the requirements of this paragraph (f).

(ii) *Standing elections to increase or use balances.* A plan sponsor may provide a standing election in writing to the plan's enrolled actuary to use the funding standard carryover balance and the prefunding balance to offset the minimum required contribution for the plan year to the extent needed to avoid an unpaid minimum required contribution under section 4971(c)(4) taking into account any contributions that are or are not made. In addition, a plan sponsor may provide a standing election in writing to the plan's enrolled actuary to add the maximum amount possible each year to the prefunding balance. Any election made pursuant to a standing election under this paragraph (f)(1)(ii) is deemed to occur on the last

day available to make the election for the plan year as provided under paragraph (f)(2)(i) of this section. Any standing election under this paragraph (f)(1)(ii) remains in effect for the plan with respect to the enrolled actuary named in the election, unless—

(A) The standing election is revoked under the rules of paragraph (f)(3) of this section; or

(B) The enrolled actuary who signs the actuarial report under section 6059 (Schedule SB, ''Single-Employer Defined Benefit Plan Actuarial Information'' of Form 5500, ''Annual Return/Report of Employee Benefit Plan'') for the plan for the plan year is not the enrolled actuary named in the standing election.

(iii) *Standing election to satisfy installments through use of funding balances*—(A) *In general.* A plan sponsor may provide a standing election in writing to the plan's enrolled actuary to use (to the extent available) the funding standard carryover balance and the prefunding balance to satisfy any otherwise unpaid portion of a required installment under section 430(j)(3). Any use pursuant to a standing election under this paragraph (f)(1)(iii) is deemed to occur on the later of the last date for making the required installment and the date the standing election is provided to the enrolled actuary.

(B) *Otherwise unpaid portion of a required installment.* For purposes of paragraph (f)(1)(iii)(A) of this section, the otherwise unpaid portion of a required installment equals the amount necessary to satisfy the required installment rules under section 430(j) based on the installment amounts determined as if the required annual payment were the amount described in §1.430(j)–1(c)(5)(ii)(B). Thus, the amount of the prefunding and funding standard carryover balances used under a standing election is the amount that is needed to satisfy an installment in the amount of 25 percent of the minimum required contribution for the prior plan year, plus installments in that amount with respect to all earlier required installment due dates for the plan year, taking into account prior contributions for the plan year and prior elections to use the funding standard carryover balance and prefunding balance for the plan year.

(C) *Duration of standing election.* Generally, any standing election under this paragraph (f)(1)(iii) remains in effect for the plan with respect to the enrolled actuary named in the election, unless either of the events described in paragraph (f)(1)(ii)(A) or (B) of this section occurs with respect to the standing election. However, a plan sponsor may suspend application of a standing election for the remaining installments with respect to a plan year by providing, in writing to the plan's enrolled actuary, notice that the standing election is not to apply for the remainder of the plan year. In addition, once the current year's minimum required contribution has been determined, a plan sponsor may modify application of a standing election for the remaining installments with respect to a plan year by providing, in writing to the plan's enrolled actuary, a replacement formula election to use the funding standard carryover balance and prefunding balance (to the extent available) so that the otherwise unpaid portions of the remaining required installments satisfy the required installment rules under section 430(j), taking into account the determination of the current year's minimum required contribution pursuant to §1.430(j)–1(c)(5)(ii)(A), prior contributions for the plan year and prior elections to use the prefunding and funding standard carryover balances.

(2) *Timing of elections*—(i) *General rule.* Except as otherwise provided in paragraph (f)(2)(ii) or (iii) of this section, any election under this section with respect to a plan year must be made no later than the last date for making the minimum required contribution for the plan year as described in section 430(j)(1), or such later date as prescribed in guidance published in the Internal Revenue Bulletin. For this purpose, an election to add to the prefunding balance relates to the plan year for which excess contributions were made. For example, an election to add to the prefunding balance as of the first day of the plan year that begins on January 1, 2010 (in an amount not in excess of the present value of the excess contribution as of the valuation

date in 2009, adjusted for interest under the rules of paragraph (b)(1)(ii) of this section), must be made no later than September 15, 2010, even though the election is reported on the 2010 Schedule SB of Form 5500, which is not due until 2011. Except for the standing elections covered by paragraph (f)(1)(ii) of this section, an election under this section may not be made prior to the first day of the plan year to which the election relates.

(ii) *Special rule for standing election revoked by a change in enrolled actuary.* If there is a change in enrolled actuary for the plan year which would result in a revocation of the standing election under the rule of paragraph (f)(1)(ii)(B) of this section, then the plan sponsor may reinstate the revoked standing election by providing a replacement to the new enrolled actuary by the due date of the Schedule SB of Form 5500.

(iii) *Election to reduce balances.* Any election under paragraph (e) of this section to reduce the prefunding balance or funding standard carryover balance for a plan year (for example, in order to avoid or terminate a benefit restriction under section 436) must be made by the end of the plan year to which the election relates.

(iv) *Earlier elections.* This paragraph (f)(2) sets forth the latest date that an election can be made. A plan sponsor is permitted to make an earlier election, and in certain circumstances may need to make such an election in order to timely satisfy a quarterly contribution requirement under section 430(j)(3).

(3) *Irrevocability of elections*—(i) *In general.* Except as otherwise provided in this paragraph (f)(3) or in guidance published in the Internal Revenue Bulletin, a plan sponsor's election under this section with respect to the plan's prefunding balance or funding standard carryover balance is irrevocable (and must be unconditional). A standing election by the plan sponsor may be revoked by providing written notification of the revocation to the plan's enrolled actuary and the plan administrator on or before the date the corresponding election is deemed to occur pursuant to paragraph (f)(1)(ii) of this section.

(ii) *Exception for certain elections.* An election to use the prefunding balance or funding standard carryover balance to offset the minimum required contribution for a plan year (including an election to satisfy the quarterly contribution requirements for a plan year) is permitted to be revoked to the extent the amount the plan sponsor elected to use to offset the minimum contribution requirements (including an election used to satisfy the quarterly contribution requirements) exceeds the minimum required contribution for a plan year (determined without regard to the election under paragraph (d) of this section) if and only if the election is revoked by providing written notification of the revocation to the plan's enrolled actuary and the plan administrator by the deadline set forth in paragraph (f)(3)(iii) of this section. If no such revocation is made, then, under paragraph (b) of this section, the funding standard carryover balance or prefunding balance is decreased by the entire amount that the plan sponsor elected to use to offset the minimum required contribution for a plan year (including an election to satisfy the quarterly contribution requirements for a plan year).

(iii) *Deadline for revoking election.* The deadline for revoking the election described in paragraph (f)(3)(ii) of this section is generally the end of the plan year. However, for plans with a valuation date other than the first day of the plan year, the deadline for the revocation is the deadline for contributions for the plan year as described in section 430(j)(1). In addition, for the first plan year beginning in 2008, the deadline for the revocation for all plans is deferred to the due date (including extensions) of the Schedule SB, ''Single-Employer Defined Benefit Plan Actuarial Information'' of Form 5500, ''Annual Return/Report of Employee Benefit Plan''.

(4) *Plan sponsor*—(i) *In general.* For purposes of the elections described in this section, except as otherwise provided in paragraph (f)(4)(ii) of this section, any reference to the plan sponsor means the employer or employers responsible for making contributions to or under the plan.

(ii) *Certain multiple employer plans.* For purposes of the elections described in this section, in the case of plans

that are multiple employer plans to which section 413(c)(4)(A) does not apply, any reference to the plan sponsor means the plan administrator within the meaning of section 414(g).

(g) *Examples.* The following examples illustrate the rules of this section:

Example 1. (i) Plan P is a defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. The funding standard carryover balance of Plan P is $25,000 and the prefunding balance is zero as of the beginning of the 2010 plan year. The sponsor of Plan P, Sponsor S, does not elect to use any portion of the balance to offset the minimum required contribution for 2010 pursuant to paragraph (d)(1) of this section, or to reduce any portion of the funding standard carryover balance prior to the determination of the value of plan assets for 2010, pursuant to paragraph (e)(1) of this section. The actual rate of return on Plan P's assets for 2010 is 2%. Plan P's effective interest rate for 2010 is 6%. The minimum required contribution for Plan P under section 430 for 2010 is $100,000, and no quarterly installments are required for Plan P for the 2010 plan year. As of January 1, 2010, the value of plan assets is $1,100,000 and the funding target is $1,000,000. Therefore, the prior plan year funding ratio for Plan P for 2010, as determined under paragraph (d)(3) of this section, is 110%.

(ii) Sponsor S makes a contribution to Plan P of $150,000 on December 1, 2010, for the 2010 plan year and makes no other contributions for the 2010 plan year. Because this contribution was made on a date other than the valuation date for the 2010 plan year, the contribution must be adjusted to reflect interest that would otherwise have accrued between the valuation date and the date of the contribution, at the effective interest rate for the 2010 plan year. The amount of the contribution after adjustment is $142,198, determined as $150,000 discounted for 11 months of compound interest at an effective annual interest rate of 6%.

(iii) The excess of employer contributions for 2010 over the minimum required contribution for 2010, as of the valuation date, is $42,198 ($142,198 less $100,000). Accordingly, the increase in Plan P's prefunding balance as of January 1, 2011, cannot exceed $44,730 (which is the present value of the excess contribution of $42,198 adjusted for 12 months of interest at an effective interest rate of 6%).

(iv) Plan P's funding standard carryover balance as of January 1, 2011, is $25,500 (which is the funding standard carryover balance as of January 1, 2010, adjusted for investment experience during 2010 at a rate of 2%).

Example 2. (i) The facts are the same as in *Example 1*, except that the contribution of $150,000 is made on February 1, 2011, for the 2010 plan year.

(ii) The amount of the contribution after adjustment is $140,824, which is determined as $150,000 discounted for 13 months of interest at an effective interest rate of 6%. Accordingly, the increase in Plan P's prefunding balance as of January 1, 2011, cannot exceed $43,273 (which is the present value of the excess contribution of $40,824 adjusted for 12 months of interest at an effective interest rate of 6%).

(iii) Plan P's funding standard carryover balance as of January 1, 2011, is $25,500, as developed in *Example 1* of this section. If Sponsor S elects to increase the prefunding balance as of January 1, 2011, by the present value of the excess contribution adjusted for interest, or $43,273, the total of the funding standard carryover balance and prefunding balance as of January 1, 2011, is $68,773.

Example 3. (i) The facts are the same as in *Example 1*, except that Sponsor S contributes $90,539 to Plan P on February 1, 2011, for the 2010 plan year and makes no other contributions to Plan P for the 2010 plan year. In addition, on February 1, 2011, Sponsor S elects to use $15,000 of the funding standard carryover balance to offset P's minimum required contribution for 2010, pursuant to paragraph (d)(1) of this section. This is permitted because Plan P's prior-year funding ratio determined under paragraph (d)(3) of this section is 110%, and is therefore not less than 80%.

(ii) Because the contribution was made on a date other than the valuation date for the 2010 plan year, the contribution must be adjusted to reflect interest that would otherwise have accrued between the valuation date and the date of the contribution, at the effective interest rate for the 2010 plan year. The amount of the contribution after adjustment is $85,000, determined as $90,539 discounted for 13 months of compound interest at an effective interest rate of 6%. The adjusted contribution of $85,000 plus the $15,000 of the funding standard carryover balance used to offset the minimum required contribution equals the minimum required contribution for the 2010 plan year of $100,000. Therefore, no excess contributions are available to increase the prefunding balance, and the prefunding balance as of January 1, 2011, remains zero.

(iii) The funding standard carryover balance as of January 1, 2011, is adjusted for investment experience during the 2010 plan year, in accordance with paragraph (b)(3) of this section. The amount of the adjustment is $200, determined as the actual rate of return on plan assets for 2010 as applied to the 2010 funding standard carryover balance after reduction for the amount of that balance used under paragraph (d)(1) of this section (that is, $25,000 less $15,000, multiplied by the actual rate of return of 2%).

(iv) The funding standard carryover balance, as of January 1, 2011, is $10,200, determined as the 2010 funding standard carryover balance less the amount used to offset the 2010 minimum required contribution, adjusted for investment experience during the 2010 year ($25,000 less $15,000 plus $200).

Example 4. (i) The facts are the same as in *Example 3,* except that Sponsor S contributes $150,000 (instead of $90,539) to Plan P on February 1, 2011, for the 2010 plan year.

(ii) Because the contribution was made on a date other than the valuation date for the 2010 plan year, the contribution must be adjusted to reflect interest that would otherwise have accrued between the valuation date and the date of the contribution, at the effective interest rate for the 2010 plan year. The amount of the contribution after adjustment is $140,824, determined as $150,000 discounted for 13 months of interest at an effective interest rate of 6%.

(iii) Because Sponsor S elected to use $15,000 of the funding standard carryover balance to offset the minimum required contribution for 2010 of $100,000, the cash contribution requirement for 2010, adjusted with interest to January 1, 2010, is $85,000. The adjusted contribution of $140,824 exceeds this amount by $55,824. Of this amount, $15,000 exceeds the minimum required contribution only because of Sponsor S's election to use the funding standard carryover balance to offset the minimum required contribution as provided in paragraph (d)(1) of this section. The remaining $40,824 ($140,824 minus $100,000) results from cash contributions made in excess of the minimum required contribution before offset by the funding standard carryover balance.

(iv) The portion of the excess contribution resulting solely because the minimum required contribution was offset by a portion of the funding standard carryover balance is adjusted for investment experience during 2009, pursuant to paragraph (b)(3)(iii) of this section. Accordingly, this portion of the present value of the excess contribution adjusted for interest as of January 1, 2011, is $15,300 ($15,000 adjusted for investment experience during 2010 at a rate of 2%).

(v) The excess contribution resulting from cash contributions in excess of the minimum required contribution before offset by the funding standard carryover balance is adjusted for interest at the effective interest rate for 2010, pursuant to paragraph (b)(1)(iv)(A) of this section. Accordingly, this portion of the present value of the excess contribution adjusted for interest as of January 1, 2011, is $43,273 ($40,824 increased by the effective interest rate of 6%). The increase in Plan P's prefunding balance as of January 1, 2011, cannot exceed the total present value of the excess contribution adjusted for interest of $58, 573 ($15,300 plus $43,273).

(vi) The funding standard carryover balance as of January 1, 2011, is $10,200, determined as the 2010 funding standard carryover balance less the $15,000 used to offset the 2010 minimum required contribution, adjusted for investment experience during the 2010 plan year as developed in *Example 3* ($25,000 less $15,000 plus $200).

(vii) Sponsor S elects to increase the prefunding balance by the maximum amount of the present value of the excess contribution adjusted for interest of $58,573, resulting in a total of the funding standard carryover balance and the prefunding balance as of January 1, 2011, of $68,773, the same amount as that developed in *Example 2.*

Example 5. (i) Plan Q is a defined benefit plan with a plan year that is the calendar year and a valuation date of July 1. The funding standard carryover balance of Plan Q is $50,000 as of January 1, 2010, the beginning of the 2010 plan year. The prefunding balance of Plan Q as of the beginning of the 2010 plan year is $0. The actual rate of return on Plan Q's assets for 2010 is 10%. Plan Q's effective interest rate for 2010 is 6.25%. The funding ratio for Plan Q for 2009 (the prior plan year funding ratio with respect to 2010, as determined under paragraph (d)(3) of this section) is 85%, which is not less than 80%. The minimum required contribution for Plan Q for 2010 is $200,000. Sponsor T makes a contribution to Plan Q of $190,000 on July 1, 2010, for the 2010 plan year, and makes no other contributions for the 2010 plan year. Sponsor T elects to use $10,000 of the funding standard carryover balance to offset Plan Q's minimum required contribution in 2010.

(ii) Pursuant to paragraph (b)(4) of this section, the funding standard carryover balance is increased to $51,539 as of July 1, 2010 (that is, an increase to reflect 6 months of interest at an effective interest rate of 6.25%) for the purpose of adjusting plan assets under paragraph (c) of this section, and for applying any election to use or reduce Plan Q's funding standard carryover balance under paragraph (d) or (e) of this section. However, Sponsor T does not elect in 2010 to reduce any portion of the funding standard carryover balance pursuant to paragraph (e) of this section. The funding standard carryover balance ($51,539) is subtracted from the value of plan assets, as of July 1, 2010, prior to the determination of the minimum funding contribution, and $51,539 is the maximum amount that may applied against the minimum required contribution.

(iii) The value of the funding standard carryover balance as of January 1, 2011, is determined by first discounting the amount used to offset the minimum required contribution for 2010 from July 1, 2010, to January 1, 2010, using the effective interest rate of 6.25%, and subtracting the discounted amount from the January 1, 2010, funding standard carryover balance. The resulting amount is adjusted

for investment experience to January 1, 2011, using a rate equal to the actual rate of return on plan assets of 10% during 2010. Thus, the $10,000 used to offset Plan Q's minimum required contribution as of July 1, 2010, is discounted for 6 months of interest, at an effective interest rate of 6.25%, to obtain an amount of $9,701 as of January 1, 2010. The remaining funding standard carryover balance as of January 1, 2010, solely for purposes of determining the adjustment for investment experience during 2010, is $40,299 ($50,000—$9,701), and the adjustment for investment experience is $4,030 ($40,299 × 10%). The value of the funding standard carryover balance as of January 1, 2011, is $44,329 (that is, $50,000 − $9,701 + $4,030).

Example 6. (i) The facts are the same as in *Example 5,* except that Sponsor T contributes $200,000 on July 1, 2010, for the 2010 plan year.

(ii) The cash contribution required for 2010, after offsetting the minimum required contribution by $10,000 of the funding standard carryover balance in accordance with T's election, is $190,000. The difference, or $10,000, must be adjusted to January 1, 2011, to determine the maximum amount that can be added to the prefunding balance as of that date.

(iii) The excess contribution is first adjusted to January 1, 2010, by discounting for 6 months of interest using the effective interest rate for 2010 of 6.25%. This results in an excess contribution of $9,701 ($10,000 ÷ $1.0625^{0.5}$). Because this amount is an excess contribution solely because of Sponsor T's election to offset the minimum required contribution for 2010 by a portion of the funding standard carryover balance, the amount is then adjusted for investment experience during 2010 at a rate of 10%, in accordance with paragraph (b)(3)(iii) of this section, for a present value of the excess contribution adjusted for interest of $10,671 ($9,701 × 1.10) as of January 1, 2011.

Example 7. (i) The facts are the same as in *Example 4.* Plan P's effective interest rate for 2011 is 6.5%, and the rate of return on investments during 2011 is 7%. All required quarterly installments for the 2011 plan year were made by the applicable due dates. On February 1, 2012, Sponsor S elects to use $50,000 of Plan P's prefunding and funding standard carryover balances to offset the minimum required contribution for the 2011 plan year. On April 15, 2012, Sponsor S elects to use Plan P's prefunding and funding standard carryover balances to offset the 2012 minimum required contribution by $20,000, in accordance with paragraph (d) of this section, in order to offset the required quarterly installment then due.

(ii) When adjusting Plan P's prefunding and funding standard carryover balances to reflect Sponsor S's election to use them to offset the 2011 minimum required contribution, the remaining $10,200 in the funding standard carryover balance as of January 1, 2011, must be used before any portion of the prefunding balance. The prefunding balance is reduced by the remaining $39,800 ($50,000 total election minus $10,200 from the funding standard carryover balance).

(iii) The amount available for Sponsor S's election to use Plan P's prefunding and funding standard carryover balances to offset the 2012 minimum required contribution is determined by reducing the January 1, 2011, prefunding and funding standard carryover balances to reflect the election to use the prefunding and funding standard carryover balances to offset the 2011 minimum required contribution, and by adjusting the resulting amount to January 1, 2012, using the rate of investment return for Plan P during 2011. Accordingly, the available amount in Plan P's funding standard carryover balance as of January 1, 2012, is zero. The available amount in Plan P's prefunding balance as of January 1, 2012, is $20,087 ($58,573 minus $39,800, increased by 7%). Therefore, Sponsor S has $20,087 available to offset the minimum required contribution for the 2012 plan year.

Example 8. (i) The facts are the same as in *Example 7,* except that based on the enrolled actuary's certification of the AFTAP on July 1, 2012, Sponsor S is deemed to elect to reduce the January 1, 2012, prefunding balance by $15,000 under section 436(f)(3).

(ii) In accordance with paragraph (d)(1)(ii)(B) of this section, the deemed election to reduce the prefunding balance is deemed to occur on the first day of the plan year, and before the date of any election to offset the minimum required contribution for the 2012 plan year. The deemed election does not affect Sponsor S's election to offset the 2011 minimum contribution because that election was made on February 1, 2012, before the date of the deemed election, July 1, 2012.

(iii) As shown in *Example 7,* the available prefunding balance as of January 1, 2012, after reflecting the February 1, 2012, election to offset the 2011 minimum required contribution but before reflecting the April 15, 2012, election to offset the 2012 minimum required contribution, is $20,087. Adjusting this amount to reflect the deemed election to reduce the prefunding balance by $15,000 leaves a balance of $5,087 available to offset the minimum required contribution for 2012.

(iv) The portion of the quarterly installment due April 15, 2012 that was not covered by the remaining $5,087 prefunding balance is considered unpaid retroactive to April 15, 2012.

Example 9. (i) The facts are the same as in *Example 8,* except that Sponsor S does not make the election to offset the 2011 minimum required contribution until August 1, 2012, and the deemed election as of July 1, 2012, reduces Plan P's prefunding and funding standard carryover balances as of January 1, 2012, by $68,500. Sponsor S does not elect to

use Plan P's prefunding and funding standard carryover balances to offset the 2012 minimum contribution.

(ii) In accordance with paragraph (d)(1)(ii)(A) of this section, the July 1, 2012, deemed election to reduce Plan P's prefunding and funding standard carryover balances must be taken into account before determining the amount available to offset the 2011 minimum required contribution because the election to offset the 2011 minimum required contribution was made after the date of the deemed election, July 1, 2012.

(iii) Pursuant to paragraph (d)(1)(ii)(C) of this section, the January 1, 2011, prefunding and funding standard carryover balances are adjusted to January 1, 2012, using Plan P's rate of investment return for 2011 of 7%. This results in an available funding standard carryover balance of $10,914 ($10,200 × 1.07) and an available prefunding balance of $62,673 (58,573 × 1.07) as of January 1, 2012.

(iv) Paragraph (d)(2) of this section requires that the funding standard carryover balance must be used before reducing Plan P's prefunding balance. Accordingly, the funding standard carryover balance is eliminated, and the prefunding balance is reduced by the remaining $57,586 ($68,500 − $10,914), resulting in an available prefunding balance of $5,087 ($62,673 − $57,586) as of January 1, 2012.

(v) In accordance with paragraph (d)(1)(ii)(D) of this section, the remaining balance is adjusted to January 1, 2011, to determine the amount available to offset the 2011 minimum required contribution. This adjustment is done by dividing the remaining balance by 1 plus the rate of investment return for 2011. Accordingly, the amount available to offset the 2011 minimum required contribution is $4,754 ($5,087 ÷ 1.07).

(vi) If the plan sponsor elects to use the $4,754 available balance to offset the 2011 minimum required contribution, the funding standard carryover balance as of January 1, 2012 (prior to the deemed reduction under section 436(f)(3)) is $5,827 ($10,200 less $4,754, plus $381 for investment experience at a rate of 7%). The prefunding balance as of January 1, 2012 (prior to the deemed reduction under section 436(f)(3)) is $62,673 (that is, $58,573 × 1.07). The deemed election to reduce Plan P's balance is first applied to eliminate the funding standard carryover balance, and the remaining $62,673 ($68,500 less $5,827) reduces the January 1, 2012, prefunding balance to zero.

Example 10. (i) Plan V is a defined benefit plan with a plan year that is the calendar year and a valuation date of December 31. The valuation is based on the fair market value of plan assets, which amounts to $1,000,000 as of December 31, 2010, before any adjustments. As of January 1, 2010, Plan V's funding standard carryover balance is $0 and its prefunding balance is $125,000. Plan V's effective interest rate for 2010 is 5.5%. The enrolled actuary's certification of AFTAP for 2010 on March 31, 2010, results in a deemed reduction of $15,000 in the plan's prefunding balance as of January 1, 2010. Plan V's sponsor elected to use the prefunding balance to offset any portion of the minimum required contribution for 2010 not covered by cash contributions.

(ii) In accordance with paragraph (b)(4)(i) of this section, the amount of the prefunding balance subtracted from plan assets is increased from the first day of the plan year to the valuation date using the effective interest rate of 5.5% for 2009. Accordingly, the prefunding balance used for this purpose is $116,050 [($125,000 − $15,000 deemed reduction) × 1.055].

(iii) The fair market value of plan assets used for the December 31, 2010, valuation is $883,950 ($1,000,000 − $116,050).

Example 11. (i) The facts are the same as in *Example 10.* The minimum contribution for Plan V for the 2010 plan year is $45,000; no quarterly installments are required for Plan V for 2010. Plan V's sponsor makes a contribution of $20,000 for the 2010 plan year on July 1, 2011. The actual rate of return on assets for Plan V during 2010 is 10%.

(ii) The contribution of $20,000 is discounted to December 31, 2010, using the effective interest rate of 5.5% to determine the remaining balance of the 2010 minimum required contribution. Accordingly, the contribution is adjusted to $19,472 ($20,000 ÷ $1.055^{0.5}$) as of December 31, 2010, and the balance of the minimum required contribution is $25,528 ($45,000 − $19,472). This balance will be covered by the plan sponsor's election to use the prefunding balance to offset any portion of the minimum required contribution not covered by cash contributions.

(iii) Under section (b)(4)(ii) of this section, the amount used to offset the 2010 minimum required contribution for the purpose of adjusting the prefunding balance is discounted to January 1, 2010, using the effective interest rate for 2010. This amount is calculated as $24,197 ($25,528 ÷ 1.055).

(iv) The prefunding balance as of January 1, 2011, is reduced by the deemed election of $15,000 and the discounted amount used to offset the 2010 minimum required contribution ($24,197), and adjusted for investment experience for 2010 using the actual rate of return of 10%. Accordingly, the prefunding balance as of January 1, 2011 is $94,383 [($125,000 − $15,000 − $24,197) × 1.10].

Example 12. (i) The facts are the same as in *Example 11*, except that the enrolled actuary's certification of the AFTAP as of March 31, 2011, results in a deemed reduction of the prefunding balance as of January 1, 2011, of $75,000.

(ii) Under paragraph (d)(1)(ii) of this section, the deemed reduction of the prefunding balance is applied before the election to use

the prefunding balance to offset the balance of the minimum required contribution for 2010. To determine the amount of the prefunding balance available to cover the remaining minimum required contribution for 2010, the deemed reduction is adjusted for investment experience to January 1, 2010, using the actual rate of return of 10% for 2010. Accordingly, the adjusted deemed reduction is $68,182 ($75,000 ÷ 1.10) and the available prefunding balance as of January 1, 2010, is $41,818 ($125,000 − $15,000 adjusted deemed reduction for 2010 − $68,182 adjusted deemed reduction for 2011).

(iii) This amount is then adjusted to December 31, 2010, using the effective interest rate of 5.5%. The amount of the prefunding balance available to offset the 2009 minimum required contribution as of December 31, 2010, is $44,118 ($41,818 × 1.055). This amount is larger than the election made by Plan V's sponsor to offset the minimum required contribution for 2010 ($25,528) and so the election remains valid.

(h) *Effective/applicability date and transition rules*—(1) *Statutory effective date/applicability date*. Section 430 generally applies to plan years beginning on or after January 1, 2008. The applicability of section 430 for purposes of determining the minimum required contribution is delayed for certain plans in accordance with sections 104 through 106 of PPA '06.

(2) *Effective date/applicability date of regulations*. This section applies to plan years beginning on or after January 1, 2010. For plan years beginning before January 1, 2010, plans are permitted to rely on the provisions set forth in this section for purposes of satisfying the requirements of section 430.

(3) *Special lookback rule for 2007 plan year's funding ratio*—(i) *Plan assets*. For purposes of determining a plan's prior plan year funding ratio under paragraph (d)(3) of this section with respect to the first plan year beginning on or after January 1, 2008, the value of plan assets on the valuation date of the preceding plan year (the ''2007 plan year'') is determined under section 412(c)(2) as in effect for the 2007 plan year, except that, for this purpose—

(A) If the value of plan assets is less than 90 percent of the fair market value of plan assets for the 2007 plan year on that date, such value is considered to be 90 percent of the fair market value; and

(B) If the value of plan assets is greater than 110 percent of the fair market value of plan assets for the 2007 plan year on that date, such value is considered to be 110 percent of the fair market value.

(ii) *Funding target*. For purposes of determining a plan's prior plan year funding ratio under paragraph (d)(3) of this section with respect to the first plan year beginning on or after January 1, 2008, the funding target of the plan for the preceding plan year is equal to the plan's current liability under section 412(l)(7) (as in effect prior to amendment by PPA '06) on the valuation date for the 2007 plan year.

(iii) *Special rules for new plans, mergers, and spinoffs*. In the case of a plan described in paragraph (d)(3)(ii), (d)(3)(iii), or (d)(3)(iv) of this section, the plan's prior plan year funding ratio with respect to the first plan year beginning on or after January 1, 2008 is determined using rules similar to the rules of paragraphs (d)(3)(ii), (d)(3)(iii), and (d)(3)(iv) of this section.

(4) *First effective plan year*. For purposes of this section, the term *first effective plan year* means the first plan year beginning on or after the date section 430 applies for purposes of determining the minimum required contribution for the plan.

(5) *Pre-effective plan year*. For purposes of this section, the term *pre-effective plan year* means the plan year immediately preceding the first effective plan year.

[T.D. 9467, 74 FR 54046, Oct. 15, 2009, as amended by T.D. 9732, 80 FR 54389, Sept. 9, 2015]

§ 1.430(g)–1 Valuation date and valuation of plan assets.

(a) *In general*—(1) *Overview*. This section provides rules relating to a plan's valuation date and the valuation of a plan's assets for a plan year under section 430(g). Section 430 and this section apply to single employer defined benefit plans (including multiple employer plans as defined in section 413(c)) that are subject to the rules of section 412, but do not apply to multiemployer plans (as defined in section 414(f)). Paragraph (b) of this section describes valuation date rules. Paragraph (c) of this section describes rules regarding

the determination of the asset value for purposes of a plan's actuarial valuation. Paragraph (d) of this section contains rules for taking employer contributions into account in the determination of the value of plan assets. Paragraph (e) of this section contains examples. Paragraph (f) of this section sets forth effective/applicability dates and transition rules.

(2) *Special rules for multiple employer plans.* In the case of a multiple employer plan to which section 413(c)(4)(A) applies, the rules of section 430 and this section are applied separately for each employer under the plan as if each employer maintained a separate plan. Thus, in such a case, the value of plan assets is determined separately for each employer under the plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), the rules of section 430 and this section are applied as if all participants in the plan were employed by a single employer.

(b) *Valuation date*—(1) *In general.* The determination of the funding target, target normal cost, and value of plan assets for a plan year is made as of the valuation date for that plan year. Except as otherwise provided in paragraph (b)(2) of this section, the valuation date for any plan year is the first day of the plan year.

(2) *Exception for small plans*—(i) *In general.* If, on each day during the preceding plan year, a plan had 100 or fewer participants determined by applying the rules of §1.430(d)–1(e)(1) and (2) (including active and inactive participants and all other individuals entitled to future benefits), then the plan may designate any day during the plan year as its valuation date for that plan year and succeeding plan years. For purposes of this paragraph (b)(2)(i), all defined benefit plans (other than multiemployer plans as defined in section 414(f)) maintained by an employer are treated as one plan, but only participants with respect to that employer are taken into account.

(ii) *Employer determination.* For purposes of this paragraph (b)(2), the employer includes all members of the employer's controlled group determined pursuant to section 414(b), (c), (m), and (o) and includes any predecessor of the employer that, during the prior year, employed any employees of the employer who are covered by the plan.

(iii) *Application of exception in first plan year.* In the case of the first plan year of any plan, the exception for small plans under paragraph (b)(2)(i) of this section is applied by taking into account the number of participants that the plan is reasonably expected to have on each day during the first plan year.

(iv) *Valuation date is part of funding method.* The selection of a plan's valuation date is part of the plan's funding method and, accordingly, may only be changed with the consent of the Commissioner. A change of a plan's valuation date that is required by section 430 is treated as having been approved by the Commissioner and does not require the Commissioner's prior specific approval. Thus, if a plan that ceases to be eligible for the small plan exception under this paragraph (b)(2) for a plan year because the number of participants exceeded 100 in the prior plan year, then the resulting change in the valuation date to the first day of the plan year is automatically approved by the Commissioner.

(c) *Determination of asset value*—(1) *In general*—(i) *General use of fair market value.* Except as otherwise provided in this paragraph (c), the value of plan assets for purposes of section 430 is equal to the fair market value of plan assets on the valuation date. Prior year contributions made after the valuation date and current year contributions made before the valuation date are taken into account to the extent provided in paragraph (d) of this section.

(ii) *Fair market value.* The fair market value of an asset is determined as the price at which the asset would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. Except as otherwise provided by the Commissioner, any guidance on the valuation of insurance contracts under Subchapter D of Chapter 1 the Internal Revenue Code applies for purposes of this paragraph (c)(1)(ii).

(2) *Averaging of fair market values*—(i) *In general.* Subject to the plan asset corridor rules of paragraph (c)(2)(iii) of this section, a plan is permitted to determine the value of plan assets on the valuation date as the average of the fair market value of assets on the valuation date and the adjusted fair market value of assets determined for one or more earlier determination dates (adjusted using the method described in paragraph (c)(2)(ii) of this section). The method of determining the value of assets is part of the plan's funding method and, accordingly, may only be changed with the consent of the Commissioner.

(ii) *Adjusted fair market value*—(A) *Determination dates.* The period of time between each determination date (treating the valuation date as a determination date) must be equal and that period of time cannot exceed 12 months. In addition, the earliest determination date with respect to a plan year cannot be earlier than the last day of the 25th month before the valuation date of the plan year (or a similar period in the case of a valuation date that is not the first day of a month). In a typical situation, the earlier determination dates will be the two immediately preceding valuation dates. However, these rules also permit the use of more frequent determination dates. For example, monthly or quarterly determination dates may be used.

(B) *Adjustments for contributions and distributions.* The adjusted fair market value of plan assets for a prior determination date is the fair market value of plan assets on that date, increased for contributions included in the plan's asset balance on the valuation date that were not included in the plan's asset balance on the earlier determination date, reduced for benefits and all other amounts paid from plan assets during the period beginning with the prior determination date and ending immediately before the valuation date, and adjusted for expected earnings as described in paragraph (c)(2)(ii)(D) of this section. For this purpose, the fair market value of assets as of a determination date includes any contribution for a plan year that ends with or prior to the determination date that is receivable as of the determination date (but only if the contribution is actually made within 8½ months after the end of the applicable plan year). If the contribution that is receivable as of the determination date is for a plan year beginning on or after January 1, 2008, then only the present value as of the determination date (determined using the effective interest rate under section 430(h)(2)(A) for the plan year for which the contribution is made) is included in the fair market value of assets.

(C) *Treatment of spin-offs and plan-to-plan transfers.* For purposes of determining the adjusted fair market value of plan assets, assets spun-off from a plan as a result of a spin-off described in §1.414(l)–1(b)(4) are treated as an amount paid from plan assets. Except as otherwise provided by the Commissioner, for purposes of determining the adjusted fair market value of plan assets, assets that are added to a plan as a result of a plan-to-plan transfer described in §1.414(l)–1(b)(3) are treated in the same manner as contributions.

(D) *Adjustments for expected earnings.* [Reserved]

(E) *Assumed rate of return.* [Reserved]

(F) *Limitation on the assumed rate of return for periods within plan years for which the three segment rates were used.* [Reserved]

(G) *Limitation on the assumed rate of return for periods within plan years for which the full yield curve was used.* [Reserved]

(iii) *Restriction to 90–110 percent corridor*—(A) *In general.* This paragraph (c)(2)(iii) provides rules for applying the 90 to 110 percent corridor set forth in section 430(g)(3)(B)(iii). The rules for accounting for contribution receipts under paragraphs (d)(1) and (d)(2) of this section are applied prior to the application of the 90 to 110 percent corridor under this paragraph (c)(2)(iii).

(B) *Asset value less than 90 percent of fair market value.* If the value of plan assets determined under paragraph (c)(2)(i) of this section is less than 90 percent of the fair market value of plan assets, then the value of plan assets under this paragraph (c)(2) is equal to 90 percent of the fair market value of plan assets.

(C) *Asset value greater than 110 percent of fair market value.* If the value of plan

assets determined under paragraph (c)(2)(i) of this section is greater than 110 percent of the fair market value of plan assets, then the value of plan assets under this paragraph (c)(2) is equal to 110 percent of the fair market value of plan assets.

(3) *Qualified transfers to health benefit accounts.* In the case of a qualified transfer (as defined in section 420), any assets so transferred are not treated as plan assets for purposes of section 430 and this section.

(d) *Accounting for contribution receipts*—(1) *Prior year contributions*—(i) *In general.* For purposes of determining the value of plan assets under paragraph (c) of this section, if an employer makes a contribution to the plan after the valuation date for the current plan year and the contribution is for an earlier plan year, then the present value of the contribution determined as of that valuation date is taken into account as an asset of the plan as of the valuation date, but only if the contribution is made before the deadline for contributions as described in section 430(j)(1) for the plan year immediately preceding the current plan year. For this purpose, the present value is determined using the effective interest rate under section 430(h)(2)(A) for the plan year for which the contribution is made.

(ii) *Special rule for contributions for the 2007 plan year*—(A) *Timely contributions.* Notwithstanding paragraph (d)(1)(i) of this section, if the employer makes a contribution to the plan after the valuation date for the first plan year that begins on or after January 1, 2008, and the contribution is for the immediately preceding plan year and is made by the deadline for contributions for that preceding plan year under section 412(c)(10) (as in effect before amendment by the Pension Protection Act of 2006 (PPA '06), Public Law 109–280 (120 Stat. 780)), then the contribution is taken into account as a plan asset under paragraph (d)(1)(i) of this section without applying any present value discount.

(B) *Late contributions.* If a contribution is for the plan year that immediately precedes the first plan year that begins on or after January 1, 2008, and is not described in paragraph (d)(1)(ii)(A) of this section, then the rules of paragraph (d)(1)(i) apply to the contribution except that the present value is determined using the valuation interest rate under section 412(c)(2) for that plan year.

(iii) *Ordering rules.* For purposes of this paragraph (d)(1), the ordering rules of section 4971(c)(4)(B) apply for purposes of determining the plan year for which a contribution is made.

(2) *Current year contributions made before valuation date.* In the case of a plan with a valuation date that is not the first day of the plan year, for purposes of determining the value of plan assets under paragraph (c) of this section, if an employer makes a contribution for a plan year before that year's valuation date, that contribution (and any interest on the contribution for the period between the contribution date and the valuation date, determined using the effective interest rate under section 430(h)(2)(A) for the plan year) must be subtracted from plan assets in determining the value of plan assets as of the valuation date. If the result of this subtraction is a number less than zero, the value of plan assets as of the valuation date is equal to zero.

(e) *Examples.* [Reserved]

(f) *Effective/applicability dates and transition rules*—(1) *Statutory effective date/applicability date.* Section 430 generally applies to plan years beginning on or after January 1, 2008. The applicability of section 430 for purposes of determining the minimum required contribution is delayed for certain plans in accordance with sections 104 through 106 of PPA '06.

(2) *Effective date/applicability date of regulations*—(i) *In general.* This section applies to plan years beginning on or after January 1, 2010, regardless of whether section 430 applies to determine the minimum required contribution for the plan year. For plan years beginning before January 1, 2010, plans are permitted to rely on the provisions set forth in this section for purposes of satisfying the requirements of section 430.

(ii) *Permission to use averaging for 2008.* For purposes of determining the actuarial value of assets for a plan year beginning during 2008 using the averaging rules of paragraph (c)(2) of this

section, a plan is permitted to apply an assumed earnings rate of zero under paragraph (c)(2)(ii)(E) of this section (even if zero is not the actuary's best estimate of the anticipated annual rate of return on plan assets).

(3) *Approval for changes in the valuation date and valuation method.* Any change in a plan's valuation date or asset valuation method that satisfies the rules of this section and is made for either the first plan year beginning in 2008, the first plan year beginning in 2009, or the first plan year beginning in 2010 is treated as having been approved by the Commissioner and does not require the Commissioner's specific prior approval. In addition, a change in a plan's valuation date or asset valuation method for the first plan year to which section 430 applies to determine the plan's minimum required contribution (even if that plan year begins after December 31, 2010) that satisfies the rules of this section is treated as having been approved by the Commissioner and does not require the Commissioner's specific prior approval.

[T.D. 9467, 74 FR 53053, Oct. 15, 2009]

§ 1.430(h)(2)–1 Interest rates used to determine present value.

(a) *In general*—(1) *Overview.* This section provides rules relating to the interest rates to be applied for a plan year under section 430(h)(2). Section 430(h)(2) and this section apply to single employer defined benefit plans (including multiple employer plans as defined in section 413(c)) that are subject to section 412 but do not apply to multiemployer plans (as defined in section 414(f)). Paragraph (b) of this section describes how the segment interest rates are used for a plan year. Paragraph (c) of this section describes those segment rates. Paragraph (d) of this section describes the monthly corporate bond yield curve that is used to develop the segment rates. Paragraph (e) of this section describes certain elections that are permitted to be made under this section. Paragraph (f) of this section describes other rules related to interest rates. Paragraph (g) of this section contains examples. Paragraph (h) of this section contains effective/applicability dates and transition rules.

(2) *Special rules for multiple employer plans.* In the case of a multiple employer plan to which section 413(c)(4)(A) applies, the rules of section 430 and this section are applied separately for each employer under the plan as if each employer maintained a separate plan. Thus, each employer under such a multiple employer plan may make elections with respect to the interest rate rules under this section that are independent of the elections of other employers under the plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), the rules of section 430 and this section are applied as if all participants in the plan were employed by a single employer.

(b) *Interest rates for determining plan liabilities*—(1) *In general.* The interest rates used in determining the present value of the benefits that are included in the target normal cost and the funding target for the plan for a plan year are determined as set forth in this paragraph (b).

(2) *Benefits payable within 5 years*—(i) *In general.* In the case of benefits expected to be payable during the 5-year period beginning on the valuation date for the plan year, the interest rate used in determining the present value of the benefits that are included in the target normal cost and the funding target for the plan is the first segment rate with respect to the applicable month, as described in paragraph (c)(2)(i) of this section.

(ii) *Special rule for plan years beginning before January 1, 2014.* With respect to a plan year beginning before January 1, 2014, for a plan with a valuation date other than the first day of the plan year, the 5-year period beginning on the first day of the plan year is permitted to be used in lieu of the 5-year period beginning on the valuation date for the plan year under paragraph (b)(2)(i) of this section.

(3) *Benefits payable after 5 years and within 20 years.* In the case of benefits expected to be payable during the 15-year period beginning after the end of the period described in paragraph (b)(2) of this section, the interest rate used

in determining the present value of the benefits that are included in the target normal cost and the funding target for the plan is the second segment rate with respect to the applicable month, as described in paragraph (c)(2)(ii) of this section.

(4) *Benefits payable after 20 years.* In the case of benefits expected to be payable after the period described in paragraph (b)(3) of this section, the interest rate used in determining the present value of the benefits that are included in the target normal cost and the funding target for the plan is the third segment rate with respect to the applicable month, as described in paragraph (c)(2)(iii) of this section.

(5) *Applicable month.* Except as otherwise provided in paragraph (e) of this section, the term *applicable month* for purposes of this paragraph (b) means the month that includes the valuation date of the plan for the plan year.

(6) *Special rule for certain airlines*—(i) *In general.* Pursuant to section 6615 of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007, Public Law 110–28 (121 Stat. 112), for a plan sponsor that makes the election described in section 402(a)(2) of the Pension Protection Act of 2006 (PPA '06), Public Law 109–280 (120 Stat. 780), the interest rate required to be used to determine the plan's funding target for each of the 10 years under that election is 8.25 percent (rather than the segment rates otherwise described in this paragraph (b) or the full yield curve as permitted under paragraph (e)(4) of this section).

(ii) *Special interest rate not applicable for other purposes.* The special interest rate described in paragraph (b)(6)(i) of this section does not apply for other purposes such as the determination of the plan's target normal cost.

(c) *Segment rates*—(1) *Overview.* This paragraph (c) sets forth rules for determining the first, second, and third segment rates for purposes of paragraph (b) of this section. The first, second, and third segment rates are set forth in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin. *See* § 601.601(d)(2) relating to objectives and standards for publishing regulations, revenue rulings and revenue procedures in the Internal Revenue Bulletin. *See* paragraph (h)(4) of this section for a transition rule under which the definition of the segment rates is modified for plan years beginning in 2008 and 2009.

(2) *Definition of segment rates*—(i) *First segment rate.* For purposes of this section, except as otherwise provided under the transition rule of paragraph (h)(4) of this section, the *first segment rate* is, with respect to any month, the single rate of interest determined by the Commissioner on the basis of the average of the monthly corporate bond yield curves (described in paragraph (d) of this section) for the 24-month period ending with the month preceding that month, taking into account only the first 5 years of each of those yield curves.

(ii) *Second segment rate.* For purposes of this section, except as otherwise provided under the transition rule of paragraph (h)(4) of this section, the *second segment rate* is, with respect to any month, the single rate of interest determined by the Commissioner on the basis of the average of the monthly corporate bond yield curves (described in paragraph (d) of this section) for the 24-month period ending with the month preceding that month, taking into account only the portion of each of those yield curves corresponding to the 15-year period that follows the end of the 5-year period described in paragraph (c)(2)(i) of this section.

(iii) *Third segment rate.* For purposes of this section, except as otherwise provided under the transition rule of paragraph (h)(4) of this section, the *third segment rate* is, with respect to any month, the single rate of interest determined by the Commissioner on the basis of the average of the monthly corporate bond yield curves (described in paragraph (d) of this section) for the 24-month period ending with the month preceding that month, taking into account only the portion of each of those yield curves corresponding to the 40-year period that follows the end of the 15-year period described in paragraph (c)(2)(ii) of this section.

(d) *Monthly corporate bond yield curve*—(1) *In general.* For purposes of this section, the *monthly corporate bond yield curve* is, with respect to any

month, a yield curve that is prescribed by the Commissioner for that month based on yields for that month on investment grade corporate bonds with varying maturities that are in the top three quality levels available.

(2) *Determination and publication of yield curve.* A description of the methodology for determining the monthly corporate bond yield curve is provided in guidance issued by the Commissioner that is published in the Internal Revenue Bulletin. The yield curve for a month will be set forth in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin. *See* §601.601(d)(2) relating to objectives and standards for publishing regulations, revenue rulings and revenue procedures in the Internal Revenue Bulletin.

(e) *Elections*—(1) *In general.* This paragraph (e) describes elections for a plan year that a plan sponsor can make to use alternative interest rates under this section. Any election under this paragraph (e) must be made by providing written notification of the election to the plan's enrolled actuary. Any election in this paragraph (e) may be adopted for a plan year without obtaining the consent of the Commissioner, but, once adopted, that election will apply for that plan year and all future plan years and may be changed only with the consent of the Commissioner.

(2) *Election for alternative applicable month.* As an alternative to defining the applicable month as the month that includes the valuation date for the plan year, a plan sponsor that is using segment rates as provided under paragraph (b) of this section may elect to use one of the 4 months preceding that month as the applicable month.

(3) *Election not to apply transition rule.* The plan sponsor may elect not to apply the transition rule in paragraph (h)(4) of this section.

(4) *Election to use full yield curve*—(i) *In general.* For purposes of determining the plan's funding target and target normal cost, and for all other purposes under section 430 (including the determination of shortfall amortization installments, waiver installments, and the present values of those installments as described in paragraph (f)(2) of this section), the plan sponsor may elect to use interest rates under the monthly corporate bond yield curve described in paragraph (d) of this section for the month preceding the month that includes the valuation date in lieu of the segment rates determined under paragraph (c) of this section. In order to address the timing of benefit payments during a year, reasonable approximations are permitted to be used to value benefit payments that are expected to be made during a plan year.

(ii) *Reasonable techniques permitted.* In the case of a plan sponsor using the monthly corporate bond yield curve under this paragraph (e)(4), if with respect to a decrement the benefit is only expected to be paid for one-half of a year (because the decrement was assumed to occur in the middle of the year), the interest rate for that year can be determined as if the benefit were being paid for the entire year. See §1.430(d)–1(f)(7) for additional reasonable techniques that can be used in determining present value.

(5) *Plan sponsor.* For purposes of the elections described in this section, any reference to the plan sponsor generally means the employer or employers responsible for making contributions to or under the plan. In the case of plans that are multiple employer plans to which section 413(c)(4)(A) does not apply, any reference to the plan sponsor means the plan administrator within the meaning of section 414(g).

(f) *Interest rates used for other purposes*—(1) *Effective interest rate*—(i) *In general.* Except as otherwise provided in paragraph (f)(2) of this section, the effective interest rate determined under section 430(h)(2)(A) for the plan year is the single interest rate that, if used to determine the present value of the benefits that are taken into account in determining the plan's funding target for the plan year, would result in an amount equal to the plan's funding target determined for the plan year under section 430(d) as described in §1.430(d)–1(b)(2) (without regard to calculations for plans in at-risk status under section 430(i)).

(ii) *Zero funding target.* If, for the plan year, the plan's funding target is equal to zero, then the effective interest rate determined under section 430(h)(2)(A)

for the plan year is the single interest rate that, if used to determine the present value of the benefits that are taken into account in determining the plan's target normal cost for the plan year, would result in an amount equal to the plan's target normal cost determined for the plan year under section 430(b) as described in § 1.430(d)–1(b)(1) (without regard to calculations for plans in at-risk status under section 430(i)).

(2) *Interest rates used for determining shortfall amortization installments and waiver amortization installments.* The interest rates used to determine the amount of shortfall amortization installments and waiver amortization installments and the present value of those installments are determined based on the dates those installments are assumed to be paid, using the same timing rules that apply in determining target normal cost as described in paragraph (b) of this section. Thus, for a plan that uses the segment rates described in paragraph (c) of this section, the first segment rate applies to the installments assumed to be paid during the first 5-year period beginning on the valuation date for the plan year, and the second segment rate applies to the installments assumed to be paid during the subsequent 15-year period. For purposes of this paragraph (f)(2), the shortfall amortization installments for a plan year are assumed to be paid on the valuation date for that plan year. For example, for a plan that uses the segment rates described in paragraph (c) of this section, the shortfall amortization installment for the fifth plan year following the current plan year (the sixth installment) is assumed to be paid on the valuation date for that year so that such shortfall amortization installment will be determined using the second segment rate.

(g) *Examples.* The following examples illustrate the rules of this section:

Example 1. (i) The January 1, 2009, valuation of Plan P is performed using the segment rates applicable for September 2008 (determined without regard to the transition rule of section 430(h)(2)(G)), and the 2009 annuitant and nonannuitant (male and female) mortality tables as published in Notice 2008–85. See § 601.601(d)(2) relating to objectives and standards for publishing regulations, revenue rulings and revenue procedures in the Internal Revenue Bulletin. Plan P provides for early retirement benefits as early as age 50, and offers a single-sum distribution payable immediately at retirement. The single-sum payment is equal to the present value of the participant's accrued benefit, based on the applicable interest rates and the applicable mortality table under section 417(e)(3). Participant E is the only participant in the plan, and is a male age 46 as of January 1, 2009, with an annual accrued benefit of $23,000 payable beginning at age 65. The actuary assumes a 100% probability that Participant E will terminate at age 50 and will elect to receive his benefit in the form of a single-sum payment.

(ii) Plan P's funding target is $68,908 as of January 1, 2009. This figure is based on the male nonannuitant rates for ages prior to age 50, the applicable mortality rates under section 417(e)(3) for ages 50 and later, and segment interest rates of 5.07% for the first 5 years after the valuation date, 6.09% for the next 15 years, and 6.56% for periods more than 20 years after the valuation date. (See § 1.430(d)–1(f)(9), *Example 10,* for additional details.)

(iii) The present value of Participant E's benefits as of January 1, 2009, is $68,908 if a single interest rate of 6.52805% is substituted for the segment interest rates but all other assumptions remain the same. Thus (rounded), the effective interest rate for Plan P is 6.53% for 2009.

Example 2. (i) The facts are the same as for *Example 1,* except that Plan P offers a single-sum distribution equal to the present value of the accrued benefit based on the applicable interest rates under section 417(e)(3) or an interest rate of 6.25%, whichever produces the higher amount. The applicable mortality table under section 417(e)(3) is used for both calculations.

(ii) The present value of Participant E's age-50 single-sum distribution as of January 1, 2009 (when Participant E is age 46) is $77,392. This amount is determined by calculating the projected single-sum distribution at age 50 using the applicable mortality table under section 417(e)(3) and an interest rate of 6.25%, and discounting the result to January 1, 2009, using the first segment rate of 5.07% and male nonannuitant mortality rates for 2009. Because this amount is larger than the present value of Participant E's single-sum payment based on the applicable interest rates under section 417(e)(3) (that is, $68,908), the funding target for Plan P is $77,392 as of January 1, 2009. (See § 1.430(d)–1(f)(9), *Example 12* for additional details.)

(iii) The effective interest rate is the single interest rate that will produce the same funding target if substituted for the segment interest rates keeping all other assumptions the same, including the fixed interest rate used by the plan to determine single-sum payments. The only segment interest rate

used to develop the funding target of $77,392 was the first segment rate of 5.07%. Therefore, considering only this calculation, the single interest rate that would produce the same funding target would be 5.07%.

(iv) However, the effective interest rate must also reflect the fact that the single-sum payment under Plan P is equal to the greater of the present value of Participant E's accrued benefit based on the fixed rate of 6.25% or the applicable interest rates under section 417(e)(3). If the single rate of 5.07% is substituted for the segment rates used to calculate the present value of the single-sum payment based on the applicable interest rates, the resulting funding target would be higher than $77,392.

(v) Using a single interest rate of 6.0771%, the January 1, 2009, present value of Participant E's single-sum payment based on the applicable interest rates is $77,392, and the present value of Participant E's single sum payment based on the plan's interest rate of 6.25% is $74,494. Plan P's funding target is the larger of the two, or $77,392, which is the same as the funding target based on the segment interest rates used for the 2009 valuation. Therefore, Plan P's effective interest rate for 2009 (rounded) is 6.08%.

(h) *Effective/applicability dates and transition rules*—(1) *Statutory effective date/applicability date*. Section 430 generally applies to plan years beginning on or after January 1, 2008. The applicability of section 430 for purposes of determining the minimum required contribution is delayed for certain plans in accordance with sections 104 through 106 of PPA'06.

(2) *Effective date/applicability date of regulations*. This section applies to plan years beginning on or after January 1, 2010, regardless of whether section 430 applies to determine the minimum required contribution for the plan year. For plan years beginning before January 1, 2010, plans are permitted to rely on the provisions set forth in this section for purposes of satisfying the requirements of section 430.

(3) *Approval for changes in interest rate*. Any change to an election under paragraph (e) of this section that is made for the first plan year beginning in 2009 or the first plan year beginning in 2010 is treated as having been approved by the Commissioner and does not require the Commissioner's specific prior approval.

(4) *Transition rule*—(i) *In general*. Notwithstanding the general rules for determination of segment rates under paragraph (c)(2) of this section, for plan years beginning in 2008 or 2009, the first, second, or third segment rate for a plan with respect to any month is equal to the sum of—

(A) The product of that rate for that month determined without regard to this paragraph (h)(4), multiplied by the applicable percentage; and

(B) The product of the weighted average interest rate determined under the rules of paragraph (h)(4)(iii) of this section, multiplied by a percentage equal to 100 percent minus the applicable percentage.

(ii) *Applicable percentage*. For purposes of this paragraph (h)(4), the applicable percentage is 33⅓ percent for plan years beginning in 2008 and 66⅔ percent for plan years beginning in 2009.

(iii) *Weighted average interest rate*. The weighted average interest rate for purposes of paragraph (h)(4)(i)(B) of this section is the weighted average interest rate under section 412(b)(5)(B)(ii)(II) (as that provision was in effect for plan years beginning in 2007) as of—

(A) The month which contains the first day of the plan year;

(B) The month which contains the valuation date (if the applicable month is determined under paragraph (b)(5) of this section); or

(C) The applicable month (if the applicable month is determined under paragraph (e)(2) of this section).

(iv) *New plans ineligible*. The transition rule of this paragraph (h)(4) does not apply if the first plan year of the plan begins on or after January 1, 2008.

[T.D. 9467, 74 FR 53055, Oct. 15, 2009; T.D. 9732, 80 FR 54390, Sept. 9, 2015]

§ 1.430(h)(3)–1 Mortality tables used to determine present value.

(a) *Basis for mortality tables*—(1) *In general*. This section sets forth rules for the mortality tables to be used in determining present value or making any computation under section 430. Generally applicable mortality tables for participants and beneficiaries are set forth in this section pursuant to section 430(h)(3)(A). In lieu of using the mortality tables provided under this section with respect to participants

and beneficiaries, plan-specific substitute mortality tables are permitted to be used for this purpose pursuant to section 430(h)(3)(C) provided that the requirements of § 1.430(h)(3)–2 are satisfied. Mortality tables that may be used with respect to disabled individuals are to be provided in guidance published in the Internal Revenue Bulletin. See § 601.601(d)(2)(ii)(*b*) of this chapter.

(2) *Static tables or generational tables permitted.* The generally applicable mortality tables provided under section 430(h)(3)(A) are the static tables described in paragraph (a)(3) of this section and the generational mortality tables described in paragraph (a)(4) of this section. A plan is permitted to use either of those sets of mortality tables with respect to participants and beneficiaries pursuant to this section.

(3) *Static tables.* The static mortality tables that are permitted to be used pursuant to paragraph (a)(2) of this section are updated annually to reflect expected improvements in mortality experience as described in paragraph (c)(2) of this section. Static mortality tables that are to be used with respect to valuation dates occurring during 2008 are provided in paragraph (e) of this section. The mortality tables to be used with respect to valuation dates occurring in later years are to be provided in guidance published in the Internal Revenue Bulletin. See § 601.601(d)(2)(ii)(*b*) of this chapter.

(4) *Generational mortality tables*—(i) *In general.* The generational mortality tables that are permitted to be used pursuant to paragraph (a)(2) of this section are determined pursuant to this paragraph (a)(4) using the base mortality tables and projection factors set forth in paragraph (d) of this section. Under the generational mortality tables, the probability of an individual's death at a particular age is determined as the individual's base mortality rate (that is, the applicable mortality rate from the table set forth in paragraph (d) of this section for the age for which the probability of death is being determined) multiplied by the mortality improvement factor. The mortality improvement factor is equal to $(1-\text{projection factor for that age})^n$, where n is equal to the projection period. For this purpose, the projection period is the number of years between 2000 and the year for which the probability of death is being determined.

(ii) *Examples of calculation.* As an example of the use of generational mortality tables under paragraph (a)(4)(i) of this section, for purposes of determining the probability of death at age 54 for a male annuitant born in 1974, the base mortality rate is .005797, the projection factor is .020, and the projection period (the period from the year 2000 until the year the participant will attain age 54) is 28 years, so that the mortality improvement factor is .567976, and the probability of death at age 54 is .003293. Similarly, under these generational mortality tables, the probability of death at age 55 for the same male annuitant would be determined by using the base mortality rate and projection factor at age 55, and a projection period of 29 years (the period from the year 2000 until the year the participant will attain age 55). Thus, the base mortality rate is .005905, the projection factor is .019, so that the mortality improvement factor is .573325 ($(1-.019)^{29}$), and the probability of death at age 55 is .003385 (.573325 times .005905). Because these generational mortality tables reflect expected improvements in mortality experience, no periodic updates are needed.

(b) *Use of the tables*—(1) *Separate tables for annuitants and nonannuitants*—(i) *In general.* Separate tables are provided for use for annuitants and nonannuitants. The nonannuitant mortality table is applied to determine the probability of survival for a nonannuitant for the period before the nonannuitant is projected to commence receiving benefits. The annuitant mortality table is applied to determine the present value of benefits for each annuitant, and for each nonannuitant for the period beginning when the nonannuitant is projected to commence receiving benefits. For purposes of this section, an annuitant means a plan participant who has commenced receiving benefits and a nonannuitant means a plan participant who has not yet commenced receiving benefits (for example, an active employee or a terminated vested participant). A participant whose benefit has partially commenced is treated as an annuitant with

respect to the portion of the benefit which has commenced and a nonannuitant with respect to the balance of the benefit. In addition, for any period in which an annuitant is projected to be receiving benefits, any beneficiary with respect to that annuitant is also treated as an annuitant for purposes of this paragraph (b)(1).

(ii) *Examples of calculation.* As an example of the use of separate annuitant and nonannuitant tables under paragraph (b)(1)(i) of this section, with respect to a 45-year-old active participant who is projected to commence receiving an annuity at age 55, the funding target would be determined using the nonannuitant mortality table for the period before the participant attains age 55 (so that, if the static mortality tables are used pursuant to paragraph (a)(3) of this section, the probability of an active male participant living from age 45 to age 55 using the table that applies for a plan year beginning in 2008 is 98.61%) and the annuitant mortality table for the period ages 55 and above. Similarly, if a 45-year-old terminated vested participant is projected to commence an annuity at age 65, the funding target would be determined using the nonannuitant mortality table for the period before the participant attains age 65 and the annuitant mortality table for ages 65 and above.

(2) *Small plan tables.* If static mortality tables are used pursuant to paragraph (a)(3) of this section, as an alternative to the separate static tables specified for annuitants and nonannuitants pursuant to paragraph (b)(1) of this section, a combined static table that applies the same mortality rates to both annuitants and nonannuitants is permitted to be used for a small plan. For this purpose, a small plan is defined as a plan with 500 or fewer participants (including both active and inactive participants) on the valuation date.

(c) *Construction of static tables*—(1) *Source of basic rates.* The static mortality tables that are used pursuant to paragraph (a)(3) of this section are based on the base mortality tables set forth in paragraph (d) of this section.

(2) *Projected mortality improvements.* The mortality rates under the base mortality tables are projected to improve using the projection factors provided in Projection Scale AA, as set forth in paragraph (d) of this section. Using these projection factors, the mortality rate for an individual at each age is determined as the individual's base mortality rate (that is, the applicable base mortality rate from the table set forth in paragraph (d) of this section for the individual at that age) multiplied by the mortality improvement factor. The mortality improvement factor is equal to $(1-\text{projection factor for that age})^n$, where n is equal to the projection period. The annuitant mortality rates for a plan year are determined using a projection period that runs from the calendar year 2000 until 7 years after the calendar year that contains the valuation date for the plan year. The nonannuitant mortality rates for a plan year are determined using a projection period that runs from the calendar year 2000 until 15 years after the calendar year that contains the valuation date for the plan year. Thus, for example, for a plan year with a January 1, 2012, valuation date, the annuitant mortality rates are determined using a projection period that runs from 2000 until 2019 (19 years) and the nonannuitant mortality rates are determined using a projection period that runs from 2000 until 2027 (27 years).

(3) *Construction of combined tables for small plans.* The combined mortality tables that are permitted to be used for small plans pursuant to paragraph (b)(2) of this section are constructed from the separate nonannuitant and annuitant tables using the weighting factors for small plans that are set forth in paragraph (d) of this section. The weighting factors are applied to develop these mortality tables using the following equation: Combined mortality rate = [nonannuitant rate * (1 − weighting factor)] + [annuitant rate * weighting factor].

(d) *Base mortality tables and projection factors.* The following base mortality tables and projection factors are used to determine generational mortality tables for purposes of determining present value or making any computation under section 430 as set forth in

paragraph (a)(4) of this section. In addition, the following base mortality tables and projection factors are used to determine the static mortality tables that are used for purposes of determining present value or making any computation under section 430 as set forth in paragraphs (a)(3) and (c) of this section. See §1.430(h)(3)–2(c)(3) for rules regarding the required use of the projection factors set forth in this paragraph (d) in connection with a plan-specific substitute mortality table.

Age	Male	Male	Male	Male	Female	Female	Female	Female
	Base non-annuitant mortality rates (year 2000)	Base annuitant mortality rates (year 2000)	Scale AA projection factors	Weighting factors for small plans	Base non-annuitant mortality rates (year 2000)	Base annuitant mortality rates (year 2000)	Scale AA projection factors	Weighting factors for small plans
1	0.000637	0.000637	0.020	0.000571	0.000571	0.020		
2	0.000430	0.000430	0.020	0.000372	0.000372	0.020		
3	0.000357	0.000357	0.020	0.000278	0.000278	0.020		
4	0.000278	0.000278	0.020	0.000208	0.000208	0.020		
5	0.000255	0.000255	0.020	0.000188	0.000188	0.020		
6	0.000244	0.000244	0.020	0.000176	0.000176	0.020		
7	0.000234	0.000234	0.020	0.000165	0.000165	0.020		
8	0.000216	0.000216	0.020	0.000147	0.000147	0.020		
9	0.000209	0.000209	0.020	0.000140	0.000140	0.020		
10	0.000212	0.000212	0.020	0.000141	0.000141	0.020		
11	0.000219	0.000219	0.020	0.000143	0.000143	0.020		
12	0.000228	0.000228	0.020	0.000148	0.000148	0.020		
13	0.000240	0.000240	0.020	0.000155	0.000155	0.020		
14	0.000254	0.000254	0.019	0.000162	0.000162	0.018		
15	0.000269	0.000269	0.019	0.000170	0.000170	0.016		
16	0.000284	0.000284	0.019	0.000177	0.000177	0.015		
17	0.000301	0.000301	0.019	0.000184	0.000184	0.014		
18	0.000316	0.000316	0.019	0.000188	0.000188	0.014		
19	0.000331	0.000331	0.019	0.000190	0.000190	0.015		
20	0.000345	0.000345	0.019	0.000191	0.000191	0.016		
21	0.000357	0.000357	0.018	0.000192	0.000192	0.017		
22	0.000366	0.000366	0.017	0.000194	0.000194	0.017		
23	0.000373	0.000373	0.015	0.000197	0.000197	0.016		
24	0.000376	0.000376	0.013	0.000201	0.000201	0.015		
25	0.000376	0.000376	0.010	0.000207	0.000207	0.014		
26	0.000378	0.000378	0.006	0.000214	0.000214	0.012		
27	0.000382	0.000382	0.005	0.000223	0.000223	0.012		
28	0.000393	0.000393	0.005	0.000235	0.000235	0.012		
29	0.000412	0.000412	0.005	0.000248	0.000248	0.012		
30	0.000444	0.000444	0.005	0.000264	0.000264	0.010		
31	0.000499	0.000499	0.005	0.000307	0.000307	0.008		
32	0.000562	0.000562	0.005	0.000350	0.000350	0.008		
33	0.000631	0.000631	0.005	0.000394	0.000394	0.009		
34	0.000702	0.000702	0.005	0.000435	0.000435	0.010		
35	0.000773	0.000773	0.005	0.000475	0.000475	0.011		
36	0.000841	0.000841	0.005	0.000514	0.000514	0.012		
37	0.000904	0.000904	0.005	0.000554	0.000554	0.013		
38	0.000964	0.000964	0.006	0.000598	0.000598	0.014		
39	0.001021	0.001021	0.007	0.000648	0.000648	0.015		
40	0.001079	0.001079	0.008	0.000706	0.000706	0.015		
41	0.001142	0.001157	0.009	0.0045	0.000774	0.000774	0.015	
42	0.001215	0.001312	0.010	0.0091	0.000852	0.000852	0.015	
43	0.001299	0.001545	0.011	0.0136	0.000937	0.000937	0.015	
44	0.001397	0.001855	0.012	0.0181	0.001029	0.001029	0.015	
45	0.001508	0.002243	0.013	0.0226	0.001124	0.001124	0.016	0.0084
46	0.001616	0.002709	0.014	0.0272	0.001223	0.001223	0.017	0.0167
47	0.001734	0.003252	0.015	0.0317	0.001326	0.001335	0.018	0.0251
48	0.001860	0.003873	0.016	0.0362	0.001434	0.001559	0.018	0.0335
49	0.001995	0.004571	0.017	0.0407	0.001550	0.001896	0.018	0.0419
50	0.002138	0.005347	0.018	0.0453	0.001676	0.002344	0.017	0.0502
51	0.002288	0.005528	0.019	0.0498	0.001814	0.002459	0.016	0.0586
52	0.002448	0.005644	0.020	0.0686	0.001967	0.002647	0.014	0.0744
53	0.002621	0.005722	0.020	0.0953	0.002135	0.002895	0.012	0.0947
54	0.002812	0.005797	0.020	0.1288	0.002321	0.003190	0.010	0.1189
55	0.003029	0.005905	0.019	0.2066	0.002526	0.003531	0.008	0.1897
56	0.003306	0.006124	0.018	0.3173	0.002756	0.003925	0.006	0.2857
57	0.003628	0.006444	0.017	0.3780	0.003010	0.004385	0.005	0.3403
58	0.003997	0.006895	0.016	0.4401	0.003291	0.004921	0.005	0.3878
59	0.004414	0.007485	0.016	0.4986	0.003599	0.005531	0.005	0.4360

Age	Male	Male	Male	Male	Female	Female	Female	Female
	Base non-annuitant mortality rates (year 2000)	Base annuitant mortality rates (year 2000)	Scale AA projection factors	Weighting factors for small plans	Base non-annuitant mortality rates (year 2000)	Base annuitant mortality rates (year 2000)	Scale AA projection factors	Weighting factors for small plans
60	0.004878	0.008196	0.016	0.5633	0.003931	0.006200	0.005	0.4954
61	0.005382	0.009001	0.015	0.6338	0.004285	0.006919	0.005	0.5805
62	0.005918	0.009915	0.015	0.7103	0.004656	0.007689	0.005	0.6598
63	0.006472	0.010951	0.014	0.7902	0.005039	0.008509	0.005	0.7520
64	0.007028	0.012117	0.014	0.8355	0.005429	0.009395	0.005	0.8043
65	0.007573	0.013419	0.014	0.8832	0.005821	0.010364	0.005	0.8552
66	0.008099	0.014868	0.013	0.9321	0.006207	0.011413	0.005	0.9118
67	0.008598	0.016460	0.013	0.9510	0.006583	0.012540	0.005	0.9367
68	0.009069	0.018200	0.014	0.9639	0.006945	0.013771	0.005	0.9523
69	0.009510	0.020105	0.014	0.9714	0.007289	0.015153	0.005	0.9627
70	0.009922	0.022206	0.015	0.9740	0.007613	0.016742	0.005	0.9661
71	0.010912	0.024570	0.015	0.9766	0.008309	0.018579	0.006	0.9695
72	0.012892	0.027281	0.015	0.9792	0.009700	0.020665	0.006	0.9729
73	0.015862	0.030387	0.015	0.9818	0.011787	0.022970	0.007	0.9763
74	0.019821	0.033900	0.015	0.9844	0.014570	0.025458	0.007	0.9797
75	0.024771	0.037834	0.014	0.9870	0.018049	0.028106	0.008	0.9830
76	0.030710	0.042169	0.014	0.9896	0.022224	0.030966	0.008	0.9864
77	0.037640	0.046906	0.013	0.9922	0.027094	0.034105	0.007	0.9898
78	0.045559	0.052123	0.012	0.9948	0.032660	0.037595	0.007	0.9932
79	0.054469	0.057927	0.011	0.9974	0.038922	0.041506	0.007	0.9966
80	0.064368	0.064368	0.010	1.0000	0.045879	0.045879	0.007	1.0000
81	0.072041	0.072041	0.009	1.0000	0.050780	0.050780	0.007	1.0000
82	0.080486	0.080486	0.008	1.0000	0.056294	0.056294	0.007	1.0000
83	0.089718	0.089718	0.008	1.0000	0.062506	0.062506	0.007	1.0000
84	0.099779	0.099779	0.007	1.0000	0.069517	0.069517	0.007	1.0000
85	0.110757	0.110757	0.007	1.0000	0.077446	0.077446	0.006	1.0000
86	0.122797	0.122797	0.007	1.0000	0.086376	0.086376	0.005	1.0000
87	0.136043	0.136043	0.006	1.0000	0.096337	0.096337	0.004	1.0000
88	0.150590	0.150590	0.005	1.0000	0.107303	0.107303	0.004	1.0000
89	0.166420	0.166420	0.005	1.0000	0.119154	0.119154	0.003	1.0000
90	0.183408	0.183408	0.004	1.0000	0.131682	0.131682	0.003	1.0000
91	0.199769	0.199769	0.004	1.0000	0.144604	0.144604	0.003	1.0000
92	0.216605	0.216605	0.003	1.0000	0.157618	0.157618	0.003	1.0000
93	0.233662	0.233662	0.003	1.0000	0.170433	0.170433	0.002	1.0000
94	0.250693	0.250693	0.003	1.0000	0.182799	0.182799	0.002	1.0000
95	0.267491	0.267491	0.002	1.0000	0.194509	0.194509	0.002	1.0000
96	0.283905	0.283905	0.002	1.0000	0.205379	0.205379	0.002	1.0000
97	0.299852	0.299852	0.002	1.0000	0.215240	0.215240	0.001	1.0000
98	0.315296	0.315296	0.001	1.0000	0.223947	0.223947	0.001	1.0000
99	0.330207	0.330207	0.001	1.0000	0.231387	0.231387	0.001	1.0000
100	0.344556	0.344556	0.001	1.0000	0.237467	0.237467	0.001	1.0000
101	0.358628	0.358628	0.000	1.0000	0.244834	0.244834	0.000	1.0000
102	0.371685	0.371685	0.000	1.0000	0.254498	0.254498	0.000	1.0000
103	0.383040	0.383040	0.000	1.0000	0.266044	0.266044	0.000	1.0000
104	0.392003	0.392003	0.000	1.0000	0.279055	0.279055	0.000	1.0000
105	0.397886	0.397886	0.000	1.0000	0.293116	0.293116	0.000	1.0000
106	0.400000	0.400000	0.000	1.0000	0.307811	0.307811	0.000	1.0000
107	0.400000	0.400000	0.000	1.0000	0.322725	0.322725	0.000	1.0000
108	0.400000	0.400000	0.000	1.0000	0.337441	0.337441	0.000	1.0000
109	0.400000	0.400000	0.000	1.0000	0.351544	0.351544	0.000	1.0000
110	0.400000	0.400000	0.000	1.0000	0.364617	0.364617	0.000	1.0000
111	0.400000	0.400000	0.000	1.0000	0.376246	0.376246	0.000	1.0000
112	0.400000	0.400000	0.000	1.0000	0.386015	0.386015	0.000	1.0000
113	0.400000	0.400000	0.000	1.0000	0.393507	0.393507	0.000	1.0000
114	0.400000	0.400000	0.000	1.0000	0.398308	0.398308	0.000	1.0000
115	0.400000	0.400000	0.000	1.0000	0.400000	0.400000	0.000	1.0000
116	0.400000	0.400000	0.000	1.0000	0.400000	0.400000	0.000	1.0000
117	0.400000	0.400000	0.000	1.0000	0.400000	0.400000	0.000	1.0000
118	0.400000	0.400000	0.000	1.0000	0.400000	0.400000	0.000	1.0000
119	0.400000	0.400000	0.000	1.0000	0.400000	0.400000	0.000	1.0000
120	1.000000	1.000000	0.000	1.0000	1.000000	1.000000	0.000	1.0000

(e) *Static mortality tables with respect to valuation dates occurring during 2008.* The following static mortality tables are used pursuant to paragraph (a)(3) of this section for determining present value or making any computation

under section 430 with respect to valuation dates occurring during 2008.

Age	Male	Male	Male	Female	Female	Female
	Non-annuitant mortality rates	Annuitant mortality rates	Optional combined table for small plans	Non-annuitant mortality rates	Annuitant mortality rates	Optional combined table for small plans
1	0.000400	0.000400	0.000400	0.000359	0.000359	0.000359
2	0.000270	0.000270	0.000270	0.000234	0.000234	0.000234
3	0.000224	0.000224	0.000224	0.000175	0.000175	0.000175
4	0.000175	0.000175	0.000175	0.000131	0.000131	0.000131
5	0.000160	0.000160	0.000160	0.000118	0.000118	0.000118
6	0.000153	0.000153	0.000153	0.000111	0.000111	0.000111
7	0.000147	0.000147	0.000147	0.000104	0.000104	0.000104
8	0.000136	0.000136	0.000136	0.000092	0.000092	0.000092
9	0.000131	0.000131	0.000131	0.000088	0.000088	0.000088
10	0.000133	0.000133	0.000133	0.000089	0.000089	0.000089
11	0.000138	0.000138	0.000138	0.000090	0.000090	0.000090
12	0.000143	0.000143	0.000143	0.000093	0.000093	0.000093
13	0.000151	0.000151	0.000151	0.000097	0.000097	0.000097
14	0.000163	0.000163	0.000163	0.000107	0.000107	0.000107
15	0.000173	0.000173	0.000173	0.000117	0.000117	0.000117
16	0.000183	0.000183	0.000183	0.000125	0.000125	0.000125
17	0.000194	0.000194	0.000194	0.000133	0.000133	0.000133
18	0.000203	0.000203	0.000203	0.000136	0.000136	0.000136
19	0.000213	0.000213	0.000213	0.000134	0.000134	0.000134
20	0.000222	0.000222	0.000222	0.000132	0.000132	0.000132
21	0.000235	0.000235	0.000235	0.000129	0.000129	0.000129
22	0.000247	0.000247	0.000247	0.000131	0.000131	0.000131
23	0.000263	0.000263	0.000263	0.000136	0.000136	0.000136
24	0.000278	0.000278	0.000278	0.000142	0.000142	0.000142
25	0.000298	0.000298	0.000298	0.000150	0.000150	0.000150
26	0.000329	0.000329	0.000329	0.000162	0.000162	0.000162
27	0.000340	0.000340	0.000340	0.000169	0.000169	0.000169
28	0.000350	0.000350	0.000350	0.000178	0.000178	0.000178
29	0.000367	0.000367	0.000367	0.000188	0.000188	0.000188
30	0.000396	0.000396	0.000396	0.000210	0.000210	0.000210
31	0.000445	0.000445	0.000445	0.000255	0.000255	0.000255
32	0.000501	0.000501	0.000501	0.000291	0.000291	0.000291
33	0.000562	0.000562	0.000562	0.000320	0.000320	0.000320
34	0.000626	0.000626	0.000626	0.000345	0.000345	0.000345
35	0.000689	0.000689	0.000689	0.000368	0.000368	0.000368
36	0.000749	0.000749	0.000749	0.000389	0.000389	0.000389
37	0.000806	0.000806	0.000806	0.000410	0.000410	0.000410
38	0.000839	0.000839	0.000839	0.000432	0.000432	0.000432
39	0.000869	0.000869	0.000869	0.000458	0.000458	0.000458
40	0.000897	0.000897	0.000897	0.000499	0.000499	0.000499
41	0.000928	0.000955	0.000928	0.000547	0.000547	0.000547
42	0.000964	0.001070	0.000965	0.000602	0.000602	0.000602
43	0.001007	0.001243	0.001010	0.000662	0.000662	0.000662
44	0.001058	0.001474	0.001066	0.000727	0.000727	0.000727
45	0.001116	0.001763	0.001131	0.000776	0.000779	0.000776
46	0.001168	0.002109	0.001194	0.000824	0.000882	0.000825
47	0.001225	0.002513	0.001266	0.000873	0.001037	0.000877
48	0.001284	0.002975	0.001345	0.000944	0.001244	0.000954
49	0.001345	0.003495	0.001433	0.001021	0.001502	0.001041
50	0.001408	0.004072	0.001529	0.001130	0.001812	0.001164
51	0.001472	0.004146	0.001605	0.001252	0.001931	0.001292
52	0.001538	0.004168	0.001718	0.001422	0.002142	0.001476
53	0.001647	0.004226	0.001893	0.001617	0.002415	0.001693
54	0.001767	0.004281	0.002091	0.001842	0.002744	0.001949
55	0.001948	0.004428	0.002460	0.002100	0.003130	0.002295
56	0.002177	0.004663	0.002966	0.002400	0.003586	0.002739
57	0.002446	0.004983	0.003405	0.002682	0.004067	0.003153
58	0.002758	0.005413	0.003926	0.002933	0.004565	0.003566
59	0.003046	0.005876	0.004457	0.003207	0.005130	0.004045
60	0.003366	0.006435	0.005095	0.003503	0.005751	0.004617
61	0.003802	0.007175	0.005940	0.003818	0.006418	0.005327
62	0.004180	0.007904	0.006825	0.004149	0.007132	0.006117
63	0.004680	0.008864	0.007986	0.004490	0.007893	0.007049
64	0.005082	0.009807	0.009030	0.004838	0.008715	0.007956
65	0.005476	0.010861	0.010232	0.005187	0.009613	0.008972
66	0.005994	0.012218	0.011795	0.005531	0.010586	0.010140
67	0.006363	0.013527	0.013176	0.005866	0.011632	0.011267

Age	Male	Male	Male	Female	Female	Female
	Non-annuitant mortality rates	Annuitant mortality rates	Optional combined table for small plans	Non-annuitant mortality rates	Annuitant mortality rates	Optional combined table for small plans
68	0.006557	0.014731	0.014436	0.006189	0.012774	0.012460
69	0.006876	0.016273	0.016004	0.006495	0.014055	0.013773
70	0.007009	0.017702	0.017424	0.006784	0.015529	0.015233
71	0.007888	0.019586	0.019312	0.007411	0.016975	0.016683
72	0.009646	0.021747	0.021495	0.008666	0.018881	0.018604
73	0.012283	0.024223	0.024006	0.010548	0.020673	0.020433
74	0.015799	0.027024	0.026849	0.013058	0.022912	0.022712
75	0.020195	0.030622	0.030486	0.016195	0.024916	0.024768
76	0.025470	0.034131	0.034041	0.019959	0.027451	0.027349
77	0.031624	0.038547	0.038493	0.024351	0.030694	0.030629
78	0.038657	0.043489	0.043464	0.029370	0.033835	0.033805
79	0.046569	0.049071	0.049064	0.035017	0.037355	0.037347
80	0.055360	0.055360	0.055360	0.041291	0.041291	0.041291
81	0.062905	0.062905	0.062905	0.045702	0.045702	0.045702
82	0.071350	0.071350	0.071350	0.050664	0.050664	0.050664
83	0.079534	0.079534	0.079534	0.056255	0.056255	0.056255
84	0.089800	0.089800	0.089800	0.062565	0.062565	0.062565
85	0.099680	0.099680	0.099680	0.070761	0.070761	0.070761
86	0.110516	0.110516	0.110516	0.080120	0.080120	0.080120
87	0.124300	0.124300	0.124300	0.090716	0.090716	0.090716
88	0.139683	0.139683	0.139683	0.101042	0.101042	0.101042
89	0.154366	0.154366	0.154366	0.113903	0.113903	0.113903
90	0.172706	0.172706	0.172706	0.125879	0.125879	0.125879
91	0.188113	0.188113	0.188113	0.138232	0.138232	0.138232
92	0.207060	0.207060	0.207060	0.150672	0.150672	0.150672
93	0.223365	0.223365	0.223365	0.165391	0.165391	0.165391
94	0.239646	0.239646	0.239646	0.177391	0.177391	0.177391
95	0.259578	0.259578	0.259578	0.188755	0.188755	0.188755
96	0.275506	0.275506	0.275506	0.199303	0.199303	0.199303
97	0.290981	0.290981	0.290981	0.212034	0.212034	0.212034
98	0.310600	0.310600	0.310600	0.220611	0.220611	0.220611
99	0.325288	0.325288	0.325288	0.227940	0.227940	0.227940
100	0.339424	0.339424	0.339424	0.233930	0.233930	0.233930
101	0.358628	0.358628	0.358628	0.244834	0.244834	0.244834
102	0.371685	0.371685	0.371685	0.254498	0.254498	0.254498
103	0.383040	0.383040	0.383040	0.266044	0.266044	0.266044
104	0.392003	0.392003	0.392003	0.279055	0.279055	0.279055
105	0.397886	0.397886	0.397886	0.293116	0.293116	0.293116
106	0.400000	0.400000	0.400000	0.307811	0.307811	0.307811
107	0.400000	0.400000	0.400000	0.322725	0.322725	0.322725
108	0.400000	0.400000	0.400000	0.337441	0.337441	0.337441
109	0.400000	0.400000	0.400000	0.351544	0.351544	0.351544
110	0.400000	0.400000	0.400000	0.364617	0.364617	0.364617
111	0.400000	0.400000	0.400000	0.376246	0.376246	0.376246
112	0.400000	0.400000	0.400000	0.386015	0.386015	0.386015
113	0.400000	0.400000	0.400000	0.393507	0.393507	0.393507
114	0.400000	0.400000	0.400000	0.398308	0.398308	0.398308
115	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
116	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
117	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
118	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
119	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
120	1.000000	1.000000	1.000000	1.000000	1.000000	1.000000

(f) *Effective/Applicability date.* This section applies for plan years beginning on or after January 1, 2008.

[T.D. 9419, 73 FR 44639, July 31, 2008]

§ 1.430(h)(3)–2 Plan-specific substitute mortality tables used to determine present value.

(a) *In general.* This section sets forth rules for the use of substitute mortality tables under section 430(h)(3)(C) in determining any present value or making any computation under section 430 in accordance with §1.430(h)(3)–1(a)(1). In order to use substitute mortality tables, a plan sponsor must obtain approval to use substitute mortality tables for the plan in accordance with the procedures set forth in paragraph (b) of this section. Paragraph (c)

of this section sets forth rules for the development of substitute mortality tables, including guidelines for determining whether a plan has sufficient credible mortality experience to use substitute mortality tables. Paragraph (d) of this section sets forth special rules regarding the use of substitute mortality tables. The Commissioner may, in revenue rulings and procedures, notices or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter), provide additional guidance regarding approval and use of substitute mortality tables under section 430(h)(3)(C) and related matters.

(b) *Procedures for obtaining approval to use substitute mortality tables*—(1) *Written request to use substitute mortality tables*—(i) *General requirements*. In order to use substitute mortality tables, a plan sponsor must submit a written request to the Commissioner that demonstrates that those substitute mortality tables meet the requirements of section 430(h)(3)(C) and this section. This request must state the first plan year and the term of years (not more than 10) that the tables are requested to be used.

(ii) *Time for written request*—(A) *In general*. Except as provided in this paragraph (b)(1)(ii), substitute mortality tables cannot be used for a plan year unless the plan sponsor submits the written request described in paragraph (b)(1)(i) of this section at least 7 months prior to the first day of the first plan year for which the substitute mortality tables are to apply.

(B) *Special rule for requests submitted on or before October 1, 2007*. Notwithstanding the rule of paragraph (b)(1)(ii)(A) of this section, the timing of the written request described in paragraph (b)(1)(i) of this section does not prevent a plan from using substitute mortality tables for a plan year provided that the written request is submitted no later than October 1, 2007.

(C) *Special rule for requests submitted on or before October 1, 2008, with respect to plan years beginning during 2009*. Notwithstanding the rule of paragraph (b)(1)(ii)(A) of this section, the timing of the written request described in paragraph (b)(1)(i) of this section does not prevent a plan from using substitute mortality tables for a plan year that begins during 2009 provided that the written request is submitted no later than October 1, 2008.

(2) *Commissioner's review of request*—(i) *In general*. During the 180-day period that begins on the date the plan sponsor submits a request to use substitute mortality tables for a plan pursuant to this section, the Commissioner will determine whether the request to use substitute mortality tables satisfies the requirements of this section (including any published guidance issued pursuant to paragraph (a) of this section), and will either approve or deny the request. The Commissioner will deny a request if the request fails to meet the requirements of this section or if the Commissioner determines that a substitute mortality table does not sufficiently reflect the mortality experience of the applicable plan population.

(ii) *Request for additional information*. The Commissioner may request additional information with respect to the submission. Failure to provide that information on a timely basis constitutes grounds for denial of the request.

(iii) *Deemed approval*. Except as provided in paragraph (b)(2)(iv) of this section, if the Commissioner does not issue a denial within the 180-day review period, the request is deemed to have been approved.

(iv) *Extension of time permitted*. The Commissioner and a plan sponsor may, before the expiration of the 180-day review period, agree in writing to extend that period, provided that any such agreement also specifies any revisions in the plan sponsor's request, including any change in the requested term of use of the substitute mortality tables.

(c) *Development of substitute mortality tables*—(1) *Mortality experience requirements*—(i) *In general*. Substitute mortality tables must reflect the actual mortality experience of the pension plan for which the tables are to be used and that mortality experience must be credible mortality experience as described in paragraph (c)(1)(ii) of this section. Separate mortality tables must be established for each gender under the plan, and a substitute mortality table is permitted to be established for a gender only if the plan has

credible mortality experience with respect to that gender.

(ii) *Credible mortality experience*. There is credible mortality experience for a gender within a plan if and only if, over the period covered by the experience study described in paragraph (c)(2)(ii) of this section, there are at least 1,000 deaths within that gender.

(iii) *Gender without credible mortality experience*—(A) *In general*. If, for the first year for which a plan uses substitute mortality tables, one gender has credible mortality experience but the other gender does not have credible mortality experience, the substitute mortality tables are used for the gender that does have credible mortality experience and the mortality tables under §1.430(h)(3)–1 are used for the gender that does not have credible mortality experience. For a subsequent plan year, the plan sponsor may continue to use substitute mortality tables for the gender with credible mortality experience without using substitute mortality tables for the other gender only if the other gender continues to lack credible mortality experience for that subsequent plan year.

(B) *Demonstration of lack of credible mortality experience for a gender*. In general, in order to demonstrate that a gender within a plan does not have credible mortality experience for a plan year, the demonstration that the gender population within the plan has fewer than 1,000 deaths over a 4-year period must be made using a 4-year period that ends less than 3 years before the first day of that plan year. For example, if a plan uses substitute mortality tables based on credible mortality experience obtained over a 4-year experience study period for its male population and the standard mortality tables under §1.430(h)(3)–1 for its female population, there must be a demonstration that the plan's female population does not have at least 1,000 deaths in a 4-year period that ends less than 3 years before the first day of that plan year. However, if the experience study period described in paragraph (c)(2)(ii)(A) of this section exceeds 4 years, then in order to demonstrate that a gender within a plan does not have credible mortality experience for a plan year, the mortality experience of that population must be analyzed over a period that is the same length as the experience study on which the substitute mortality tables are based and that ends less than 3 years before the first day of that plan year.

(iv) *Disabled individuals*. Under section 430(h)(3)(D), separate mortality tables are permitted to be used for certain disabled individuals. If such separate mortality tables are used for those disabled individuals, then those individuals are disregarded for all purposes under this section. Thus, if the mortality tables under section 430(h)(3)(D) are used for disabled individuals under a plan, mortality experience with respect to those individuals must be excluded in developing mortality rates for substitute mortality tables under this section.

(2) *Base table and base year*—(i) *In general*. Development of a substitute mortality table under this section requires creation of a base table and identification of a base year under this paragraph (c)(2). The base table and base year are then used to determine a substitute mortality table under paragraph (c)(3) of this section.

(ii) *Experience study and base table requirements*—(A) *In general*. The base table for a plan population must be developed from an experience study of the mortality experience of that plan population that generates amounts-weighted mortality rates based on experience data for the plan that is collected over an experience study period. The minimum length of the experience study period is 2 years. The maximum length of the experience study period is 5 years, but can be extended by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter). The last day of the final year reflected in the experience data must be less than 3 years before the first day of the first plan year for which the substitute mortality tables are to apply. For example, if July 1, 2009, is the first day of the first plan year for which the substitute mortality tables will be used, then an experience study using calendar year data must include data collected for a period that ends no earlier than December 31, 2006.

(B) *Amounts-weighted mortality rates.* The amounts-weighted mortality rate for an age is equal to the quotient determined by dividing the sum of the accrued benefits (or payable benefits, in the case of individuals in pay status) for all individuals at that age at the beginning of the year who died during the year, by the sum of the accrued benefits (or payable benefits, in the case of individuals in pay status) for all individuals at that age at the beginning of the year, with appropriate adjustments for individuals who left the relevant plan population during the year for reasons other than death. Because amounts-weighted mortality rates for a plan cannot be determined without accrued (or payable) benefits, the mortality experience study used to develop a base table cannot include periods before the plan was established.

(C) *Grouping of ages.* Amounts-weighted mortality rates may be derived from amounts-weighted mortality rates for age groups. The Commissioner, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter), may specify grouping rules (for example, 5-year age groups, except for extreme ages such as ages above 100 or below 20) and methods for developing amounts-weighted mortality rates for individual ages from amounts-weighted mortality rates initially determined for each age group.

(D) *Base table construction.* The base tables must be constructed from the amounts-weighted mortality rates determined in paragraph (c)(2)(ii)(B) of this section. The base tables must be constructed either directly through graduation of the amounts-weighted mortality rates or indirectly by applying a level percentage to the applicable mortality table set forth in § 1.430(h)(3)–1, provided that the adjusted table sufficiently reflects the mortality experience of the plan. The Commissioner also may permit the use of other recognized mortality tables in the construction of base tables, applying a similar mortality experience standard.

(iii) *Base year requirements.* The base year is the calendar year that contains the day before the midpoint of the experience study period. If the base table is constructed by applying a level percentage to a table set forth in § 1.430(h)(3)–1, then the percentage must be applied to the table under § 1.430(h)(3)–1 after it has been projected to the base year using Projection Scale AA, as set forth in § 1.430(h)(3)–1(d). Thus, for example, if the base year of the mortality experience study is 2005, the applicable base (year 2000) mortality rates must be projected 5 years prior to determining the level percentage to be applied to the applicable projected base (year 2000) mortality rates.

(iv) *Change in number of individuals covered by table.* Experience data cannot be used to develop a base table if the number of individuals in the population covered by the table (for example, the male annuitant population) as of the last day of the plan year before the year the request to use substitute mortality tables is made, compared to the average number of individuals in that population over the years covered by the experience study on which the substitute mortality tables are based, reflects a difference of 20 percent or more, unless it is demonstrated to the satisfaction of the Commissioner that the experience data is accurately predictive of future mortality of that plan population (taking into account the effect of the change in individuals) after appropriate adjustments to the data are made (for example, excluding data from individuals with respect to a spun-off portion of the plan). For this purpose, a reasonable estimate of the number of individuals in the population covered by the table may be used, such as the estimated number of participants and beneficiaries used for purposes of the PBGC Form 1–ES.

(3) *Determination of substitute mortality tables*—(i) *In general.* A plan's substitute mortality tables must be generational mortality tables. Substitute mortality tables are determined using the base mortality tables developed pursuant to paragraph (c)(2) of this section and the projection factors provided in Projection Scale AA, as set forth in § 1.430(h)(3)–1(d). Under the generational mortality tables, the probability of an individual's death at a particular age is determined as the individual's base mortality rate (that

is, the applicable mortality rate from the base mortality table for the age for which the probability of death is being determined) multiplied by the mortality improvement factor. The mortality improvement factor is equal to $(1 - \text{projection factor for that age})^n$, where n is equal to the projection period (the number of years between the base year for the base mortality table and the calendar year in which the individual attains the age for which the probability of death is being determined).

(ii) *Example of calculation.* As an example of the use of generational mortality tables under paragraph (c)(3)(i) of this section, if approved substitute mortality tables are based on data collected during 2005 and 2006, the base year would be 2005 because 2005 would be the year that contains the day before the midpoint of the experience study period. If the tables show a base mortality rate of .006000 for male annuitants at age 54, the probability of death at age 54 for a male annuitant born in 1974 would be determined using the base mortality rate of .006000, the age-54 projection factor of .020 (pursuant to the Scale AA Projection Factors set forth in §1.430(h)(3)–1(d)) and a projection period of 23 years. The projection period is the number of years between the base year of 2005 and the calendar year in which the individual reaches age 54. Accordingly, the mortality improvement factor would be .628347 and the probability of death at age 54 would be .003770.

(4) *Separate tables for specified populations*—(i) *In general.* Except as provided in this paragraph (c)(4), separate substitute mortality tables are permitted to be used for separate populations within a gender under a plan only if—

(A) All individuals of that gender in the plan are divided into separate populations;

(B) Each separate population has credible mortality experience as provided in paragraph (c)(4)(iii) of this section; and

(C) The separate substitute mortality table for each separate population is developed using mortality experience data for that population.

(ii) *Annuitant and nonannuitant separate populations.* Notwithstanding paragraph (c)(4)(i)(B) of this section, substitute mortality tables for separate populations of annuitants and nonannuitants within a gender may be used even if only one of those separate populations has credible mortality experience. Similarly, if separate populations that satisfy paragraph (c)(4)(i)(B) of this section are established, then any of those populations may be further subdivided into separate annuitant and nonannuitant subpopulations, provided that at least one of the two resulting subpopulations has credible mortality experience. The standard mortality tables under §1.430(h)(3)–1 are used for a resulting subpopulation that does not have credible mortality experience. For example, in the case of a plan that has credible mortality experience for both its male hourly and salaried individuals, if the male salaried annuitant population has credible mortality experience, the plan may use substitute mortality tables with respect to that population even if the standard mortality tables under §1.430(h)(3)–1 are used for the male salaried nonannuitant population (because that nonannuitant population does not have credible mortality experience).

(iii) *Credible mortality experience for separate populations.* In determining whether a separate population within a gender has credible mortality experience, the requirements of paragraph (c)(1)(ii) of this section must be satisfied but, in applying that paragraph (c)(1)(ii), the separate population should be substituted for the particular gender. In demonstrating that an annuitant or nonannuitant population within a gender or within a separate population does not have credible mortality experience, the requirements of paragraph (c)(1)(iii) of this section must be satisfied but, in applying that paragraph, the annuitant (or nonannuitant) population should be substituted for the particular gender.

(d) *Special rules*—(1) *All plans in controlled group must use substitute mortality tables*—(i) *In general.* Except as otherwise provided in this paragraph (d)(1), substitute mortality tables are permitted to be used for a plan for a plan

year only if, for that plan year (or any portion of that plan year), substitute mortality tables are also approved and used for each other pension plan subject to the requirements of section 430 that is maintained by the sponsor and by each member of the plan sponsor's controlled group. For purposes of this section, the term *controlled group* means any group treated as a single employer under paragraph (b), (c), (m), or (o) of section 414.

(ii) *Plans without credible experience*—(A) *In general.* For the first year for which a plan uses substitute mortality tables, the use of substitute mortality tables for the plan is not prohibited merely because another plan described in paragraph (d)(1)(i) of this section cannot use substitute mortality tables because neither the males nor the females under that other plan have credible mortality experience for a plan year. For each subsequent plan year, the plan sponsor may continue to use substitute mortality tables for the plan with credible mortality experience without using substitute mortality tables for the other plan only if neither the males nor the females under that other plan have credible mortality experience for that subsequent plan year.

(B) *Analysis of mortality experience.* For each plan year in which a plan uses substitute mortality tables, in order to demonstrate that the male and female populations of another plan maintained by the plan sponsor (or by a member of the plan sponsor's controlled group) do not have credible mortality experience, the requirements of paragraph (c)(1)(iii)(B) of this section must be satisfied for that plan year. Thus, a plan is not prohibited from using substitute mortality tables for a plan year merely because another plan in the controlled group of the plan sponsor does not have at least 1,000 male deaths and does not have at least 1,000 female deaths in a 4-year period (or a period that is the length of the experience study period if the experience study period under paragraph (c)(2)(ii)(A) of this section is longer than 4 years) that ends less than 3 years before the first day of that plan year.

(iii) *Newly affiliated plans not using substitute mortality tables*—(A) *In general.* The use of substitute mortality tables for a plan is not prohibited merely because a newly affiliated plan does not use substitute mortality tables, but only through the last day of the plan year of the plan using substitute mortality tables that contains the last day of the period described in section 410(b)(6)(C)(ii) for either the newly affiliated plan or the plan using substitute mortality tables, whichever is later. Thus, for the following plan year, the mortality tables prescribed under §1.430(h)(3)–1 apply with respect to the plan (and all other plans within the plan sponsor's controlled group, including the newly affiliated plan) unless—

(*1*) Approval to use substitute mortality tables has been obtained with respect to the newly affiliated plan pursuant to paragraph (b)(1) of this section; or

(*2*) The newly affiliated plan cannot use substitute mortality tables because neither the males nor the females under the plan have credible mortality experience as described in paragraph (c)(1)(ii) of this section (as determined in accordance with the rules of paragraph (d)(1)(iv) of this section).

(B) *Definition of newly affiliated plan.* For purposes of this section, a plan is treated as a newly affiliated plan if it becomes maintained by the plan sponsor (or by a member of the plan sponsor's controlled group) in connection with a merger, acquisition, or similar transaction described in §1.410(b)–2(f). A plan also is treated as a newly affiliated plan for purposes of this section if the plan is established in connection with a transfer of assets and liabilities from another employer's plan in connection with a merger, acquisition, or similar transaction described in §1.410(b)–2(f).

(iv) *Demonstration of credible mortality experience for newly affiliated plan*—(A) *In general.* In general, in the case of a newly affiliated plan described in paragraph (d)(1)(iii) of this section, the demonstration of whether credible mortality experience exists for the plan for a plan year may be made by either including or excluding mortality experience data for the period prior to the date the plan becomes maintained by a member of the new plan sponsor's

controlled group. If a plan sponsor excludes mortality experience data for the period prior to the date the plan becomes maintained within the new plan sponsor's controlled group, the exclusion must apply for all populations within the plan.

(B) *Demonstration of credible mortality experience.* Regardless of whether mortality experience data for the period prior to the date a newly affiliated plan becomes maintained within the new plan sponsor's controlled group is included or excluded for a plan year, the provisions of this section, including the demonstration of credible mortality experience in accordance with paragraph (c)(1)(ii) of this section, must be satisfied before substitute mortality tables may be used with respect to the plan. Thus, for example, the plan must meet the rule in paragraph (c)(2)(ii)(A) of this section that the base table be based on mortality experience data for the plan over a 2-year or longer consecutive period that ends less than 3 years before the first day of the plan year for which substitute mortality tables will be used.

(C) *Demonstration of lack of credible mortality experience.* In the case of a newly affiliated plan described in paragraph (d)(1)(iii) of this section, in order to demonstrate a lack of credible mortality experience with respect to a gender for a plan year, the rules of paragraph (c)(1)(iii)(B) of this section generally will apply. However, a special rule applies if the plan's mortality experience demonstration for a plan year is made by excluding mortality experience for the period prior to the date the plan becomes maintained by a member of the new plan sponsor's controlled group. In such a case, an employer is permitted to demonstrate a plan's lack of credible mortality experience using an experience study period of less than four years, provided that the experience study period begins with the date the plan becomes maintained within the sponsor's controlled group and ends not more than one year and one day before the first day of the plan year with respect to which the lack of credible mortality experience demonstration is made.

(D) *Example.* The following example illustrates the application of this paragraph (d)(1):

Example. (i) Employer A is a corporation and maintains Plan M, which has a calendar year plan year and has obtained approval to use substitute mortality tables for 10 years beginning with the plan year that begins on January 1, 2009. Employer B is a corporation and maintains Plan N, which does not use substitute mortality tables and has a calendar year plan year. On July 1, 2010, Employer A acquires 100% of the stock of Employer B.

(ii) Pursuant to paragraph (d)(1)(iii) of this section, the maintenance of Plan N within the controlled group that maintains Plan M does not impair the use of substitute mortality tables by Plan M through the end of the plan year that ends on December 31, 2011.

(iii) Pursuant to paragraph (d)(1)(iii) of this section, beginning with the plan year that begins on January 1, 2012, Plan M continues to use substitute mortality tables only if either Plan N obtains approval to use substitute mortality tables or Employer A can demonstrate that Plan N does not have credible mortality experience. Pursuant to paragraph (d)(1)(iv)(C) of this section, Employer A is permitted to either exclude mortality experience date for the period of time before July 1, 2010 (the date Plan N became maintained with Employer A's controlled group), or include that mortality experience data for purposes of demonstrating that Plan N does not have credible mortality experience. Thus, if there is an experience study that shows that the male and female populations of Plan N each do not have 1,000 deaths during the period from July 1, 2010, through December 31, 2010, then the maintenance of Plan N within the Employer A's controlled group does not impair Plan M's use of substitute mortality tables for Plan M's 2012 plan year.

(iv) For Plan M's 2013 plan year, pursuant to paragraph (d)(1)(iv)(C) of this section, the maintenance of Plan N within Employer A's controlled group does not impair Plan M's use of substitute mortality tables if there is an experience study that shows that the male and female populations of Plan N each do not have 1,000 deaths during the period from July 1, 2010, through December 31, 2011.

(2) *Duration of use of tables.* Except as provided in paragraph (d)(4) of this section, substitute mortality tables are used with respect to a plan for the term of consecutive plan years specified in the plan sponsor's written request to use such tables under paragraph (b)(1) of this section and approved by the Commissioner, or such

shorter period prescribed by the Commissioner in the approval to use substitute mortality tables. Following the end of such term of use, or following any early termination of use described in paragraph (d)(4) of this section, the mortality tables specified in §1.430(h)(3)–1 apply with respect to the plan unless approval under paragraph (b)(1) of this section has been received by the plan sponsor to use substitute mortality tables for a further term.

(3) *Aggregation*—(i) *Permissive aggregation of plans*. In order for a plan sponsor to use a set of substitute mortality tables with respect to two or more plans, the rules of this section are applied by treating those plans as a single plan. In such a case, the substitute mortality tables must be used for the aggregated plans and must be based on data collected with respect to those aggregated plans.

(ii) *Required aggregation of plans*. In general, plans are not required to be aggregated for purposes of applying the rules of this section. However, for purposes of this section, a plan is required to be aggregated with any plan that was previously spun off from that plan for purposes of this section if the Commissioner determines that one purpose of the spinoff is to avoid the use of substitute mortality tables for any of the plans that were involved in the spinoff.

(4) *Early termination of use of tables*—(i) *General rule*. A plan's substitute mortality tables cannot be used as of the earliest of—

(A) The plan year in which the plan fails to satisfy the requirements of paragraph (c)(1) of this section (regarding credible mortality experience requirements and demonstrations);

(B) The plan year in which the plan fails to satisfy the requirements of paragraph (d)(1) of this section (regarding use of substitute mortality tables by controlled group members);

(C) The second plan year following the plan year in which there is a significant change in individuals covered by the plan as described in paragraph (d)(4)(ii) of this section;

(D) The plan year following the plan year in which a substitute mortality table used for a plan population is no longer accurately predictive of future mortality of that population, as determined by the Commissioner or as certified by the plan's actuary to the satisfaction of the Commissioner; or

(E) The date specified in guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter) pursuant to a replacement of mortality tables specified under section 430(h)(3)(A) and §1.430(h)(3)–1 (other than annual updates to the static mortality tables issued pursuant to §1.430(h)(3)–1(a)(3)).

(ii) *Significant change in coverage*—(A) *Change in coverage from time of experience study*. For purposes of applying the rules of paragraph (d)(4)(i)(C) of this section, a significant change in the individuals covered by a substitute mortality table occurs if there is an increase or decrease in the number of individuals of at least 20 percent compared to the average number of individuals in that population over the years covered by the experience study on which the substitute mortality tables are based. However, a change in coverage is not treated as significant if the plan's actuary certifies in writing to the satisfaction of the Commissioner that the substitute mortality tables used for the plan population continue to be accurately predictive of future mortality of that population (taking into account the effect of the change in the population).

(B) *Change in coverage from time of certification*. For purposes of applying the rules of paragraph (d)(4)(i)(C) of this section, a significant change in the individuals covered by a substitute mortality table occurs if there is an increase or decrease in the number of individuals covered by a substitute mortality table of at least 20 percent compared to the number of individuals in a plan year for which a certification described in paragraph (d)(4)(ii)(A) of this section was made on account of a prior change in coverage. However, a change in coverage is not treated as significant if the plan's actuary certifies in writing to the satisfaction of the Commissioner that the substitute mortality tables used by the plan with respect to the covered population continue to be accurately predictive of future mortality of that population (taking into account the effect of the change in the plan population).

(e) *Effective/Applicability date.* This section applies for plan years beginning on or after January 1, 2009.

[T.D. 9419, 73 FR 44644, July 31, 2008]

§ 1.430(i)–1 Special rules for plans in at-risk status.

(a) *In general*—(1) *Overview.* This section provides special rules related to determining the funding target and making other computations for certain defined benefit plans that are in at-risk status for the plan year. Section 430(i) and this section apply to single employer defined benefit plans (including multiple employer plans) but do not apply to multiemployer plans (as defined in section 414(f)). Paragraph (b) of this section describes rules for determining whether a plan is in at-risk status for a plan year, including the determination of a plan's funding target attainment percentage and at-risk funding target attainment percentage. Paragraph (c) of this section describes the funding target for a plan in at-risk status. Paragraph (d) of this section describes the target normal cost for a plan in at-risk status. Paragraph (e) of this section describes rules regarding how the funding target and the target normal cost are determined for a plan that has been in at-risk status for fewer than 5 consecutive plan years. Paragraph (f) of this section sets forth effective/applicability dates and transition rules.

(2) *Special rules for multiple employer plans.* In the case of a multiple employer plan to which section 413(c)(4)(A) applies, the rules of section 430 and this section are applied separately for each employer under the plan, as if each employer maintained a separate plan. For example, at-risk status is determined separately for each employer under such a multiple employer plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), the rules of section 430 and this section are applied as if all participants in the plan were employed by a single employer.

(b) *Determination of at-risk status of a plan*—(1) *General rule.* Except as otherwise provided in this section, a plan is in at-risk status for a plan year if—

(i) The funding target attainment percentage for the preceding plan year (determined under paragraph (b)(3) of this section) is less than 80 percent; and

(ii) The at-risk funding target attainment percentage for the preceding plan year (determined under paragraph (b)(4) of this section) is less than 70 percent.

(2) *Small plan exception.* If, on each day during the preceding plan year, a plan had 500 or fewer participants (including both active and inactive participants), determined in accordance with the same rules that apply for purposes of § 1.430(g)–1(b)(2)(ii), then the plan is not treated as being in at-risk status for the plan year.

(3) *Funding target attainment percentage.* For purposes of this section, except as otherwise provided in paragraph (b)(5) of this section, the funding target attainment percentage of a plan for a plan year is the funding target attainment percentage as defined in § 1.430(d)–1(b)(3).

(4) *At-risk funding target attainment percentage.* Except as otherwise provided in paragraph (b)(5) of this section, the at-risk funding target attainment percentage of a plan for a plan year is a fraction (expressed as a percentage)—

(i) The numerator of which is the value of plan assets for the plan year after subtraction of the prefunding balance and the funding standard carryover balance under section 430(f)(4)(B); and

(ii) The denominator of which is the at-risk funding target of the plan for the plan year (determined under paragraph (c) of this section, but without regard to the loading factor imposed under paragraph (c)(2)(ii) of this section).

(5) *Special rules*—(i) *Special rule for new plans.* Except as otherwise provided in paragraph (b)(5)(iii) of this section, in the case of a new plan that was neither the result of a merger nor involved in a spinoff, the funding target attainment percentage under paragraph (b)(3) of this section and the at-risk funding target attainment percentage under paragraph (b)(4) of this

section are equal to 100 percent for years before the plan exists.

(ii) *Special rule for plans with zero funding target*. Except as otherwise provided in paragraph (b)(5)(iii) of this section, if the funding target of the plan is equal to zero for a plan year, then the funding target attainment percentage under paragraph (b)(3) of this section and the at-risk funding target attainment percentage under paragraph (b)(4) of this section are equal to 100 percent for that plan year.

(iii) *Exception when plan has predecessor plan that was in at-risk status*. [Reserved]

(iv) *Special rules for plans that are the result of a merger*. [Reserved]

(v) *Special rules for plans that are involved in a spinoff*. [Reserved]

(6) *Special rule for determining at-risk status of plans of specified automobile manufacturers*. See section 430(i)(4)(C) for special rules for determining the at-risk status of plans of specified automobile and automobile parts manufacturers.

(c) *Funding target for plans in at-risk status*—(1) *In general*. If the plan has been in at-risk status for 5 consecutive years, including the current plan year, then the funding target for the plan is the at-risk funding target determined under paragraph (c)(2) of this section. See paragraph (e) of this section for the determination of the funding target where the plan is in at-risk status for the plan year but was not in at-risk status for one or more of the 4 preceding plan years.

(2) *At-risk funding target*—(i) *Use of modified actuarial assumptions*. Except as otherwise provided in this paragraph (c)(2), the at-risk funding target of the plan under this paragraph (c)(2) for the plan year is equal to the present value of all benefits accrued or earned under the plan as of the beginning of the plan year, as determined in accordance with §1.430(d)–1 but using the additional actuarial assumptions described in paragraph (c)(3) of this section.

(ii) *Funding target includes load*. The at-risk funding target is increased by the sum of—

(A) $700 multiplied by the number of participants in the plan (including active participants, inactive participants, and beneficiaries); plus

(B) Four percent of the funding target (determined under §1.430(d)–1(b)(2) as if the plan was not in at-risk status) of the plan for the plan year.

(iii) *Minimum amount*. Notwithstanding any otherwise applicable provisions of this section, the at-risk funding target of a plan for a plan year is not less than the plan's funding target for the plan year determined without regard to this section.

(3) *Additional actuarial assumptions*—(i) *In general*. The actuarial assumptions used to determine a plan's at-risk funding target for a plan year are the actuarial assumptions that are applied under section 430, with the modifications described in this paragraph (c)(3).

(ii) *Special retirement age assumption*—(A) *Participants eligible to retire and collect benefits within 11 years*. Subject to paragraph (c)(3)(ii)(B) of this section, if a participant would be eligible to commence an immediate distribution by the end of the 10th plan year after the current plan year (that is, the end of the 11th plan year beginning with the current plan year), that participant is assumed to commence an immediate distribution at the earliest retirement age under the plan, or, if later, at the end of the current plan year. The rule of this paragraph (c)(3)(ii)(A) does not affect the application of plan assumptions regarding an employee's termination of employment prior to the employee's earliest retirement age.

(B) *Participants otherwise assumed to retire immediately*. The special retirement age assumption of paragraph (c)(3)(ii)(A) of this section does not apply to a participant to the extent the participant is otherwise assumed to commence benefits during the current plan year under the actuarial assumptions for the plan. For example, if generally applicable retirement assumptions would provide for a 25 percent probability that a participant will commence benefits during the current plan year, the special retirement age assumption of paragraph (c)(3)(ii)(A) of this section requires the plan's enrolled actuary to assume a 75 percent probability that the participant will commence benefits at the end of the plan year.

(C) *Definition of earliest retirement date*. For purposes of this paragraph

(c)(3)(ii), a plan's earliest retirement date for an employee is the earliest date on which the employee can commence receiving an immediate distribution of a fully vested benefit under the plan. *See* § 1.401(a)–20, Q&A–17(b).

(iii) *Requirement to assume most valuable benefit.* All participants and beneficiaries who are assumed to retire on a particular date are assumed to elect the optional form of benefit available under the plan that would result in the highest present value of benefits commencing at that date.

(iv) *Reasonable techniques permitted.* The plan's actuary is permitted to use reasonable techniques in determining the actuarial assumptions that are required to be used pursuant to this paragraph (c)(3). For example, the plan's actuary is permitted to use reasonable assumptions in determining the optional form of benefit under the plan that would result in the highest present value of benefits for this purpose.

(d) *Target normal cost of plans in at-risk status*—(1) *General rule.* If the plan has been in at-risk status for 5 consecutive years, including the current plan year, then the target normal cost for the plan is the at-risk target normal cost determined under paragraph (d)(2) of this section. *See* paragraph (e) of this section for the determination of the target normal cost where the plan is in at-risk status for the plan year but was not in at-risk status for one or more of the 4 preceding plan years.

(2) *At-risk target normal cost*—(i) *Use of modified actuarial assumptions*—(A) *In general.* Except as otherwise provided in this paragraph (d)(2), the at-risk target normal cost of a plan for the plan year is equal to the present value (determined as of the valuation date) of all benefits that accrue during, are earned during, or are otherwise allocated to service in the plan year, as determined in accordance with § 1.430(d)–1 but using the additional actuarial assumptions described in paragraph (c)(3) of this section.

(B) *Special adjustments.* The target normal cost of the plan for the plan year (determined under paragraph (d)(2)(i)(A) of this section) is adjusted (not below zero) by adding the amount of plan-related expenses expected to be paid from plan assets during the plan year and subtracting the amount of any mandatory employee contributions expected to be made during the plan year.

(C) *Plan-related expenses.* For purposes of this paragraph (d)(2), plan-related expenses are determined using the rules of § 1.430(d)–1(b)(1)(iii)(B).

(ii) *Loading factor.* The at-risk target normal cost is increased by a loading factor equal to 4 percent of the present value (determined as of the valuation date) of all benefits under the plan that accrue, are earned, or are otherwise allocated to service for the plan year under the applicable rules of § 1.430(d)–1(c)(1)(ii)(B), (C), or (D), determined as if the plan were not in at-risk status.

(iii) *Minimum amount.* The at-risk target normal cost of a plan for a plan year is not less than the plan's target normal cost determined without regard to section 430(i) and this section.

(e) *Transition between applicable funding targets and applicable target normal costs*—(1) *Funding target.* If a plan that is in at-risk status for the plan year has not been in at-risk status for one or more of the preceding 4 plan years, the plan's funding target for the plan year is determined as the sum of—

(i) The funding target determined without regard to section 430(i) and this section; plus

(ii) The phase-in percentage for the plan year multiplied by the excess of—

(A) The at-risk funding target determined under paragraph (c)(2) of this section (determined taking into account paragraph (e)(4) of this section); over

(B) The funding target determined without regard to section 430(i) and this section.

(2) *Target normal cost.* If a plan that is in at-risk status for the plan year has not been in at-risk status for one or more of the preceding 4 plan years, the plan's target normal cost for the plan year is determined as the sum of—

(i) The target normal cost determined without regard to section 430(i) and this section; plus

(ii) The phase-in percentage for the plan year multiplied by the excess of—

(A) The at-risk target normal cost determined under paragraph (d)(2) of

this section (determined taking into account paragraph (e)(4) of this section); over

(B) The target normal cost determined without regard to section 430(i) and this section.

(3) *Phase-in percentage*. For purposes of this paragraph (e), the phase-in percentage is 20 percent multiplied by the number of consecutive plan years that the plan has been in at-risk status (including the current plan year) and not taking into account years before the first effective plan year for a plan.

(4) *Transition funding target and target normal cost determined without load*. Notwithstanding paragraph (c)(2)(ii) of this section, if a plan has not been in at-risk status for 2 or more of the preceding 4 plan years (not taking into account years before the first effective plan year for a plan), then the plan's at-risk funding target that is used for purposes of paragraph (e)(1)(ii)(A) of this section (to calculate the plan's funding target where the plan has been in at-risk status for fewer than 5 plan years) is determined without regard to the loading factor set forth in paragraph (c)(2)(ii) of this section. Similarly, if a plan has not been in at-risk status for 2 or more of the preceding 4 plan years (not taking into account years before the first effective plan year for a plan), then the plan's at-risk target normal cost that is used for purposes of paragraph (e)(2)(ii)(A) of this section (to calculate the plan's target normal cost where the plan has been in at-risk status for fewer than 5 plan years) is determined without regard to the loading factor set forth in paragraph (d)(2)(ii) of this section.

(f) *Effective/applicability dates and transition rules*—(1) *Statutory effective date/applicability date*—(i) *General rule*. Section 430 generally applies to plan years beginning on or after January 1, 2008. The applicability of section 430 for purposes of determining the minimum required contribution is delayed for certain plans in accordance with sections 104 through 106 of the Pension Protection Act of 2006 (PPA '06), Public Law 109–280 (120 Stat. 780).

(ii) *Applicability of special adjustments to target normal cost*. The special adjustments of paragraph (d)(2)(i)(B) of this section (relating to adjustments to the target normal cost for plan-related expenses and mandatory employee contributions) apply to plan years beginning after December 31, 2008. In addition, a plan sponsor may elect to make the special adjustments of paragraph (d)(2)(i)(B) of this section for plan years beginning in 2008. This election is made in the same manner and is subject to the same rules as an election to add an amount to the plan's prefunding balance pursuant to §1.430(f)–1(f). Thus, the election can be made no later than the last day for making the minimum required contribution for the plan year to which the election relates.

(2) *Effective date/applicability date of regulations*. This section applies to plan years beginning on or after January 1, 2010. For plan years beginning before January 1, 2010, plans are permitted to rely on the provisions set forth in this section for purposes of satisfying the requirements of section 430.

(3) *First effective plan year*. For purposes of this section, the first effective plan year for a plan is the first plan year to which section 430 applies to the plan for purposes of determining the minimum required contribution.

(4) *Transition rule for determining at-risk status*. In the case of plan years beginning in 2008, 2009, and 2010, paragraph (b)(1)(i) of this section is applied by substituting the following percentages for ''80 percent''—

(i) 65 percent in the case of 2008;

(ii) 70 percent in the case of 2009; and

(iii) 75 percent in the case of 2010.

[T.D. 9467, 74 FR 53058, Oct. 15, 2009]

§ 1.430(j)–1 Payment of minimum required contributions.

(a) *In general*—(1) *Overview*. This section provides rules related to the payment of minimum required contributions, including the payment of required installments. Section 430(j) and this section apply to single-employer defined benefit plans (including multiple employer plans as defined in section 413(c)) but do not apply to multiemployer plans (as defined in section 414(f)). Paragraph (b) of this section describes the general timing requirement for minimum required contributions. Paragraph (c) of this section describes the accelerated required installment schedule for plans with a funding

shortfall in the preceding plan year. Paragraph (d) of this section provides rules regarding liquidity requirements. Paragraph (e) of this section provides definitions. Paragraph (f) of this section provides examples that illustrate the rules of this section. Paragraph (g) of this section sets forth effective/applicability dates and transition rules.

(2) *Special rules for multiple employer plans*—(i) *In general*. In the case of a multiple employer plan to which section 413(c)(4)(A) applies, the rules of section 430 and this section are applied separately for each employer under the plan, as if each employer maintained a separate plan. Thus, for example, required installments are determined separately for each employer under such a multiple employer plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), the rules of section 430 and this section are applied as if all participants in the plan were employed by a single employer.

(ii) *CSEC plans*. A CSEC plan (that is, a plan that fits within the definition of a CSEC plan in section 414(y) for plan years beginning on or after January 1, 2014 and for which the election under section 414(y)(3)(A) has not been made) is not subject to the rules of section 430. See section 433 for the minimum funding rules that apply to CSEC plans.

(3) *Applicability of section 430(j) to plans of commercial passenger airlines*—(i) *In general*. Except as otherwise provided in this section, the rules of section 430(j) and this section apply to a plan for which an election described in section 402 of the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780 (2006)), as amended (PPA '06), has been made in the same manner as those rules apply to any other plan subject to section 430.

(ii) *Special rules for plans for which election was made pursuant to section 402(a)(1) of PPA '06*. For purposes of applying the rules of section 430(j) and this section to a plan with respect to which the election under section 402(a)(1) of PPA '06 has been made, the effective interest rate for the plan is deemed to be 8.85 percent during the period for which the election applies. In addition, see paragraph (e)(4)(ii) of this section for a special determination of the funding shortfall for a plan for which the election in section 402(a)(1) of PPA '06 has been made.

(b) *General timing requirement for minimum required contributions*—(1) *Earliest date for contributions*. A payment made before the first day of the plan year cannot be applied toward the minimum required contribution under section 430 for that plan year.

(2) *Deadline for contributions*. The deadline for any payment of any minimum required contribution for a plan year is 8½ months after the close of the plan year. See section 4971 and the regulations thereunder regarding an excise tax that applies with respect to minimum required contributions not paid by this deadline. For additional rules that may apply in the case of a failure to pay minimum required contributions by this deadline, see also section 430(k) of the Code and sections 101(d) and 4043 of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

(3) *Allocation of contribution to a plan year*—(i) *Plans with unpaid minimum required contributions that have not been corrected*. If a plan has unpaid minimum required contributions within the meaning of § 54.4971(c)–1(c) of this chapter that have not yet been corrected within the meaning of § 54.4971(c)–1(d)(2) of this chapter at the time a contribution is made, then the contribution is treated as a late contribution for the earliest plan year for which there is an unpaid minimum required contribution (to the extent necessary to correct that unpaid minimum required contribution). To the extent the contribution exceeds the amount necessary to correct the earlier unpaid minimum required contribution, the excess is treated as a late contribution for the next earliest plan year for which there is an unpaid minimum required contribution (to the extent necessary to correct that next earliest unpaid minimum required contribution). The allocation of the contribution

under the preceding sentence is repeated until all unpaid minimum required contributions have been corrected, or until the entire contribution is allocated, whichever comes first.

(ii) *Plans without unpaid minimum required contributions.* If a contribution is made during the current plan year but before the deadline under paragraph (b)(2) of this section for contributions for a prior plan year, and the plan has no unpaid minimum required contribution for any plan year at the time the contribution is made, then the contribution may be designated as a contribution for either that prior plan year or the current plan year. Similarly, if a contribution made during the current plan year but before the deadline under paragraph (b)(2) of this section for contributions for a prior plan year is more than enough to correct a plan's unpaid minimum required contributions for all plan years, the portion of a contribution that was not used to correct unpaid minimum required contributions may be designated as a contribution for either that prior plan year or the current plan year.

(iii) *Method of allocating contributions*—(A) *Reporting for contributions to correct unpaid minimum required contributions.* The allocation of a contribution under the rules of paragraph (b)(3)(i) of this section to correct unpaid minimum required contributions is automatic and must be shown on the actuarial report (Schedule SB, ''Single-Employer Defined Benefit Plan Actuarial Information'' of Form 5500, ''Annual Return/Report of Employee Benefit Plan'') for the earliest plan year with respect to which, as of the date of the contribution, the deadline for making contributions under paragraph (b)(2) of this section has not passed. See §1.430(g)–1(d)(1) for the rules for determining the plan year for which these contributions are taken into account in determining the value of plan assets.

(B) *Designation of plan year if no unpaid minimum contribution.* In the case of a contribution described in paragraph (b)(3)(ii) of this section, the designation is established by the completion (and filing, if required) of the actuarial report (Schedule SB, ''Single-Employer Defined Benefit Plan Actuarial Information'' of Form 5500, ''Annual Return/Report of Employee Benefit Plan'') for the plan year for which the contribution is designated and cannot be changed after the actuarial report that reflects the contribution is completed (and filed, if required) except as provided in guidance published in the Internal Revenue Bulletin. Thus, a contribution that has been designated for a plan year on an actuarial report pursuant to this paragraph (b)(3)(iii)(B) generally cannot be redesignated as a contribution for either an earlier or later plan year.

(4) *Adjustment for interest*—(i) *In general.* Except as provided in this paragraph (b)(4), any payment toward the minimum required contribution under section 430 for a plan year that is paid on a date other than the valuation date for that plan year is adjusted for interest for the period between the valuation date and the payment date, at the plan's effective interest rate for that plan year determined pursuant to §1.430(h)(2)–1(f)(1). The direction of the adjustment depends on whether the contribution is paid before or after the valuation date for the plan year. If the contribution is paid after the valuation date for the plan year, the contribution is discounted to the valuation date using the plan's effective interest rate. By contrast, if the contribution is paid before the valuation date for the plan year (which could only occur in the case of a small plan described in section 430(g)(2)(B)), the contribution is increased for interest using the plan's effective interest rate.

(ii) *Interest adjustment for late quarterly installments.* In the case of a plan that must make required installments under the rules of paragraph (c) of this section, to the extent a contribution for a plan year constitutes a late required installment, the adjustment for interest for the period between the valuation date and the payment date is made in two steps. In the first step, the portion of the contribution that constitutes a late required installment is adjusted for interest from the date of the contribution to the due date for the installment by discounting it using the plan's effective interest rate for that plan year determined pursuant to §1.430(h)(2)–1(f)(1) plus 5 percentage

points. In the second step, this discounted amount is treated as if it were contributed on the installment due date for purposes of the interest adjustment under paragraph (b)(4)(i) of this section. However, a contribution made toward the unpaid liquidity amount (as defined in paragraph (d)(3) of this section) that is made before the close of the quarter in which it is due is adjusted under paragraph (b)(4)(iii) of this section.

(iii) *Interest adjustment for unpaid liquidity amounts.* In the case of a plan that is subject to the liquidity requirement rules of paragraph (d) of this section, to the extent a contribution made during a quarter constitutes a payment of the unpaid liquidity amount for that quarter as described in paragraph (d)(3) of this section, the adjustment for interest for the period between the valuation date and the payment date is made in two steps. In the first step, the portion of the contribution that constitutes a payment of the unpaid liquidity amount is increased for interest from the date of the contribution to the last day of the quarter, at the plan's effective interest rate for that plan year determined pursuant to §1.430(h)(2)–1(f)(1). In the second step, this adjusted amount is treated as if it were contributed on the last day of that quarter for purposes of the interest adjustment for late required installments under the rules of paragraph (b)(4)(ii) of this section. See paragraph (d)(3)(iv)(B) of this section for an increase to the minimum required contribution that gives effect to this interest adjustment for unpaid liquidity amounts in the event a portion of the required installment is no longer treated as unpaid after the close of the quarter under paragraph (d)(3)(iv)(A) of this section.

(c) *Accelerated quarterly installments required for underfunded plans*—(1) *Plans subject to quarterly installment requirement.* The plan sponsor of a plan that has a funding shortfall for the preceding plan year is required to pay the installments described in paragraph (c)(5) of this section by the due dates described in paragraph (c)(6) of this section. See paragraph (b)(4)(ii) of this section, section 430(k) of the Internal Revenue Code (Code) (regarding the imposition of a lien), and sections 101(d) and 4043 of ERISA (regarding notice to participants and beneficiaries and to the Pension Benefit Guaranty Corporation) for examples of consequences that generally apply following a failure to make required installments.

(2) *Satisfaction of quarterly installment requirement.* A plan sponsor may satisfy the requirement to pay an installment under paragraph (c)(1) of this section by one or a combination of the following—

(i) Making a contribution for the plan year which is allocated among the required installments under the rules of paragraph (c)(3) of this section; and

(ii) Making an election to use some or all of the plan's prefunding balance or funding standard carryover balance in accordance with the rules of paragraph (c)(4) of this section.

(3) *Satisfaction of quarterly installment requirement with contributions*—(i) *Contributions allocated to earliest quarterly installments.* For purposes of this section, a contribution for a plan year is allocated among the required installments for the plan year under the rules of paragraph (c)(3)(ii) or (iii) of this section, whichever is applicable. Which rule applies depends on whether, at the time the contribution is made, the plan sponsor has unpaid required installments (that is, the plan sponsor has not fully satisfied all required installments for which the due date has passed, taking into account the special rule with respect to the unpaid liquidity amounts in paragraph (d)(3)(iv)(A) of this section).

(ii) *Early contributions increased with interest.* If a plan has no unpaid required installments for a plan year at the time a contribution for the plan year is made, then the contribution is allocated to the required installments (if any) for the plan year due on or after the date of the contribution under the rules of this paragraph (c)(3)(ii). The contribution is allocated in the order in which those installments occur, and the amount allocated to each required installment is limited to the amount necessary to satisfy the required installment (including satisfaction of the liquidity requirement under paragraph (d)(1) of this section, taking into account the special rule

with respect to the unpaid liquidity amounts in paragraph (d)(3)(iv)(A) of this section) taking into account any interest as described in the next sentence. If the contribution is made before the due date of the installment to which it is allocated, then the amount credited toward the installment includes interest on the contribution from the date of the contribution to the due date of the required installment (except as provided in paragraph (d)(2) of this section). This interest adjustment is made using an interest rate equal to the plan's effective interest rate under §1.430(h)(2)–1(f)(1) for the plan year.

(iii) *Allocation of contributions to late required installments without interest*—(A) *In general.* If a plan has any unpaid required installments for a plan year at the time a contribution for the plan year is made, then the contribution is allocated to those unpaid required installments under the rules of this paragraph (c)(3)(iii). The contribution is allocated in the order in which those unpaid required installments occur, and the amount allocated to each required installment is limited to the amount that satisfies the required installment without any adjustment for interest. If a contribution is allocated to an unpaid required installment under this paragraph (c)(3)(iii), then that contribution is adjusted for interest under the rules of paragraph (b)(4) of this section (regarding interest adjustments for late quarterly installments) for purposes of determining the extent to which that contribution satisfies the minimum required contribution for the plan year.

(B) *Bifurcation of contributions that exceed unpaid required installments.* Any amount of a contribution described in paragraph (c)(3)(iii)(A) of this section that is not used to satisfy the unpaid required installments for the plan year is allocated toward any remaining required installments for the plan year under the rules of paragraph (c)(3)(ii) of this section.

(4) *Satisfaction of quarterly installment requirements through use of funding balances.* A plan sponsor may satisfy the requirement to pay an installment under paragraph (c)(1) of this section by making an election to use some or all of the plan's prefunding balance or funding standard carryover balance under section 430(f). Such an election is subject to the rules of §1.430(f)–1 and cannot exceed the available amount of the plan's prefunding balance and funding standard carryover balance determined under §1.430(f)–1(d)(1)(ii) as of the date of the election. The amount elected is allocated toward satisfaction of the required installments in the same manner as a contribution made on the date of the election. Thus, the amount of an election to use the plan's prefunding balance or funding standard carryover balance is increased with interest under the rules of paragraph (c)(3)(ii) of this section or is credited against the earliest unpaid required installment under the rules of paragraph (c)(3)(iii) of this section. See §1.430(f)–1(f)(1)(iii) for rules permitting the use of a standing election for purposes of satisfying required installments through use of funding balances. See §1.430(f)–1(d)(1)(i)(B) for rules relating to late elections to use the funding standard carryover balance or prefunding balance to satisfy the required installment rules.

(5) *Amount of required installment*—(i) *In general.* For purposes of this section, the amount of any required installment due for a plan year is equal to 25 percent of the required annual payment for the plan year as described in paragraph (c)(5)(ii) of this section.

(ii) *Required annual payment.* The required annual payment for a plan year is equal to the lesser of—

(A) 90 percent of the minimum required contribution under section 430 for the plan year; or

(B) 100 percent of the minimum required contribution under section 430 (determined without regard to any funding waiver under section 412) for the preceding plan year.

(iii) *Treatment of funding balances.* For purposes of paragraph (c)(5)(ii) of this section, the minimum required contribution for a plan year is determined without regard to the use of the prefunding balance or funding standard carryover balance for the current year or the prior year. However, see paragraph (c)(4) of this section regarding a plan sponsor's election to use the plan's prefunding balance or funding

standard carryover balance for the current year in order to satisfy the requirement to pay an installment.

(iv) *Disregard of certain amounts.* For purposes of paragraph (c)(5)(ii) of this section, the minimum required contribution for a plan year is determined without regard to the installment acceleration amount for the plan year determined under section 430(c)(7) or any increase to the minimum required contribution under paragraph (d)(3)(iv)(B) of this section (relating to an unpaid liquidity amount).

(6) *Due dates for installments.* For purposes of this section, there is a required installment for each quarter of the plan year, and the due dates for the required installments with respect to a full plan year are set forth in the following table:

Installment	Due date
First required installment	15th day of 4th plan month.
Second required installment ..	15th day of 7th plan month.
Third required installment	15th day of 10th plan month.
Fourth required installment	15th day after the end of the plan year.

(7) *Special rules for short plan years*—(i) *In general.* In the case of a short plan year, the rules of this paragraph (c) are modified as provided in this paragraph (c)(7).

(ii) *Current plan year is short plan year*—(A) *Amount of required annual payment.* In determining the required annual payment pursuant to paragraph (c)(5)(ii) of this section for a short plan year, the amount otherwise determined under paragraph (c)(5)(ii)(B) of this section (based on the prior year's minimum required contribution) is multiplied by a fraction, the numerator of which is the duration of the short plan year and the denominator of which is 1 year. This rule applies to the year that contains the plan's termination date if that date is before the date that would otherwise be the end of the plan year (because the plan is treated as having a short plan year for purposes of section 430 pursuant to § 1.430(a)–1(b)(5)).

(B) *Number and due dates of installments.* If the plan has a short plan year, then an installment is due 15 days after the end of that short plan year. In addition, an installment is required for each due date determined under paragraph (c)(6) of this section that falls within the short plan year. Thus, for example, if the short plan year ends before the 15th day of the 4th plan month of the plan year, there will be only one installment for that short plan year, and that installment will be due on the 15th day after the end of the short plan year.

(C) *Amount of installments.* The amount of each installment required to be paid for the short plan year is equal to the required annual payment determined pursuant to paragraph (c)(5)(ii) of this section (as modified by paragraph (c)(7)(ii)(A) of this section) divided by the number of installments determined pursuant to paragraph (c)(7)(ii)(B) of this section.

(D) *No increase in prior required installments.* If a plan is amended to have a short plan year (including as a result of plan termination) and the required installments determined under paragraph (c)(7)(ii)(C) of this section are greater than the required installments determined without regard to the amendment, then—

(*1*) The required installments for which the due dates occur before the end of the short plan year are determined without regard to the amendment, and

(*2*) The required installment due on the 15th day after the end of the short plan year is increased to the extent necessary so that the total of the required installments for the year is the required annual payment determined under paragraph (c)(5)(ii) of this section, determined taking into account the rules of paragraph (c)(7)(ii)(A) of this section.

(iii) *Prior plan year is short plan year.* If the prior plan year is a short plan year, the amount otherwise determined under paragraph (c)(5)(ii)(B) of this section (based on the prior year's minimum required contribution) is multiplied by a fraction, the numerator of which is 1 year and the denominator of which is the duration of the short plan year.

(d) *Liquidity requirement in connection with quarterly installments*—(1) *In general*—(i) *Additional requirement with respect to quarterly installments.* Except as provided in this paragraph (d)(1), if a plan sponsor is required to pay the installments described in paragraph (c)

of this section, then the plan sponsor is treated as failing to pay the full amount of the required installment for a quarter to the extent that the value of the liquid assets paid in the required installment after the end of that quarter and on or before the due date for the installment is less than the liquidity shortfall for that quarter. If the amount of any required installment is increased by reason of this paragraph (d)(1)(i), in no event shall this increase exceed the amount which, when added to the current required installment (determined without regard to the increase) and prior required installments for the plan year (not including any portion of a required installment that is no longer treated as unpaid under paragraph (d)(3)(iv)(A) of this section), is necessary to increase the funding target attainment percentage for the plan year to 100 percent (taking into account the expected increase in the funding target due to benefits accruing or earned during the plan year).

(ii) *Small plan exception.* The liquidity requirement of this paragraph (d) does not apply to a plan for any plan year for which the plan is a small plan described in §1.430(g)–1(b)(2).

(2) *Satisfaction of liquidity requirement.* The additional requirement with respect to a required installment under paragraph (d)(1) of this section can be satisfied only with an actual contribution of liquid assets that, after application of paragraph (c)(3) of this section, is allocated to satisfy the required installment for the quarter. The liquidity requirement cannot be satisfied through the use of funding balances, and satisfaction of this requirement is determined without taking into account the increase for interest for early contributions set forth in paragraph (c)(3)(ii) of this section. Any contribution of liquid assets that is allocated to satisfy the required installment for a quarter applies for purposes of determining whether the requirements of paragraph (d)(1) of this section are satisfied, even if the contribution is less than the total amount needed to satisfy the requirements of paragraph (c) of this section for the quarter (taking into account any increase in the required installment under this paragraph (d)).

(3) *Failure to satisfy liquidity requirement*—(i) *Treatment as failure to satisfy quarterly installment.* If an employer fails to satisfy the additional requirement with respect to a required installment for a quarter under paragraph (d)(1) of this section, the portion of that required installment that is treated as not paid by reason of paragraph (d)(1) of this section (the unpaid liquidity amount for that quarter) is treated as an underpayment of the required installment. See paragraph (c)(1) of this section for examples of consequences of underpayment of a required installment.

(ii) *Late satisfaction of liquidity requirement.* The rules of paragraph (d)(2) of this section apply to determine whether a contribution made after the deadline for a required installment satisfies the liquidity requirement of paragraph (d)(1) of this section. However, pursuant to section 430(j)(4)(C), the unpaid liquidity amount is treated as unpaid until the end of the quarter in which the due date for that installment occurs, even if liquid assets in that amount are contributed during that quarter (but after the due date for the installment). See paragraph (b)(4)(iii) of this section for the application of this rule for purposes of applying the additional interest for late required installments.

(iii) *Additional consequences of failure to pay liquidity shortfall.* See section 206(e) of ERISA and section 401(a)(32) of the Code (regarding suspension of accelerated distributions for a plan with an unpaid liquidity amount). See also section 4971(f) regarding an excise tax imposed in the event of a failure to pay a liquidity shortfall.

(iv) *Treatment in subsequent quarter*—(A) *Adjustment to required installment.* After the close of the quarter in which the due date of a required installment occurs, any portion of the installment that was treated as unpaid solely by reason of paragraph (d)(1) of this section, and that was not satisfied with a contribution of liquid assets during that quarter, is no longer treated as unpaid (but any portion of the installment that would be treated as unpaid without regard to paragraph (d)(1) of

this section must be satisfied in accordance with the rules of paragraph (c) of this section).

(B) *Increase to minimum required contribution for additional interest.* If a portion of the required installment is no longer treated as unpaid by reason of paragraph (d)(3)(iv)(A) of this section, then the minimum required contribution for the plan year for which the installment was due is increased by an amount equal to—

(*1*) The portion of the required installment that is no longer treated as unpaid by reason of paragraph (d)(3)(iv)(A) of this section, discounted for interest for the period from the last day of the quarter that includes the due date of the required installment to the valuation date, using the plan's effective interest rate for the plan year (determined pursuant to §1.430(h)(2)–1(f)(1)); minus

(*2*) The portion of the required installment that is no longer treated as unpaid by reason of paragraph (d)(3)(iv)(A) of this section, discounted for interest for the period from the last day of the quarter that includes the due date of the required installment to the due date of the installment, using the plan's effective interest rate for the plan year plus 5 percentage points, and further discounted for interest for the period from the due date of the required installment to the valuation date using the plan's effective interest rate for the plan year.

(e) *Definitions*—(1) *In general.* The definitions set forth in this paragraph (e) apply for purposes of this section.

(2) *Adjusted disbursements*—(i) *In general.* The term *adjusted disbursements* means, with respect to a time period, the amount described in paragraph (e)(2)(ii) of this section if the time period is within a single plan year, or the amount described in paragraph (e)(2)(iii) of this section if the time period spans more than one plan year.

(ii) *Period within a single plan year.* With respect to a period within a plan year, the adjusted disbursements are the disbursements from the plan during that period reduced by the product of—

(A) The plan's funding target attainment percentage determined under section 430(d)(2) for the plan year that contains that period; and

(B) The sum of the purchases of annuities and payments of single sums for that period.

(iii) *Period spanning more than one plan year.* With respect to a period of time that spans more than one plan year, the adjusted disbursements are the sum of the adjusted disbursements determined separately under paragraph (e)(2)(ii) of this section for each portion of a plan year that is included in the time period for which adjusted disbursements are determined.

(3) *Disbursements from the plan.* The term *disbursements from the plan* means all disbursements from the plan's trust, including purchases of annuities, payments of single sums and other benefits, and payments of administrative expenses.

(4) *Funding shortfall*—(i) *In general.* Except as otherwise provided in this paragraph (e)(4), the term *funding shortfall* has the same meaning as under §1.430(a)–1(f)(2).

(ii) *Special rule for plans of commercial passenger airlines.* In the case of a plan year for which an election described in section 402(a)(1) of PPA '06 is in effect, the term *funding shortfall* means the unfunded liability for that plan year determined under §1.430(a)–1(b)(4)(ii).

(iii) *Special rule for first effective plan year.* See paragraph (g)(5)(ii) of this section for a calculation of the funding shortfall for the plan's pre-effective plan year.

(iv) *Special rule for plan spinoffs and mergers.* [Reserved]

(5) *Liquid assets*—(i) *In general.* The term *liquid assets* means cash, marketable securities, and other assets described in this paragraph (e)(5)(i). For this purpose, marketable securities include financial instruments such as stocks and other equity interests, evidences of indebtedness (including certificates of deposit), options, futures contracts, and other derivatives, for which there is a liquid financial market, and other interests in entities (such as partnerships, trusts, or regulated investment companies) for which there is a liquid financial market. For purposes of the preceding sentence, a liquid financial market is an established financial market described in §1.1092(d)–1(b) (other than an interbank

market or an interdealer market described in §1.1092(d)–1(b)(1)(v) and (vi), respectively). Any security that is issued or guaranteed by the government of the United States or an agency or instrumentality thereof for which there is an established financial market described in §1.1092(d)–1(b) is a marketable security. Finally, any financial instrument or other interest in an entity that, under its terms, contains a right by which the instrument or other interest may immediately be redeemed, exchanged, or converted into cash or a marketable security, is a marketable security, provided there are no restrictions on the exercise of that right.

(ii) *Insurance and annuity contracts.* Other assets that are treated as liquid assets of a plan are insurance, annuity, or other contracts issued by an insurance company that is licensed to do business under the laws of any State, but only if the insurance, annuity, or other contract—

(A) Contains an unrestricted right by which the insurance, annuity or other contract may immediately be redeemed, exchanged, or converted into cash or a marketable security;

(B) Provides for substantially equal monthly disbursements to the extent provided in paragraph (e)(5)(iii) of this section; or

(C) Is benefit responsive within the meaning of paragraph (e)(5)(iv) of this section.

(iii) *Insurance and annuity contracts providing for substantially equal periodic payments.* If the contract provides for substantially equal monthly disbursements (for example, an annuity contract in pay status), the only portion of the contract that may be treated as liquid assets for a quarter is the amount equal to 36 times the monthly disbursement (in the month containing the last day of the quarter) which is available under the terms of the contract, provided there are no restrictions on the right to disbursements.

(iv) *Benefit responsive insurance and annuity contracts.* A contract is considered benefit responsive if, under applicable law and contractual provisions, the plan has the right to receive disbursements from the contract in order to pay plan benefits for any participant in the plan, without restrictions on that right.

(v) *Restrictions.* For purposes of this paragraph (e)(5), a restriction on a redemption, exchange, or conversion right, or a restriction on a right to receive a disbursement, may result not only from applicable law or contractual provisions, but also from rehabilitation, conservatorship, receivership, insolvency, bankruptcy, or similar proceedings.

(6) *Liquidity shortfall*—(i) *In general.* Except as modified in paragraph (e)(6)(iii) of this section with respect to multiple employer plans, the term *liquidity shortfall* means, with respect to any required installment, an amount equal to the excess (as of the last day of the quarter for which that installment is due) of—

(A) The base amount with respect to the quarter, over

(B) The value (as of the last day of the quarter) of the plan's liquid assets.

(ii) *Base amount*—(A) *In general.* For purposes of this paragraph (e)(6), the term *base amount* means, with respect to any quarter, an amount equal to 3 times the sum of the adjusted disbursements from the plan for the 12 months ending on the last day of that quarter.

(B) *Special rule.* If the generally applicable base amount for a quarter (as determined under paragraph (e)(6)(ii)(A) of this section) exceeds an amount equal to 2 times the sum of the adjusted disbursements from the plan for the 36 months ending on the last day of the quarter and the enrolled actuary for the plan certifies to the satisfaction of the Commissioner that such excess is the result of nonrecurring circumstances, then the base amount with respect to that quarter is determined without regard to amounts related to those nonrecurring circumstances.

(iii) *Multiple employer plans*—(A) *Satisfaction of liquidity requirement as if plan were not a multiple employer plan.* For a multiple employer plan to which section 413(c)(4)(A) applies, the liquidity requirement of paragraph (d)(1)(i) of this section is satisfied if the liquidity requirement would be satisfied if the plan were a single-employer plan that is not a multiple employer plan to which section 413(c)(4)(A) applies.

(B) *Failure to satisfy the liquidity requirement on a plan-wide basis.* For a multiple employer plan to which section 413(c)(4)(A) applies, if the plan does not satisfy the liquidity requirement in accordance with paragraph (e)(6)(iii)(A) of this section, then the liquidity requirement must be applied separately for each employer under the plan, as if each employer maintained a separate plan. Thus, the value of plan assets as of the end of each quarter under such a multiple employer plan must be allocated among the employers sponsoring the plan, and the liquidity shortfall must be determined for each employer based on that allocation. See section 413(c)(7)(B) and paragraph (a)(2) of this section.

(7) *Plan month*—(i) *Plan year begins on the first day of a calendar month.* For a plan year that begins with the first day of a calendar month, the term *plan month* means any calendar month that begins during the plan year.

(ii) *Plan year begins on a date other than the first day of a calendar month.* For a plan year that begins on a date other than the first day of a calendar month, the first day of each plan month is the day of the calendar month that corresponds to the day of the calendar month that is the first day of the plan year. Thus, for example, if the first day of a plan year is January 15, then a plan month starts on the 15th of each calendar month. However, if a calendar month does not contain a day that corresponds to the day of the calendar month that is the first day of the plan year (for example, if a calendar month has only 30 days and the first day of the plan year is the 31st day of a calendar month), then the first day of the plan month that begins during that calendar month is the last day of that calendar month.

(8) *Quarter.* The term *quarter* means, with respect to any required installment, the 3-plan-month period preceding the plan month in which the due date for that installment occurs.

(9) *Short plan year.* The term *short plan year* means a plan year that is shorter than 12 months (and is not a 52-week plan year of a plan that uses a 52–53 week plan year).

(f) *Examples.* The following examples illustrate the rules of this section. Unless otherwise indicated, these examples are based on the following assumptions: section 430 applies to determine the minimum required contribution for plan years beginning on or after January 1, 2008; the plan year is the calendar year; the valuation date is January 1; the plan sponsor is required to pay the installments described in paragraph (c) of this section; the plan does not have a liquidity shortfall; and the plan sponsor has not elected any funding relief under section 430(c)(2)(D) for any plan year. In addition, these examples assume that, under the funding method used for the plan, interest adjustments are calculated to the nearest half month (rather than days) for transactions that occur on the 1st and 15th of a calendar month.

Example 1. (i) Plan A has a funding standard carryover balance of $15,000 and a prefunding balance of zero as of January 1, 2016, and the plan's funding ratio for 2015 (determined under §1.430(f)–1(d)(3)) was over 80%. The minimum required contribution for Plan A (determined prior to any offset for the funding standard carryover balance) is $100,000 for 2016 and is $125,000 for 2017. The effective interest rate for the 2017 plan year is 5.90%.

(ii) The required annual payment for 2017 is equal to the lesser of (a) 100% of the 2016 minimum required contribution ($100,000) or (b) 90% of the 2017 minimum required contribution (90% of $125,000, or $112,500). Therefore, each required installment for 2017 is 25% of $100,000, or $25,000.

(iii) Installments of $25,000 each are due by April 15, 2017, July 15, 2017, October 15, 2017, and January 15, 2018. The final contribution for the 2017 plan year is due by September 15, 2018. The amount of this final contribution is equal to $125,000, less the contributions made prior to that date, with all contributions adjusted to the valuation date using the effective interest rate for the 2017 plan year. If the plan sponsor makes each required installment on the date due, the remaining amount due is determined as follows:

(A) The contribution paid April 15, 2017 is adjusted by discounting the contribution amount for 3½ months at the effective interest rate ($\$25,000 \div 1.0590^{(3.5/12)} = \$24,585$).

(B) The contribution paid July 15, 2017 is discounted for 6½ months at the effective interest rate ($\$25,000 \div 1.0590^{(6.5/12)} = \$24,236$).

(C) The contribution paid October 15, 2017 is discounted for 9½ months at the effective interest rate ($\$25,000 \div 1.0590^{(9.5/12)} = \$23,891$).

(D) The contribution paid January 15, 2018 is discounted for 12½ months at the effective interest rate ($\$25,000 \div 1.0590^{(12.5/12)} = \$23,551$).

(E) The sum of the above contributions for the 2017 plan year paid through January 15, 2018, adjusted for interest to the valuation date, is $96,263. The remaining amount due for the 2017 plan year is $125,000 minus $96,263, or $28,737, as of January 1, 2017.

(iv) If the final contribution is made on September 15, 2018, the remaining amount due must be increased for interest at the plan's effective interest rate for the 20½ months between January 1, 2017 and September 15, 2018 (so that, when it is discounted with interest for those 20½ months, the resulting amount will equal $28,737). Therefore, the remaining contribution due on September 15, 2018 is $28,737 × $1.0590^{(20.5/12)}$ = $31,694.

Example 2. (i) The facts are the same as in *Example 1,* except that the plan sponsor elects to use the $15,000 funding standard carryover balance as of January 1, 2016, to offset the minimum required contribution for the 2016 plan year. The plan sponsor makes a contribution on January 1, 2016 of $85,000, which satisfies the minimum contribution requirement for 2016.

(ii) The required installments for 2017 are unaffected by the plan sponsor's election to offset the minimum required contribution by the funding standard carryover balance for 2016. Therefore, the required annual payment for 2017 is $100,000 (determined as the lesser of (a) 100% of $100,000 or (b) 90% of $125,000) and the amount of each required installment for the 2017 plan year is 25% of the required annual payment, or $25,000.

Example 3. (i) The facts are the same as in *Example 1.* Plan A's funding standard carryover balance has increased to $17,000 as of January 1, 2017, based on the actual rate of return of plan assets during the 2016 plan year. Plan A's funding ratio for 2016 (determined under §1.430(f)–1(d)(3)) is over 80%. On March 15, 2017, the plan sponsor elects to use the entire amount of the funding standard carryover balance to offset the minimum required contribution for 2017.

(ii) The plan sponsor's election to use the funding standard carryover balance to offset the minimum required contribution is treated as satisfying the requirement to make a required installment to the extent of the amount elected, adjusted with interest for the period from the beginning of the plan year to the due date of the installment using the plan's effective interest rate for the 2017 plan year. This adjustment is made for the 2.5-month period from the beginning of the plan year to the date of the election as provided in §1.430(f)–1(b)(5), and for the one-month period from the date of the election to the due date for the installment, as provided in paragraphs (c)(3)(ii) and (c)(4) of this section. Therefore, the $17,000 funding standard carryover balance as of January 1, 2017 offsets $17,000 × $1.0590^{(2.5/12)}$ × $1.0590^{(1/12)}$ or $17,287 of the $25,000 required installment due April 15, 2017, and the remaining contribution due on April 15, 2017 is $25,000 minus $17,287, or $7,713.

(iii) The interest adjustments in paragraph (ii) of this *Example 3* are based on the effective interest rate even if that rate is not determined by the time that the required installment is due. If the plan's effective interest rate for the plan year has not been determined at the time that the required installment is due, the actual amount of the required installment satisfied by the use of the funding standard carryover balance is determined after the effective interest rate is determined. If the extent to which the funding standard carryover balance satisfies the required installment is overestimated and the result is that the full amount of the required installment is not paid by the due date, the plan is subject to the consequences for late or unpaid required installments as described in paragraph (c)(1) of this section.

Example 4. (i) The facts are the same as in *Example 3.* The plan sponsor makes a contribution of $7,713 (which is equal to the remaining portion of the first required installment) on April 15, 2017. For the 2017 plan year, the plan sponsor makes another contribution of $200,000 on June 30, 2017. No further contributions are made for the 2017 plan year.

(ii) The contributions made for the 2017 plan year are adjusted to the valuation date using the plan's effective interest rate for the 2017 plan year. The contribution paid April 15, 2017 is discounted for the 3½ months between January 1, 2017 and the date of payment, using the effective interest rate of 5.90% ($7,713 ÷ $1.0590^{(3.5/12)}$ = $7,585). The contribution paid June 30, 2017 is discounted for 6 months using the effective interest rate ($200,000 ÷ $1.0590^{(6/12)}$ = $194,349), for a total interest-adjusted contribution of $201,934.

(iii) The present value of the excess contribution for 2017 is based on the net contribution required for that year, which is the minimum required contribution minus the offset for the funding standard carryover balance, or $108,000 (that is, $125,000 minus $17,000). Accordingly, the present value of the excess contribution for 2017 is $201,934 minus $108,000, or $93,934. All or a portion of this amount may be credited to the prefunding balance at the election of the plan sponsor.

Example 5. (i) The facts are the same as in *Example 3.* The plan sponsor pays the required installment of $7,713 on April 15, 2017 and installments of $25,000 each on July 15, 2017 and October 15, 2017. However, only $10,000 of the installment due on January 15, 2018 is paid. No additional contributions are made until the final contribution for the plan year of $55,000 is paid on September 15, 2018.

(ii) The 2017 Schedule SB shows that the contributions for the plan year exceed the

minimum required contribution. This is determined by comparing the net contribution requirement of $108,000 (equal to the minimum required contribution of $125,000 offset by $17,000 for the amount of funding standard carryover balance used) and the interest-adjusted contributions made for the 2017 plan year, developed as shown:

(A) The contribution paid April 15, 2017 is adjusted by discounting the contribution amount for 3½ months at the effective interest rate ($7,713 ÷ $1.0590^{(3.5/12)}$ = $7,585).

(B) The contribution paid July 15, 2017 is discounted for 6½ months at the effective interest rate ($25,000 ÷ $1.0590^{(6.5/12)}$ = $24,236).

(C) The contribution paid October 15, 2017 is discounted for 9½ months at the effective interest rate ($25,000 ÷ $1.0590^{(9.5/12)}$ = $23,891).

(D) The contribution paid January 15, 2018 is discounted for 12½ months at the effective interest rate ($10,000 ÷ $1.0590^{(12.5/12)}$ = $9,420).

(E) Pursuant to paragraph (b)(4)(ii) of this section, the interest rate used to adjust the $15,000 underpayment of the required installment due January 15, 2018 is increased by 5 percentage points for the 8-month period of underpayment (January 15, 2018 through September 15, 2018). Accordingly, $15,000 of the contribution paid on September 15, 2018 is discounted using a rate of 10.90% for 8 months to the due date of January 15, 2018, and is then further adjusted using the 5.90% effective interest rate for the 12½ months between the required installment due date of January 15, 2018 and the valuation date of January 1, 2017. This portion of the September 15, 2018 contribution results in an adjusted amount of $13,189 as of January 1, 2017 ($15,000 ÷ $1.1090^{(8/12)}$ ÷ $1.0590^{(12.5/12)}$).

(F) The remaining $40,000 of the contribution paid on September 15, 2018 is discounted using the effective interest rate of 5.90% for the 20½-month period between the date of payment and the valuation date. This portion of the payment is therefore adjusted to $36,268 as of the valuation date (that is, $40,000 ÷ $1.0590^{(20.5/12)}$).

(G) The sum of the contributions (as calculated in paragraphs (ii)(A) through (F) of this *Example 5*) for the 2017 plan year paid through September 15, 2018, adjusted for interest to the valuation date, is $114,589. This is greater than the net contribution required for the 2017 plan year of $108,000.

Example 6. (i) The facts are the same as in *Example 5*, except that the plan sponsor does not make the contribution on September 15, 2018.

(ii) The 2017 Schedule SB shows an unpaid minimum required contribution of $42,868 as of January 1, 2017. This is equal to the difference between the net contribution required for 2017 of $108,000 (the minimum required contribution of $125,000, offset by $17,000 for the amount of the funding standard carryover balance used) and $65,132 (the interest-adjusted contributions made for the 2017 plan year before the 8½ month deadline, as illustrated in paragraphs (ii)(A) through (ii)(D) of *Example 5*).

Example 7. (i) The facts are the same as in *Example 1*, except that the plan year is changed to an August 1–July 31 plan year effective August 1, 2017. This results in a short plan year beginning January 1, 2017 and ending July 31, 2017. The minimum required contribution for the 7-month period covered by the plan year is calculated as $72,917 in accordance with § 1.430(a)–1(b)(2)(ii).

(ii) As provided in paragraph (c)(7) of this section, a required installment is due 15 days after the end of the short plan year (August 15, 2017), and required installments are also due on the regularly scheduled due dates for required installments that occur within the short plan year (April 15, 2017 and July 15, 2017).

(iii) The required installments are determined based on the lesser of (a) 90% of the minimum required contribution for the short plan year ending July 31, 2017 (90% of $72,917, or $65,625) or (b) 7/12 of 100% of the 2016 minimum required contribution ($100,000 × 7/12, or $58,333). The required installments are thus based on $58,333 because that is the smaller amount.

(iv) The amount of each required installment is determined by dividing the amount determined in paragraph (iii) of this *Example 7* by the number of required installments for the short plan year. This calculation results in required installments of $19,444 each (that is, $58,333 divided by 3 installments).

(v) The deadline for the remaining payment is 8½ months after the end of the short plan year, or April 15, 2018. If the plan sponsor pays the minimum required amount at each installment date, does not elect to offset any amounts by any funding standard carryover or prefunding balance, and makes a final payment on April 15, 2018, then the remaining payment is $17,429, determined as follows:

(A) The contribution paid April 15, 2017 is adjusted by discounting the contribution amount for 3½ months at the effective interest rate ($19,444 ÷ $1.0590^{(3.5/12)}$ = $19,122).

(B) The contribution paid July 15, 2017 is discounted for 6½ months at the effective interest rate ($19,444 ÷ $1.0590^{(6.5/12)}$ = $18,850).

(C) The contribution paid August 15, 2017 is discounted for 7½ months at the effective interest rate ($19,444 ÷ $1.0590^{(7.5/12)}$ = $18,760).

(D) The sum of the contributions for the 2017 plan year paid through August 15, 2017, adjusted for interest to the valuation date, is $56,732. The remaining amount paid April 15, 2018 for the 2017 plan year is ($72,917 − $56,732) × $1.059^{(15.5/12)}$ = $17,429.

Example 8. (i) Plan B has an August 10 to August 9 plan year.

(ii) For the plan year that begins on August 10, 2017, a plan month begins on the 10th day of each calendar month. Accordingly,

the due dates for the required installments for that plan year are November 24, 2017, February 24, 2018, May 24, 2018 and August 24, 2018. The deadline for the final contribution for the plan year is April 24, 2019.

Example 9. (i) Plan C has a funding standard carryover balance of $0 and a prefunding balance of $65,000 as of January 1, 2017. Plan C's funding ratio for 2016 (determined under § 1.430(f)–1(d)(3)) was over 80%. The minimum required contribution for Plan C (determined prior to any offset for the funding standard carryover balance) is $120,000 for 2016. Required installments for the 2016 plan year were made timely, and the final installment of the minimum required contribution for the 2016 plan year is due on September 15, 2017 in the amount of $40,000.

(ii) Prior to April 15, 2017, the plan sponsor makes a standing election to use Plan C's funding balances to offset any otherwise unpaid required installments and any otherwise unpaid minimum required contribution. On June 1, 2017, the actuary completes the 2017 valuation and notifies the plan sponsor that the minimum required contribution for the 2017 plan year is $100,000. The effective interest rate for the 2017 plan year is 5.90%. No contributions are made for the 2017 plan year until September 15, 2018.

(iii) The first required installment for the 2017 plan year is due on April 15, 2017. Under § 1.430(f)–1(f)(1)(iii)(B), the amount of the prefunding balance used as of April 15, 2017 pursuant to the standing election is 25% of the $120,000 required annual payment for the 2016 plan year ($30,000). The prefunding balance is reduced by this amount, adjusted for the 3½-month period between the January 1, 2017 valuation date and the April 15, 2017 due date, using the effective rate for Plan C for 2017 ($30,000 ÷ $1.0590^{(3.5/12)}$, or $29,503). The prefunding balance is available to offset the April 15, 2017 required installment even though the minimum required contribution for the 2016 plan year has not yet been made, because the standing election to use Plan C's balances to offset the minimum required contribution for the 2016 plan year does not take effect until the due date for that contribution, or September 15, 2017. Therefore, as of April 15, 2017, the prefunding balance still exists and may be used to offset the required installment due as of that date.

(iv) The second required installment for the 2017 plan year is due on July 15, 2017, after the actuary determined the minimum required contribution for the 2017 plan year. The required annual payment for 2017 is equal to the lesser of (a) 100% of the 2017 minimum required contribution ($120,000) or (b) 90% of the 2017 minimum required contribution (90% of $100,000, or $90,000). Therefore, each required installment for 2017 is 25% of $90,000, or $22,500.

(v) Although the amount of the required installments for 2017 ($22,500) is smaller than the amount based on the 2016 minimum required contribution ($30,000), under § 1.430(f)–1(f)(1)(iii)(B), the amount of the prefunding balance used under the standing election continues to be the $30,000 based on the minimum required contribution for the 2016 plan year. Alternatively, the plan sponsor can make a replacement formula election to use the prefunding balance to cover the remaining required installments for the 2017 plan year as described in § 1.430(f)–1(f)(1)(iii)(C), based on required installments of $22,500 each.

(vi) The use of $30,000 of the prefunding balance as of April 15, 2017 pursuant to the standing election is irrevocable, and therefore the prefunding balance is not adjusted to reflect the fact that the first required installment for the 2017 plan year (based on the actual 2017 minimum required contribution) is lower than $30,000.

(vii) However, the excess of the $30,000 of prefunding balance used on April 15, 2017 over the first required installment is allocated toward the second required installment. In addition, if the plan sponsor makes a replacement formula election in accordance with § 1.430(f)–1(f)(1)(iii)(C), the amount of prefunding balance used pursuant to that election takes into account the actual required installment. In this case, the amount of the prefunding balance used to satisfy the July 15, 2017 required installment is $14,437. This amount is determined by (1) calculating the excess of the amount of the prefunding balance used on April 15, 2017 over the amount of the required installment due on that date ($30,000 − $22,500 = $7,500), and adjusting it for the 3 months from April 15, 2017 to July 15, 2017, using the effective interest rate ($7,500 × $1.0590^{(3/12)}$ = $7,608), (2) deducting that amount from the required installment due July 15, 2017, to determine the net amount due as of that date ($22,500 − $7,608 = $14,892), and (3) adjusting the net amount to the valuation date of January 1, 2017 for the 6½-month period between the valuation date and the due date for the required installment, using the effective interest rate for Plan C for 2017 ($14,892 ÷ $1.0590^{(6.5/12)}$ = $14,437).

Example 10. (i) The facts are the same as in *Example 9,* except that Plan C's prefunding balance as of January 1, 2017 is only $20,000, and Plan C's sponsor makes a contribution larger than the minimum required contribution for the 2016 plan year on March 1, 2017.

(ii) The amount of the April 15, 2017 required installment that is satisfied by the plan sponsor's election to offset the prefunding balance is calculated by increasing the January 1, 2017 prefunding balance with interest for 3½ months to April 15, 2017, using the effective interest rate for Plan C for 2017. This results in an offset of $20,337 ($20,000 × $1.0590^{(3.5/12)}$). A cash contribution of

$2,163 ($22,500 − $20,337) is needed to satisfy the required installment on that date.

(iii) The excess contribution made for the 2016 plan year cannot be used to offset the remainder of the April 15, 2017 required installment even though it was contributed prior to the date the installment is due, because the sponsor had not yet elected to credit the excess contribution to the prefunding balance. If the plan sponsor elects at a later date to credit the excess contribution to the prefunding balance, the amount can be used to offset required installments due on or after the date of that election. However, note that if Plan C's actuary reflected the excess contribution for 2016 in certifying the 2017 adjusted funding target attainment percentage (AFTAP) used to apply benefit restrictions under section 436, a later election to credit the excess contribution to the prefunding balance would reduce the AFTAP and could cause Plan C to violate section 436.

Example 11. (i) Plan D is not a small plan described in §1.430(g)–1(b)(2). The valuation date for Plan D is January 1, and Plan D's funding target attainment percentage (FTAP) was 82% as of January 1, 2016 and is 90% as of January 1, 2017. The amount needed to increase the plan's FTAP for the 2017 plan year to 100% (including the expected increase in the funding target due to benefits accruing or earned during the plan year) is $500,000. Before taking the liquidity requirement of paragraph (d) of this section into account, the plan sponsor of Plan D is required to pay installments for the 2017 plan year in the amount of $50,000 each. During the 12-month period ending March 31, 2017, periodic annuity payments of $425,000 and single sum payments of $200,000 were made by Plan D. Of the single sum payments, $125,000 were made during the 2016 plan year and $75,000 were made during the 2017 plan year. None of these payments were due to nonrecurring circumstances. In addition, administrative expenses of $25,000 were paid from the plan trust during the 12-month period ending March 31, 2017. As of March 31, 2017, the reported value of Plan D's assets is $1,500,000, and the fair market value of Plan D's liquid assets is $1,300,000.

(ii) The amount of the adjusted disbursements from Plan D for the 12-month period ending March 31, 2017 is calculated as the sum of the annuity benefits, single sum payments, and administrative expenses paid during the 12-month period, reduced by the product of the plan's FTAP and the sum of the single sum payments and any payments for annuities purchased during the plan year. This results in adjusted disbursements for the period of $480,000 (that is, $425,000 plus $200,000 plus $25,000, reduced by 82% of $125,000 in single sum payments during 2016 and 90% of $75,000 in single sum payments during 2017).

(iii) The base amount is calculated in accordance with paragraph (e)(6)(ii) of this section as three times the adjusted disbursements determined in paragraph (ii) of this *Example 11*, or $1,440,000.

(iv) The liquidity shortfall is the difference between the base amount of $1,440,000 determined in paragraph (iii) of this *Example 11* and the $1,300,000 in liquid assets as of March 31, 2017, or $140,000. The required installment due on April 15, 2017 is therefore $140,000, since this amount is larger than the $50,000 installment otherwise required, but less than the $500,000 needed to increase the plan's FTAP (including the expected increase in the funding target due to benefits accruing or earned during the plan year) to 100%.

(v) Note that any contributions of liquid assets made through March 31, 2017 are reflected for purposes of determining the fair market value of Plan D's liquid assets as of March 31, 2017 and are not applied toward satisfying the liquidity requirement as of April 15, 2017. Similarly, any funding standard carryover balance or prefunding balance as of January 1, 2017 cannot be applied to offset the liquidity requirement. Only contributions made in cash or other liquid assets made after March 31, 2017 and by April 15, 2017 can be used to timely satisfy this requirement.

Example 12. (i) The facts are the same as in *Example 11*. The plan sponsor makes a cash contribution for the 2017 plan year of $30,000 on April 15, 2017, and makes an additional cash contribution for the 2017 plan year of $110,000 on April 30, 2017. The effective interest rate for Plan D for the 2017 plan year is 5.90%.

(ii) Under paragraph (d)(3)(i) of this section, the underpayment of the required installment due April 15, 2017 is $110,000 (that is, $140,000 minus $30,000).

(iii) Because the $110,000 contribution was made after the due date for the required installment (which reflects an unpaid liquidity amount) but during the quarter in which the installment was due, and because that contribution does not exceed the unpaid liquidity amount for the quarter, the special interest adjustment under paragraph (b)(4)(iii) of this section applies to the entire amount of the contribution. Accordingly, the contribution is adjusted for interest in two steps for the purpose of determining the portion of the minimum required contribution that is satisfied by the contribution. In the first step, the contribution is adjusted using the effective interest rate for the 2-month period from the payment date of April 30, 2017 to June 30, 2017, the last day of the quarter during which the liquidity requirement was due ($110,000 × $1.0590^{(2/12)}$ = $111,056). In the second step, this amount is adjusted as if that amount had been paid on June 30, 2017. Accordingly, this amount ($111,056) is discounted for interest at a rate of 10.90% (the

effective interest rate for the 2017 plan year of 5.90%, increased by 5 percentage points) for the 2½-month period from June 30, 2017 to the April 15, 2017 due date for the installment, and is further discounted using the effective interest rate of 5.90% for the 3½-month period between April 15, 2017 and the valuation date of January 1, 2017. Therefore, the April 30, 2017 contribution is adjusted to $106,886 as of January 1, 2017 ($111,056 ÷ $1.1090^{(2.5/12)} \div 1.0590^{(3.5/12)}$).

(iv) The $140,000 contributed during April 2017 is needed to satisfy the required installment due April 15, 2017 (determined taking into account the liquidity shortfall as of March 31, 2017), and so the full amount is applied to satisfy that installment. No portion of those contributions is applied to the required installments for subsequent quarters, and no additional payments are needed to satisfy the required installment due April 15, 2017 (because the $110,000 payment satisfies both the unpaid liquidity amount and the remaining amount of the required installment described under paragraph (c)(5) of this section).

Example 13. (i) The facts are the same as in *Example 12,* except that the plan sponsor does not make the second cash contribution of $110,000 on April 30, 2017, but instead makes a second cash contribution of $75,000 for the 2017 plan year on July 15, 2017. The base amount as of June 30, 2017 calculated in accordance with paragraph (e)(6)(ii) of this section is $1,500,000, and the fair market value of liquid assets as of that date is $1,400,000.

(ii) Under paragraph (d)(3)(i) of this section, the underpayment of the required installment due April 15, 2017 is $110,000 (that is, $140,000 minus $30,000).

(iii) As of June 30, 2017, no portion of the $110,000 underpayment of the required installment due April 15, 2017 has been satisfied. Under paragraph (d)(3)(iv)(A) of this section, to the extent that the amount due April 15, 2017 solely because of the liquidity requirement under paragraph (d)(1) of this section is not satisfied with a contribution of liquid assets during the quarter, this amount is no longer considered unpaid. Of the $110,000 underpayment of the required installment that was due on April 15, 2017, $20,000 would have been due without regard to the liquidity requirement under paragraph (d)(1) of this section and $90,000 was due solely because of that liquidity requirement. Accordingly, as of July 1, 2017, $90,000 of the required installment due on April 15, 2017 is no longer treated as unpaid and $20,000 of that required installment continues to be treated as unpaid.

(iv) Under paragraph (d)(3)(iv)(B) of this section, the interest adjustment in paragraph (b)(4)(iii) of this section for the $90,000 portion of the installment due April 15, 2017 that is no longer treated as unpaid is given effect through an increase in the minimum required contribution. This increase to the minimum required contribution is $837, which is determined as the difference between:

(A) The $90,000 portion of the required installment that is no longer treated as unpaid by reason of paragraph (d)(3)(iv)(A) of this section, discounted for the 6-month period between June 30, 2017 (the last day of the quarter in which the liquidity amount was due) to January 1, 2017 (the valuation date) using the plan's effective interest rate for 2017 (5.90%), resulting in $87,457 (that is, $90,000 ÷ $1.0590^{(6/12)}$), and

(B) The $90,000 portion of the required installment that is no longer treated as unpaid by reason of paragraph (d)(3)(iv)(A) of this section, discounted for the 2½-month period between June 30, 2017 and the April 15, 2017 due date using the plan's effective interest rate increased by 5 percentage points (10.90%), and further discounted for the 3½-month period between April 15, 2017 and January 1, 2017 valuation date using the plan's effective interest rate, for a result of $86,620 (that is, $90,000 ÷ $1.1090^{(2.5/12)} \div 1.0590^{(3.5/12)}$).

(v) The remainder of the required installment that was due on April 15, 2017 without regard to the liquidity requirement ($20,000) remains unpaid until the July 15, 2017 contribution is made. Under paragraph (c) of this section, $20,000 of the July 15, 2017 contribution must be allocated to the required installment due on April 15, 2017. The interest adjustment under paragraph (b)(4)(ii) of this section applies to that $20,000 portion of the contribution because it is a late payment of a required installment. Accordingly, $20,000 of the July 15, 2017 contribution is adjusted to April 15, 2017, using an interest rate of 10.90% for the 3-month period between July 15, 2017 and the April 15, 2017 due date, and further adjusted using the effective interest rate of 5.90% for 3½ months between April 15, 2017 and the January 1, 2017 valuation date. Therefore, the portion of the July 15, 2017 contribution attributable to the April 15, 2017 required installment is adjusted to $19,166 as of January 1, 2017 ($20,000 ÷ $1.1090^{(3/12)} \div 1.0590^{(3.5/12)}$).

(vi) The liquidity shortfall is recalculated as of June 30, 2017 as $100,000 (that is, the base amount of $1,500,000 minus the value of liquid assets of $1,400,000). This amount is larger than the $50,000 required installment otherwise applicable, and so the amount of the required installment due on July 15, 2017 is $100,000. Of the $75,000 contribution made on July 15, 2017, $20,000 is applied to satisfy the remainder of the required installment due April 15, 2017, and the remaining $55,000 is applied toward the required installment due July 15, 2017. An additional contribution of $45,000 in liquid assets is needed to satisfy the required installment due July 15, 2017.

(vii) If instead there were no liquidity shortfall as of June 30, 2017, the required installment due July 15, 2017 would be $50,000. Of the $75,000 contribution made on July 15, 2017, $20,000 would be applied to satisfy the remainder of the required installment due April 15, 2017, $50,000 would be applied to satisfy the required installment due on July 15, 2017, and the remaining $5,000 would be applied toward the next required installment.

Example 14. (i) Plan E, which is a small plan described in section 430(g)(2)(B), has a calendar year plan year and a valuation date of December 31. The required installments for the 2017 plan year are $30,000 each and each of the required installments is paid on the due date. The effective interest rate for Plan E for the 2017 plan year is 5.90%.

(ii) The total contributions made for the plan year and before the valuation date, adjusted with interest to the valuation date, equal $92,402. This is developed as shown below:

(A) The contribution paid April 15, 2017 is adjusted by increasing the contribution amount for 8½ months at the effective interest rate ($30,000 × $1.0590^{(8.5/12)}$ = $31,243).

(B) The contribution paid July 15, 2017 is increased for 5½ months at the effective interest rate ($30,000 × $1.0590^{(5.5/12)}$ = $30,799).

(C) The contribution paid October 15, 2017 is increased for 2½ months at the effective interest rate ($30,000 × $1.0590^{(2.5/12)}$ = $30,360).

(iii) Pursuant to §1.430(g)–1(d)(2), the interest-adjusted value of the contributions for the 2017 plan year that are made before the valuation date is subtracted from the December 31, 2017 plan assets in determining the value of plan assets for the December 31, 2017 actuarial valuation.

Example 15. (i) The facts are the same as in *Example 14*, except that the first contribution for the 2017 plan year is made on May 15, 2017 in the amount of $40,000. The remaining amount of each required installment is paid on the date it is due.

(ii) In accordance with paragraph (c)(3)(iii) of this section, the amount of the required installment due on April 15, 2017 remains at $30,000, even though the associated contribution was not paid until May 15, 2017. Therefore, $30,000 of the payment is allocated to the April 15, 2017 required installment and the remaining $10,000 is allocated to the installment due on July 15, 2017.

(iii) Under paragraph (c)(3)(ii) of this section, the portion of the May 15, 2017 contribution allocated to the July 15, 2017 required installment is increased for interest for the 2 months between the date of the contribution and the due date, using the effective interest rate for 2017. Therefore, the amount allocated to the July 15, 2017 installment is $10,096 (that is, $10,000 × $1.0590^{(2/12)}$). The remaining installment due July 15, 2017 is $30,000 minus $10,096, or $19,904.

(iv) The total amount credited against the minimum required contribution is $122,062 as of December 31, 2017. This amount is calculated as shown below:

(A) The portion of the May 15, 2017 contribution allocated to the April 15, 2017 required installment is first adjusted for the 1 month between the due date and the payment date using the effective interest rate plus 5% ($30,000 ÷ $1.1090^{(1/12)}$ = $29,742). This amount is then adjusted using the effective interest rate, for the 8½ months between the due date of April 15, 2017 and the valuation date of December 31, 2017 ($29,742 × $1.0590^{(8.5/12)}$ = $30,975).

(B) The remaining portion of the May 15, 2017 contribution ($10,000) is increased for the 7½ months between the date of the contribution and the valuation date at the effective interest rate ($10,000 × $1.0590^{(7.5/12)}$ = $10,365).

(C) The contribution paid July 15, 2017 is increased for 5½ months at the effective interest rate ($19,904 × $1.0590^{(5.5/12)}$ = $20,434).

(D) The contribution paid October 15, 2017 is increased for 2½ months at the effective interest rate ($30,000 × $1.0590^{(2.5/12)}$ = $30,360).

(E) The contribution paid January 15, 2018 is discounted for ½ month at the effective interest rate ($30,000 ÷ $1.0590^{(0.5/12)}$ = $29,928).

(v) The amount deducted from valuation assets as of December 31, 2017 for contributions made before the valuation date is determined without regard to the special interest adjustment for late payment of the required installment due April 15, 2017 (and without regard to the contribution paid on January 15, 2018).

Example 16. (i) Plan F has a required installment of $10,000 per quarter for the 2016 plan year. The plan sponsor makes a contribution of $9,993 on April 10, 2016. The effective interest rate for Plan F for the 2016 plan year is 5.90%.

(ii) In accordance with paragraph (c)(3)(ii) of this section, the contribution is increased for interest at the effective interest rate, for the 5 days between the contribution date and the due date for the required installment. Therefore, the amount credited against the required installment due April 15, 2016 is $10,001 ($9,993 × $1.0590^{(5/365)}$), and the required installment is satisfied.

Example 17. (i) The facts are the same as in *Example 16*, except that a contribution of $8,000 is made on April 20, 2016.

(ii) In accordance with paragraph (c)(3)(iii) of this section, the amount of the required installment due on April 15, 2016 remains at $10,000, even though the associated contribution was not paid until after the due date, and so $2,000 ($10,000 − $8,000) of the required installment remains unpaid as of April 20, 2016.

(iii) The amount of the April 20, 2016 contribution credited against the minimum required contribution for 2016 is $7,858. This amount is determined by first adjusting the

contribution for the 5 days between the due date for the required installment and the date of the contribution using the effective interest rate for Plan F for the 2016 plan year, plus 5% ($8,000 ÷ $1.1090^{(5/365)}$ = $7,989). The result is further adjusted for the 105 days from the due date for the required installment to the valuation date of January 1, 2016 using the effective interest rate of 5.90% ($7,989 ÷ $1.0590^{(105/365)}$ = $7,858).

(iv) Alternatively, the amount of the April 20, 2016 contribution credited against the minimum required contribution for 2016 could be determined using 3½ months between the due date for the required installment and the January 1, 2016 valuation date, as long as the calculation is done consistently for each contribution and for each plan year. Using this approach, the amount adjusted to the April 15, 2016 due date (using the effective interest rate for Plan F for the 2016 plan year plus 5%) is adjusted to January 1, 2016 for 3½ months at the effective interest rate for Plan F for the 2016 plan year. Under this approach, the amount credited against the minimum required contribution is $7,856 ($8,000 ÷ $1.1090^{(5/365)}$ ÷ $1.0590^{(3.5/12)}$).

Example 18. (i) Plan G has a funding standard carryover balance of $15,000 and a prefunding balance of $50,000 as of January 1, 2016. Plan G's required installments are $25,000 each for the 2017 plan year, and the final installment of the minimum required contribution for the 2016 plan year is due on September 15, 2017, in the amount of $40,000. Plan G's funding ratios for both 2015 and 2016 (determined under §1.430(f)–1(d)(3)) were over 80%. No elections were made to reduce or use Plan G's funding balances during 2016. The effective interest rate for Plan G for the 2016 and 2017 plan years are 5.40% and 5.90%, respectively.

(ii) On April 15, 2017, Plan G's sponsor elected to use the balances to offset the required installment due on that date. The amount of the required installment is adjusted to January 1, 2017, using the effective interest rate for 2017 to determine the amount by which the balances are reduced. Accordingly, this election results in a reduction of $24,585 ($25,000 ÷ $1.0590^{(3.5/12)}$ in the funding balances as of January 1, 2017.

(iii) On September 15, 2017, Plan G's sponsor elected to use the balances to offset the remaining minimum required contribution for the 2016 plan year due on that date. This amount is adjusted to January 1, 2016, using the effective interest rate for 2016 to determine the amount by which the balances are reduced. Accordingly, this election results in a reduction of $36,563 ($40,000 ÷ $1.0540^{(20.5/12)}$ in Plan G's funding balances as of January 1, 2016.

(iv) Section 430(f)(3)(B) and §1.430(f)–1(d)(2) require that the funding standard carryover balance be exhausted before the prefunding balance is used to offset required contribution amounts. Although the due date for the April 15, 2017 required installment occurs earlier than the due date for the 2016 minimum required contribution, for this purpose contributions for the 2016 plan year are deemed to occur before those for the 2017 plan year. Therefore, the election to offset the 2016 minimum required contribution will eliminate Plan G's funding standard carryover balance, and the 2017 required installment due April 15, 2017 will be offset by the prefunding balance.

(g) *Effective/applicability dates and transition rules*—(1) *Statutory effective date/applicability date.* Section 430 generally applies to plan years beginning on or after January 1, 2008. The applicability of section 430 for purposes of determining the minimum required contribution is delayed for certain plans in accordance with sections 104 through 106 of PPA '06.

(2) *Effective date/applicability date of regulations.* This section applies to plan years beginning on or after January 1, 2016. For plan years beginning before January 1, 2016, plans are permitted to rely on the provisions set forth in this section for purposes of satisfying the requirements of section 430(j).

(3) *First effective plan year.* For purposes of this section, the *first effective plan year* for a plan is the first plan year after the pre-effective plan year.

(4) *Pre-effective plan year.* For purposes of this section, the *pre-effective plan year* is the plan year described in §1.430(a)–1(h)(5).

(5) *Special rules relating to first effective plan year*—(i) *Determination of minimum required contribution for pre-effective plan year.* In the case of the plan's first effective plan year, the minimum required contribution for the preceding plan year for purposes of paragraph (c)(5)(ii)(B) of this section is equal to the minimum required contribution under section 412 for the pre-effective plan year (determined without regard to any funding waiver under section 412), determined as of the last day of the pre-effective plan year and without regard to the plan's credit balance.

(ii) *Determination of funding shortfall for pre-effective plan year*—(A) *First effective plan year that begins during 2008.* In general, in the case of a plan with a first effective plan year that begins during 2008, the funding shortfall for

the pre-effective plan year that precedes it is determined pursuant to paragraph (e)(4) of this section. However, for this purpose, the plan's current liability for the pre-effective plan year under section 412(l)(7) (as in effect for the pre-effective plan year) is permitted to be used in place of the plan's funding target for the pre-effective plan year. In addition, for this purpose, the value of plan assets that was used for the pre-effective plan year is permitted to be used in place of the value of plan assets computed pursuant to §1.430(g)–1(c) for the pre-effective plan year, provided that the value of plan assets that was used for the pre-effective plan year was not less than 90 percent nor more than 110 percent of the value of plan assets computed pursuant to §1.430(g)–1(c). If the value of plan assets that was used for the pre-effective plan year was less than 90 percent of the value of plan assets computed pursuant to §1.430(g)–1(c), then 90 percent of the value of plan assets computed pursuant to §1.430(g)–1(c) is permitted to be used as the value of plan assets for the pre-effective plan year. If the value of plan assets that was used for the pre-effective plan year was more than 110 percent of the value of plan assets computed pursuant to §1.430(g)–1(c), then 110 percent of the value of plan assets computed pursuant to §1.430(g)–1(c) is permitted to be used as the value of plan assets for the pre-effective plan year. Finally, for this purpose, the value of plan assets is permitted to be determined without subtraction for the plan's credit balance for the pre-effective plan year.

(B) *First effective plan year begins after 2008*. In the case of a plan with a first effective plan year that begins after December 31, 2008, the determination of the funding shortfall for the pre-effective plan year that immediately precedes it is made in accordance with paragraph (e)(4)(i) of this section. Thus, the funding shortfall for the pre-effective plan year is based on the funding target for the pre-effective plan year and the value of plan assets is determined under §1.430(g)–1(c) for the pre-effective plan year, even though section 430(g) did not apply to the plan for purposes of determining the minimum required contribution for the pre-effective plan year.

[T.D. 9732, 80 FR 54390, Sept. 9, 2015]

§ 1.431(c)(6)–1 Mortality tables used to determine current liability.

(a) *Mortality tables used to determine current liability*. The mortality assumptions that apply to a defined benefit plan for the plan year pursuant to section 430(h)(3)(A) and §1.430(h)(3)–1(a)(2) are used to determine a multiemployer plan's current liability for purposes of applying the rules of section 431(c)(6). A multiemployer plan is permitted to apply either the static mortality tables used pursuant to §1.430(h)(3)–1(a)(3) or generational mortality tables used pursuant to §1.430(h)(3)–1(a)(4) for this purpose. However, for this purpose, a multiemployer plan is not permitted to use substitute mortality tables under §1.430(h)(3)–2.

(b) *Effective/applicability date*. This section applies for plan years beginning on or after January 1, 2008.

[T.D. 9419, 73 FR 44648, July 31, 2008]

§ 1.432 [Reserved]

§ 1.432(e)(9)–1T Benefit suspensions for multiemployer plans in critical and declining status (temporary).

(a) *General rules on suspension of benefits*—(1) *General rule*. Subject to section 432(e)(9)(B) through (I) and paragraphs (b) through (h) of this section, the plan sponsor of a multiemployer plan that is in critical and declining status (within the meaning of section 432(b)(6)) for a plan year may, by plan amendment adopted in the plan year, implement a suspension of benefits that the plan sponsor deems appropriate. Such a suspension is permitted notwithstanding the anti-cutback provisions of section 411(d)(6).

(2) *Adoption of plan terms inconsistent with suspension requirements*—(i) *General rule*. A plan may implement (or continue to implement) a reduction of benefits pursuant to a suspension of benefits only if the terms of the plan are consistent with the requirements of section 432(e)(9) and this section.

(ii) *Changes in level of suspension*. [Reserved]

(3) *Organization of the regulation*. This paragraph (a) contains definitions and

general rules relating to a suspension of benefits by a multiemployer plan under section 432(e)(9). Paragraph (b) of this section defines a suspension of benefits and describes the length of a suspension, the treatment of beneficiaries and alternate payees under this section, and the requirement to select a retiree representative. Paragraph (c) of this section prescribes certain rules for the actuarial certification and plan-sponsor determinations that must be made in order for a plan to suspend benefits. Paragraph (d) of this section describes certain limitations on suspensions of benefits. Paragraph (e) of this section is reserved for rules on benefit improvements under section 432(e)(9)(E). Paragraph (f) of this section describes the requirement to provide notice in connection with an application to suspend benefits. Paragraph (g) of this section describes certain requirements with respect to the approval or denial of an application for a suspension of benefits. Paragraph (h) of this section contains certain rules relating to the vote on an approved suspension, systemically important plans, and the issuance of a final authorization to suspend benefits. Paragraph (j) of this section provides the effective/applicability date of this section. Paragraph (k) provides the expiration date.

(4) *Definitions*. The following definitions apply for purposes of this section—

(i) *Pay status*. A person is in pay status under a multiemployer plan if, as described in section 432(j)(6), at any time during the current plan year, the person is a participant, beneficiary, or alternate payee under the plan and is paid an early, late, normal, or disability retirement benefit under the plan (or a death benefit under the plan related to a retirement benefit).

(ii) *Plan sponsor*. The term plan sponsor means the association, committee, joint board of trustees, or other similar group of representatives of the parties that establishes or maintains the multiemployer plan. However, in the case of a plan described in section 404(c), or a continuation of such a plan, the term plan sponsor means the association of employers that is the employer settlor of the plan.

(iii) *Effective date of suspension of benefits*. [Reserved]

(b) *Definition of suspension of benefits and related rules*—(1) *In general*—(i) *Definition*. For purposes of this section, the term suspension of benefits means the temporary or permanent reduction, pursuant to the terms of the plan, of any current or future payment obligation of the plan with respect to any participant under the plan. A suspension of benefits may apply with respect to a participant of the plan regardless of whether the participant, beneficiary, or alternate payee commenced receiving benefits before the effective date of the suspension of benefits.

(ii) *Plan not liable for suspended benefits*. If a plan pays a reduced level of benefits pursuant to a suspension of benefits that complies with the requirements of section 432(e)(9) and this section, then the plan is not liable for any benefits not paid as a result of the suspension.

(2) *Length of suspension*—(i) *In general*. A suspension of benefits may be of indefinite duration or may expire as of a date that is specified in the plan amendment implementing the suspension.

(ii) *Effect of a benefit improvement*. A plan sponsor may amend the plan to eliminate some or all of a suspension of benefits, provided that the amendment satisfies the requirements that apply to a benefit improvement under section 432(e)(9)(E), in accordance with the rules of paragraph (e) of this section.

(3) *Treatment of beneficiaries and alternate payees*. Except as otherwise specified in this section, all references to suspensions of benefits, increases in benefits, or resumptions of suspended benefits with respect to participants also apply with respect to benefits of beneficiaries or alternate payees (as defined in section 414(p)(8)) of participants.

(4) *Retiree representative*—(i) *In general*—(A) *Requirement to select retiree representative*. The plan sponsor of a plan that intends to submit an application for a suspension of benefits and that has reported a total of 10,000 or more participants as of the end of the plan year for the most recently filed Form 5500, ''Annual Return/Report of Employee Benefit Plan,'' must select a

retiree representative. The plan sponsor must select the retiree representative at least 60 days before the date the plan sponsor submits an application to suspend benefits. The retiree representative must be a plan participant who is in pay status. The retiree representative may or may not be a plan trustee.

(B) *Role of retiree representative.* The role of the retiree representative is to advocate for the interests of the retired and deferred vested participants and beneficiaries of the plan throughout the suspension approval process. In the discretion of the plan sponsor, the retiree representative may continue in this role throughout the period of the benefit suspension.

(ii) *Reasonable expenses from plan.* The plan must pay reasonable expenses incurred by the retiree representative, including reasonable expenses for legal and actuarial support, commensurate with the plan's size and funded status.

(iii) *Disclosure of information.* Upon request, the plan sponsor must promptly provide the retiree representative with relevant information, such as plan documents and data, that is reasonably necessary to enable the retiree representative to perform the role described in paragraph (b)(4)(i)(B) of this section.

(iv) *Special rules relating to fiduciary status.* See section 432(e)(9)(B)(v)(III) for rules relating to the fiduciary status of a retiree representative.

(v) *Retiree representative for other plans.* The plan sponsor of a plan that has reported fewer than 10,000 participants as of the end of the plan year for the most recently filed Form 5500, ''Annual Return/Report of Employee Benefit Plan'' is permitted to select a retiree representative. The rules in this paragraph (b)(4) (other than the rules in the first two sentences of paragraph (b)(4)(i)(A) of this section concerning the size of the plan and the timing of the appointment of the retiree representative) apply to such a representative.

(c) *Conditions for suspension*—(1) *In general*—(i) *Actuarial certification and initial-plan-sponsor determinations.* The plan sponsor of a plan in critical and declining status for a plan year may suspend benefits only if the actuarial certification requirement in paragraph (c)(2) of this section and the initial-plan-sponsor determinations requirement in paragraph (c)(3) of this section are met.

(ii) *Annual requirement to make plan-sponsor determinations.* [Reserved]

(2) *Actuarial certification.* A plan satisfies the actuarial certification requirement of this paragraph (c)(2) if, taking into account the proposed suspension of benefits (and, if applicable, a proposed partition of the plan under section 4233 of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)), as amended (ERISA)), the plan's actuary certifies that the plan is projected to avoid insolvency within the meaning of section 418E, assuming the suspension of benefits continues until it expires by its own terms or if no such expiration date is set, indefinitely.

(3) *Initial-plan-sponsor determinations*—(i) *General rule.* A plan satisfies the initial-plan-sponsor determinations requirement of this paragraph (c)(3) only if the plan sponsor determines that—

(A) All reasonable measures to avoid insolvency, within the meaning of section 418E, have been taken; and

(B) The plan is projected to become insolvent within the meaning of section 418E unless the proposed suspension of benefits (or another suspension of benefits under section 432(e)(9)) is implemented for the plan.

(ii) *Factors.* In making its determination that all reasonable measures to avoid insolvency, within the meaning of section 418E, have been taken, the plan sponsor may take into account the following non-exclusive list of factors—

(A) Current and past contribution levels;

(B) Levels of benefit accruals (including any prior reductions in the rate of benefit accruals);

(C) Prior reductions (if any) of adjustable benefits;

(D) Prior suspensions (if any) of benefits under this section;

(E) The impact on plan solvency of the subsidies and ancillary benefits available to active participants;

(F) Compensation levels of active participants relative to employees in the participants' industry generally;

(G) Competitive and other economic factors facing contributing employers;

(H) The impact of benefit and contribution levels on retaining active participants and bargaining groups under the plan;

(I) The impact of past and anticipated contribution increases under the plan on employer attrition and retention levels; and

(J) Measures undertaken by the plan sponsor to retain or attract contributing employers.

(iii) *Reliance on certification of critical and declining status.* For purposes of the insolvency projection under paragraph (c)(3)(i)(B) of this section, a plan sponsor may rely on the actuarial certification made pursuant to section 432(b)(3)(A)(i) that the plan is in critical and declining status for the plan year in making the determination that the plan is projected to become insolvent unless benefits are suspended.

(4) *Annual-plan-sponsor determinations.* [Reserved]

(5) *Failure to make annual-plan-sponsor determinations.* [Reserved]

(d) *Limitations on suspension*—(1) *In general.* Any suspension of benefits with respect to a participant made by a plan sponsor pursuant to this section is subject to the individual limitations of sections 432(e)(9)(D)(i) through (iii), in accordance with the rules of paragraphs (d)(2) through (d)(4) of this section. After applying the individual limitations in sections 432(e)(9)(D)(i) through (iii), in accordance with the rules of paragraphs (d)(2) through (d)(4) of this section, the overall size and distribution of the suspension is subject to the aggregate limitations of sections 432(e)(9)(D)(iv) and (vi) in accordance with the rules of paragraphs (d)(5) and (d)(6) of this section. See section 432(e)(9)(D)(vii) for additional rules applicable to certain plans.

(2) *Guarantee-based limitation*—(i) *General rule.* The monthly benefit with respect to any participant may not be reduced below 110 percent of the monthly benefit payable to a participant, beneficiary, or alternate payee that would be guaranteed by the Pension Benefit Guaranty Corporation (PBGC) under section 4022A of ERISA if the plan were to become insolvent as of the effective date of the suspension.

(ii) *PBGC guarantee.* [Reserved]

(iii) *Calculation of accrual rate.* [Reserved]

(iv) *Special rules for non-vested participants.* [Reserved]

(v) *Examples.* [Reserved]

(3) *Age-based limitation.* [Reserved]

(4) *Disability-based limitation*—(i) *General rule.* Benefits based on disability (as defined under the plan) may not be suspended.

(ii) *Benefits based on disability.* [Reserved]

(5) *Limitation on aggregate size of suspension.* [Reserved]

(6) *Equitable distribution.* [Reserved]

(7) *Effective date of suspension made in combination with partition.* In any case in which a suspension of benefits with respect to a plan is made in combination with a partition of the plan, the suspension of benefits may not take effect prior to the effective date of the partition. This requirement will not be satisfied if the partition order under section 4233 of ERISA has not been provided to the Secretary of the Treasury by the last day of the 225-day period described in paragraph (g)(3)(i) of this section.

(e) *Benefit improvements.* [Reserved]

(f) *Notice requirements*—(1) *In general.* No suspension of benefits may be made pursuant to this section unless notice of the proposed suspension has been given by the plan sponsor to—

(i) All participants, beneficiaries of deceased participants, and alternate payees under the plan (regardless of whether their benefits are proposed to be suspended), except those who cannot be contacted by reasonable efforts;

(ii) Each employer who has an obligation to contribute (within the meaning of section 4212(a) of ERISA) under the plan; and

(iii) Each employee organization which, for purposes of collective bargaining, represents plan participants employed by an employer described in paragraph (f)(1)(ii) of this section.

(2) *Content of notice*—(i) *In general.* The notice described under paragraph (f)(1) of this section must contain—

(A) Sufficient information to enable a participant or beneficiary to understand the effect of any suspension of benefits, including an individualized estimate (on an annual or monthly

basis) of the effect on that participant or beneficiary;

(B) A description of the factors considered by the plan sponsor in designing the benefit suspension;

(C) A statement that the application for approval of any suspension of benefits will be available on the Web site of the Department of the Treasury and that comments on the application will be accepted;

(D) Information as to the rights and remedies of plan participants and beneficiaries;

(E) If applicable, a statement describing the appointment of a retiree representative, the date of appointment of the representative, the role and responsibilities of the retiree representative, identifying information about the retiree representative (including whether the representative is a plan trustee), and how to contact the retiree representative; and

(F) Information on how to contact the Department of the Treasury for further information and assistance where appropriate.

(ii) *Description of suspension of benefits.* The notice described under paragraph (f)(1) of this section will not satisfy the requirements of paragraph (f)(2)(i) of this section unless it includes the following—

(A) If it is not possible to provide an individualized estimate on an annual or monthly basis of the quantitative effect of the suspension on a participant or beneficiary, such as in the case of a suspension that affects the payment of any future cost-of-living adjustment, a narrative description of the effect of the suspension;

(B) A statement that the plan sponsor has determined that the plan will become insolvent unless the proposed suspension takes effect, and the year in which insolvency is projected to occur without a suspension of benefits;

(C) A statement that insolvency of the plan could result in benefits lower than benefits paid under the proposed suspension and a description of the projected benefit payments upon insolvency;

(D) A description of the proposed suspension and its effect, including a description of the different categories or groups affected by the suspension, how those categories or groups are defined, and the formula that is used to calculate the amount of the proposed suspension for individuals in each category or group;

(E) A description of the effect of the proposed suspension on the plan's projected insolvency;

(F) A description of whether the suspension will remain in effect indefinitely or will expire by its own terms; and

(G) A statement describing the right to vote on the suspension application.

(iii) *Readability requirement.* A notice given under paragraph (f)(1) of this section must be written in a manner that is readily understandable by the average plan participant.

(iv) *Model notice.* The Secretary of the Treasury will provide a model notice. The use of the model notice will satisfy the content and readability requirements of this paragraph (f)(2) with respect to the language provided in the model.

(3) *Form and manner*—(i) *Timing*—(A) *In general.* A notice under paragraph (f)(1) of this section must be given no earlier than four business days before the date on which an application is submitted and no later than two business days after the Secretary of the Treasury notifies the plan sponsor that it has submitted a complete application, as described in paragraph (g)(1)(ii) of this section.

(B) *Timing for lost participants.* If additional individuals who are entitled to notice are located after the time period in paragraph (f)(3)(i)(A) of this section has elapsed, then the plan sponsor must give notice to these individuals as soon as practicable thereafter.

(ii) *Method of delivery of notice*—(A) *Written or electronic delivery.* A notice given under paragraph (f)(1) of this section may be provided in writing. It may also be provided in electronic form to the extent that the form is reasonably accessible to persons to whom the notice is required to be provided. Permissible electronic methods include those permitted under regulations of the Department of Labor at 29 CFR 2520.104b–1(c) and those described at § 54.4980F–1, Q&A–13(c) of the Excise Tax Regulations.

(B) *No alternative method of delivery.* [Reserved]

(iii) *Additional information in notice.* A notice given under paragraph (f)(1) of this section is permitted to include information in addition to the information that is required under paragraph (f)(2) of this section, including, if applicable, information relating to an application for partition under section 4233 of ERISA (such as the model notice at Appendix A of 29 CFR part 4233), provided that the requirements of paragraph (f)(3)(iv) of this section are satisfied.

(iv) *No false or misleading information.* A notice given under paragraph (f)(1) of this section may not include false or misleading information (or omit information in a manner that causes the information provided to be misleading).

(4) *Other notice requirement.* Any notice given under paragraph (f)(1) of this section satisfies the requirement for notice of a significant reduction in benefits described in section 4980F that would otherwise be required as a result of that suspension of benefits. To the extent that there are other reductions that accompany a suspension of benefits, such as a reduction in the future accrual rate described in section 4980F for active participants or a reduction in adjustable benefits under section 432(e)(8), notice that satisfies the requirements (including the applicable timing requirements) of section 4980F or section 432(e)(8), as applicable, must be provided.

(5) *Examples.* The following examples illustrate the requirement in paragraph (f)(1)(i) of this section to give notice to all participants, beneficiaries of deceased participants, and alternate payees, except those who cannot be contacted by reasonable efforts.

Example 1. (i) *Facts.* A plan sponsor distributes notice of a proposed suspension of benefits to plan participants, beneficiaries of deceased participants, and alternate payees by mailing the notice to their last known mailing addresses, using the same information that it used to send the most recent annual funding notice. Of 5,000 such notices, 300 were returned as undeliverable. The plan sponsor takes no additional steps to contact the individuals for whom the notice was returned as undeliverable.

(ii) *Conclusion.* The plan sponsor did not make any effort beyond the initial mailing to locate the 300 individuals for whom the notice was returned as undeliverable. Therefore, the plan sponsor did not satisfy the requirement to provide notice to all participants, beneficiaries of deceased participants, and alternate payees under the plan (regardless of whether their benefits are proposed to be suspended), except those who cannot be contacted by reasonable efforts.

Example 2. (i) *Facts.* The facts are the same as *Example 1*, but the plan sponsor contacts the bargaining parties to locate the missing individuals for whom the notice was returned as undeliverable. The plan sponsor then uses an Internet search tool, a credit reporting agency, and a commercial locator service to search for individuals for whom it was not able to obtain updated information from bargaining parties. Through these efforts, the plan sponsor locates the updated addresses of 250 of the 300 individuals whom it previously failed to contact. The plan sponsor mails notices to those individuals within one week of locating them.

(ii) *Conclusion.* By using effective search methods to find the previously missing individuals and promptly mailing the notice of suspension to them, the plan sponsor has satisfied the requirement to provide notice to all participants, beneficiaries of deceased participants, and alternate payees under the plan (regardless of whether their benefits are proposed to be suspended), except those who cannot be contacted by reasonable efforts.

(g) *Approval or denial of an application for suspension of benefits*—(1) *Application*—(i) *In general.* The plan sponsor of a plan in critical and declining status for a plan year that seeks to suspend benefits must submit an application for approval of the proposed suspension of benefits to the Secretary of the Treasury. The Secretary of the Treasury will approve, in consultation with the PBGC and the Secretary of Labor, a complete application described in paragraph (g)(1)(ii) of this section upon finding that the plan is eligible for the suspension and has satisfied the criteria of section 432(e)(9)(C), (D), (E), and (F), in accordance with the rules of paragraphs (c), (d), (e), and (f) of this section.

(ii) *Complete application.* After receiving a submission, the plan sponsor will be notified within two business days whether the submission constitutes a complete application. A complete application will be treated as submitted on the date that it was originally submitted to the Secretary of the Treasury. If a submission is incomplete, the

notification will inform the plan sponsor of the information that is needed to complete the submission and give the plan sponsor a reasonable opportunity to submit a complete application. In such a case, the complete application will be treated as submitted on the date on which the additional information needed to complete the application is submitted to the Secretary of the Treasury.

(iii) *Submission of application.* An application described in this paragraph (g)(1) must be submitted electronically.

(iv) *Requirements for application.* Additional guidance that may be necessary or appropriate with respect to applications described in this paragraph (g)(1), including procedures for submitting applications and the information required to be included in a complete application, may be published in the form of revenue procedures, notices, or other guidance in the Internal Revenue Bulletin.

(v) *Requirement to provide adequate time to process application.* An application for suspension that is not submitted in combination with an application to PBGC for a plan partition under section 4233 of ERISA generally will not be accepted unless the proposed effective date of the suspension is at least nine months from the date on which the application is submitted. However, in appropriate circumstances, an earlier effective date may be permitted.

(vi) *Plan sponsors that also apply for partition.* See Part 4233 of the PBGC regulations for a coordinated application process that applies in the case of a plan sponsor that is submitting an application for suspension in combination with an application to PBGC for a plan partition under section 4233 of ERISA.

(2) *Solicitation of comments*—(i) *In general.* Not later than 30 days after receipt of a complete application described in paragraph (g)(1) of this section—

(A) The application for approval of the suspension of benefits will be published on the Web site of the Department of the Treasury; and

(B) The Secretary of the Treasury will publish a notice in the FEDERAL REGISTER soliciting comments from contributing employers, employee organizations, and participants and beneficiaries of the plan for which an application was made, and other interested parties.

(ii) *Public comments.* The notice described in paragraph (g)(2)(i)(B) of this section will generally request that comments be submitted no later than 45 days after publication of that notice in the FEDERAL REGISTER, but the comment period may be shorter in appropriate circumstances. Comments received in response to this notice will be made publicly available.

(3) *Approval or denial*—(i) *Deemed approval.* A complete application described in paragraph (g)(1)(ii) of this section will be deemed approved unless, within 225 days following the date that the complete application is submitted, the Secretary of the Treasury notifies the plan sponsor that its application does not satisfy one or more of the requirements described in this paragraph (g).

(ii) *Notice of denial.* If the Secretary of the Treasury denies a plan sponsor's application, the notification of the denial will detail the specific reasons for the denial, including reference to the specific requirement not satisfied.

(iii) *Special rules for systemically important plans.* If the Secretary of the Treasury approves a plan sponsor's application and the Secretary believes that the plan is or may be a systemically important plan (as defined in paragraph (h)(5)(iv) of this section), the Secretary will notify the plan sponsor of that belief and that it will be required to provide individual participant data upon request. In such a case, this data would be used in the event of a vote to reject the suspension (as described in paragraph (h)(4) of this section) in order to assist the Secretary in determining whether to permit a modification of the rejected suspension.

(iv) *Agreement to stay 225-day period.* [Reserved]

(4) *Consideration of certain factors.* [Reserved]

(5) *Standard for accepting plan sponsor determinations.* [Reserved]

(6) *Plan-sponsor certifications with respect to plan amendments.* [Reserved]

(7) *Special Master.* The Secretary of the Treasury may appoint a Special

Master for purposes of this section. If a Special Master is appointed, the Special Master will coordinate the implementation of this section and the review of applications for the suspension of benefits and other appropriate documents, and will provide recommendations to the Secretary of the Treasury with respect to decisions required under this section.

(h) *Participant vote on proposed benefit reduction*—(1) *Requirement for vote*—(i) *In general*. If an application for suspension is approved under paragraph (g) of this section, then the Secretary of the Treasury, in consultation with the PBGC and the Secretary of Labor, will administer a vote of all plan participants and beneficiaries of deceased participants (eligible voters), as described in section 432(e)(9)(H) and this paragraph (h). Any suspension of benefits will take effect only after the vote and after a final authorization to suspend benefits under paragraph (h)(6) of this section.

(ii) *Communication by plan sponsor*. [Reserved]

(2) *Participant vote*—(i) *In general*. The participant vote described in paragraph (h)(1)(i) of this section requires completion of the following steps—

(A) Distribution of the ballot package described in paragraph (h)(2)(iii) of this section to the eligible voters;

(B) Voting by eligible voters and collection and tabulation of the votes, as described in paragraph (h)(2)(iv) of this section; and

(C) Determination of whether a majority of the eligible voters has voted to reject the suspension, as described in paragraph (h)(2)(v) of this section.

(ii) *Designation of service provider for limited functions*. The Secretary of the Treasury is permitted to designate one or more service providers to perform, under the supervision of the Secretary, any of the functions described in paragraphs (h)(2)(i)(A) and (B) of this section. If the Secretary designates a service provider to perform these functions then the service provider will provide the Secretary with a written report of the results of the vote, including (as applicable)—

(A) The number of ballot packages distributed to eligible voters;

(B) The number of eligible voters to whom ballot packages have not been provided (because the individuals could not be located);

(C) The number of eligible voters who voted (specifying the number of affirmative votes and the number of negative votes cast); and

(D) Any other information that the Secretary requires.

(iii) *Distribution of the ballot package to the eligible voters*—(A) *Ballot package*. The ballot package distributed to each eligible voter shall consist of—

(*1*) A ballot, approved under paragraph (h)(3)(iii) of this section, which contains the items described in section 432(e)(9)(H)(iii) and paragraph (h)(3)(i) of this section; and

(*2*) A unique identifier assigned to the eligible voter for use in voting.

(B) *Plan sponsor responsibilities*—(*1*) *In general*. This paragraph (h)(2)(iii)(B) sets forth the responsibilities of the plan sponsor with respect to the distribution of the ballot package to the eligible voters.

(*2*) *Furnish information regarding eligible voters*. No later than 7 days following the date the Secretary of the Treasury has approved an application for a suspension of benefits under paragraph (g) of this section, the plan sponsor must furnish the following—

(*i*) A list of all eligible voters;

(*ii*) For each eligible voter, the last known mailing address (or, if the plan sponsor has been unable to locate that individual using the standards that apply for purposes of paragraph (f)(1)(i) of this section, an indication that the individual could not be located through reasonable efforts);

(*iii*) Current electronic mailing addresses for those eligible voters identified in paragraph (h)(2)(iii)(B)(*4*) of this section; and

(*iv*) The individualized estimates provided to eligible voters as part of the earlier notices described in section 432(e)(9)(F) (or, if an individualized estimate is no longer accurate for an eligible voter, a corrected version of that estimate).

(*3*) *Communicate with eligible voters*. In accordance with section 432(e)(9)(H)(iv) and paragraph (h)(1)(ii) of this section,

the plan sponsor is responsible for communicating with eligible voters, which includes—

(*i*) Notifying the eligible voters described in paragraph (h)(2)(iii)(B)(*4*) of this section that a ballot package is being distributed by first-class U.S. mail; and

(*ii*) Making reasonable efforts (using the standards that apply for purposes of paragraph (f)(1)(i) of this section) as necessary to locate eligible voters for whom the plan sponsor has received notification that the mailed ballot packages are returned as undeliverable so that ballot packages can be sent to those eligible voters.

(*4*) *Eligible voters to receive electronic notification.* Those eligible voters whom the plan sponsor must notify electronically are—

(*i*) Eligible voters who previously received the notice described in paragraph (f) of this section in electronic form (as permitted under paragraph (f)(3)(ii) of this section), and

(*ii*) Any other eligible voters who regularly receive plan-related communications from the plan sponsor in electronic form.

(*5*) *Method of notifying certain eligible voters.* The notification described in paragraph (h)(2)(iii)(B)(*3*)(*i*) of this section for an eligible voter must be made using the electronic form normally used to send plan-related communications to that voter (or the form used to provide the notice in paragraph (f) of this section, if different). The plan sponsor must send this notification promptly after being informed of the ballot distribution date (within the meaning of paragraph (h)(2)(iii)(D) of this section) and the notification must include the ballot distribution date.

(*6*) *Pay costs associated with distribution.* The plan sponsor is responsible for paying all costs associated with printing, assembling, and distributing the ballot package, including postage.

(C) *Required method of distributing ballot package.* Ballot packages must be distributed to eligible voters by first-class U.S. mail. A supplemental copy of the mailed ballot package may also be sent by an electronic communication to an eligible voter who has consented to receive electronic communications.

(D) *Timing.* Ballot packages will be distributed to eligible voters no later than 30 days after the Secretary of the Treasury has approved an application for a suspension of benefits under paragraph (g) of this section. The date on which the ballot packages are mailed to the eligible voters is referred to as the ballot distribution date.

(iv) *Collection and tabulation of votes cast by eligible voters*—(A) *Voting period.* The voting period begins on the ballot distribution date. The voting period generally remains open until the 30th day following the date the Secretary of the Treasury has approved an application for a suspension of benefits under paragraph (g) of this section. However, the voting period will not close earlier than 21 days after the ballot distribution date. In addition, the Secretary (in consultation with the PBGC and the Secretary of Labor) may specify a later date to end the voting period in appropriate circumstances.

(B) *Required use of automated voting system.* Votes must be cast using an automated voting system that meets the requirements of paragraph (h)(2)(iv)(C) of this section. Votes cast by any other method are invalid.

(C) *Automated voting system.* An automated voting system meets the requirements of this paragraph (h)(2)(iv)(C) only if the system—

(*1*) Collects votes cast by eligible voters both electronically (through a Web site) and telephonically (through a toll-free number using a touch-tone or interactive voice response); and

(*2*) Accepts only votes cast during the voting period by an eligible voter who provides the eligible voter's unique identifier described in paragraph (h)(2)(iii)(A)(*2*) of this section.

(D) *Policies and procedures.* The Secretary of the Treasury (in consultation with the PBGC and the Secretary of Labor) may establish such policies and procedures as may be necessary to facilitate the administration of the vote under this paragraph (h)(2). These policies and procedures may include, but are not limited to, establishing a process for an eligible voter to challenge the vote.

(v) *Determination of whether a majority of the eligible voters has voted to reject the suspension.* Within 7 calendar days

after the end of the voting period, the Secretary of the Treasury (in consultation with the PBGC and the Secretary of Labor) will—

(A) Certify that a majority of all eligible voters has voted to reject the suspension that was approved under paragraph (g) of this section, or

(B) Issue a final authorization to suspend as described in paragraph (h)(6) of this section.

(3) *Ballots*—(i) *In general.* [Reserved]

(ii) *Additional rules*—(A) *Readability requirement.* A ballot provided under section 432(e)(9)(H)(iii), in accordance with the rules of paragraph (h)(3)(i) of this section, must be written in a manner that is readily understandable by the average plan participant.

(B) *No false or misleading information.* A ballot provided under section 432(e)(9)(H)(iii), in accordance with the rules of paragraph (h)(3)(i) of this section, may not include false or misleading information (or omit information in a manner that causes the information provided to be misleading).

(iii) *Ballot must be approved.* Any ballot provided under section 432(e)(9)(H)(iii), in accordance with the rules of paragraph (h)(3)(i) of this section, must be approved by the Secretary of the Treasury, in consultation with the PBGC and the Secretary of Labor, before it is provided.

(iv) *Statement in opposition to the proposed suspension.* The statement in opposition to the proposed suspension that is prepared from comments received on the application, as required under section 432(e)(9)(H)(iii)(II), will be compiled by the Secretary of Labor and will be written in accordance with the rules of paragraph (h)(3)(ii) of this section. If no comments in opposition are received, the statement in opposition to the proposed suspension will include a statement indicating that there were no such comments.

(v) *Model ballot.* A model ballot may be published in the form of a revenue procedure, notice, or other guidance published in the Internal Revenue Bulletin.

(4) *Implementing suspension following vote*—(i) *In general.* Unless a majority of all eligible voters vote to reject the suspension that was approved under paragraph (g) of this section, the suspension will be permitted to go into effect. If a majority of all eligible voters vote to reject the suspension that was approved under paragraph (g) of this section, a suspension of benefits will not be permitted to go into effect except as provided under paragraph (h)(5)(iii) of this section relating to the implementation of a suspension for a systemically important plan (as defined in paragraph (h)(5)(iv) of this section).

(ii) *Effect of not sending ballot.* [Reserved]

(5) *Systemically important plans*—(i) *In general.* If a majority of all eligible voters vote to reject the suspension that was approved under paragraph (g) of this section, the Secretary of the Treasury will consult with the PBGC and the Secretary of Labor to determine if the plan is a systemically important plan. This determination will be made no later than 14 days after the results of the vote are certified.

(ii) *Recommendations from Participant and Plan Sponsor Advocate.* Not later than 30 days after a determination that the plan is a systemically important plan, the Participant and Plan Sponsor Advocate selected under section 4004 of ERISA may submit recommendations to the Secretary of the Treasury with respect to the suspension that was approved under paragraph (g) of this section or any revisions to the suspension.

(iii) *Implementation of original or modified suspension by systemically important plans.* If a plan is a systemically important plan for which a majority of all eligible voters vote to reject the suspension that was approved under paragraph (g) of this section, then the Secretary of the Treasury must determine whether to permit the implementation of the suspension that was approved under paragraph (g) of this section or whether to permit the implementation of a modification of that suspension. Under any such modification, the plan must be projected to avoid insolvency in accordance with section 432(e)(9)(D)(iv). No later than 60 days after the results of a vote to reject a suspension are certified, the Secretary of the Treasury will notify the plan sponsor that the suspension or modified suspension is permitted to be implemented.

(iv) *Systemically important plan defined*—(A) *In general*. For purposes of this paragraph (h)(5), a systemically important plan is a plan with respect to which the PBGC projects that the present value of financial assistance payments will exceed $1.0 billion if the suspension is not implemented.

(B) *Indexing*. For calendar years beginning after 2015, the dollar amount specified in paragraph (h)(5)(iv)(A) of this section will be replaced with an amount equal to the product of the dollar amount and a fraction, the numerator of which is the contribution and benefit base (determined under section 230 of the Social Security Act) for the preceding calendar year and the denominator of which is the contribution and benefit base for calendar year 2014. If the amount otherwise determined under this paragraph (h)(5)(iv)(B) is not a multiple of $1.0 million, the amount will be rounded to the next lowest multiple of $1.0 million.

(6) *Final authorization to suspend*—(i) *In general*. In any case in which a suspension is permitted to go into effect following a vote pursuant to section 432(e)(9)(H)(ii) and paragraph (h)(4) of this section, the Secretary of the Treasury, in consultation with the PBGC and the Secretary of Labor, will issue a final authorization to suspend with respect to the suspension not later than seven days after the vote.

(ii) *Systemically important plans*. In any case in which a suspension is permitted to go into effect following a determination under paragraph (h)(5) of this section that the plan is a systemically important plan, the Secretary of the Treasury, in consultation with the PBGC and the Secretary of Labor, will issue a final authorization to suspend, at a time sufficient to allow the implementation of the suspension prior to the end of the 90-day period beginning on the date the results of the vote are certified.

(iii) *Plan partitions*. Notwithstanding any other provision of this section, in any case in which a suspension of benefits with respect to a plan is made in combination with a partition of the plan, the suspension of benefits is not permitted to take effect prior to the effective date of the partition.

(7) *Effective/applicability date*. Paragraph (h)(2) and paragraphs (h)(3)(iv) and (v) of this section apply on and after June 17, 2015.

(8) *Expiration date*. The applicability of paragraph (h)(2) and paragraphs (h)(3)(iv) and (v) of this section expires on June 15, 2018.

(i) [Reserved].

(j) *Effective/applicability date*. This section applies on and after June 17, 2015.

(k) *Expiration date*. The applicability of this section expires on June 15, 2018.

[T.D. 9723, 80 FR 35215, June 19, 2015, as amended by 80 FR 46795, Aug. 6, 2015. T.D. 9735, 80 FR 52975, Sept. 2, 2015]

§§ 1.433–1.435 [Reserved]

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[T.D. 9467, 74 FR 53060, Oct. 15, 2009]

§ 1.436–1 Limits on benefits and benefit accruals under single employer defined benefit plans.

(a) *General rules*—(1) *Qualification requirement*. Section 401(a)(29) provides that a defined benefit pension plan that is subject to section 412 and that is not a multiemployer plan (within the meaning of section 414(f)) is a qualified plan only if it satisfies the requirements of section 436. This section provides rules relating to funding-based limitations on certain benefits under section 436, and the requirements of section 436 are satisfied only if the plan meets the requirements of this section beginning with the plan's first effective plan year. This section applies to single employer defined benefit plans (including multiple employer plans), but does not apply to multiemployer plans.

(2) *Organization of the regulation*. Paragraph (b) of this section describes limitations on shutdown benefits and other unpredictable contingent event benefits. Paragraph (c) of this section describes limitations on plan amendments increasing liabilities. Paragraph (d) of this section describes limitations on prohibited payments. Paragraph (e) of this section describes limitations on benefit accruals. Paragraph (f) of this section provides rules relating to methods to avoid or terminate benefit limitations. Paragraph (g) of this section provides rules for the operation of the plan in relation to benefit limitations under section 436. Paragraph (h) of this section describes related presumptions regarding underfunding that apply for purposes of the benefit limitations under section 436 and requirements relating to certifications. Paragraph (j) of this section contains definitions. Paragraph (k) of this section contains effective/applicability date provisions.

(3) *Special rules for certain plans*—(i) *New plans*. The limitations described in paragraphs (b), (c), and (e) of this section do not apply to a plan for the first 5 plan years of the plan. Except as otherwise provided by the Commissioner in guidance of general applicability, plan years of the plan include the following (in addition to plan years during which the plan was maintained by the employer or plan sponsor):

(A) Plan years when the plan was maintained by a predecessor employer within the meaning of § 1.415(f)–1(c)(1).

(B) Plan years of another defined benefit plan maintained by a predecessor employer within the meaning of § 1.415(f)–1(c)(2) within the preceding five years if any participants in the plan participated in that other defined benefit plan (even if the plan maintained by the employer is not the plan that was maintained by the predecessor employer).

(C) Plan years of another defined benefit plan maintained by the employer within the preceding five years if any participants in the plan participated in that other defined benefit plan.

(ii) *Application of section 436 after termination of a plan*—(A) *In general*. Except as otherwise provided in paragraph (a)(3)(ii)(B) of this section, any section 436 limitations in effect immediately before the termination of a plan do not cease to apply thereafter.

(B) *Exception for payments pursuant to plan termination*. The limitations under section 436(d) and paragraph (d) of this section do not apply to prohibited payments (within the meaning of paragraph (j)(6) of this section) that are made to carry out the termination of a plan in accordance with applicable law. For example, a plan sponsor's purchase of an irrevocable commitment from an insurer to pay benefit liabilities in connection with the standard termination of a plan in accordance with section 4041(b)(3) of the Employee Retirement Income Security Act of 1974, as amended (ERISA), and in accordance with 29 CFR 4041.28, does not violate section 436(d) or this section.

(iii) *Multiple employer plans*. In the case of a multiple employer plan to which section 413(c)(4)(A) applies, this section applies separately with respect to each employer under the plan, as if each employer maintained a separate plan. Thus, the benefit limitations under section 436 and this section could apply differently to participants who are employees of different employers under such a multiple employer plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), this section applies as if all participants in the plan were employed by a single employer.

(4) *Treatment of plan as of close of prohibited or cessation period*—(i) *Application to prohibited payments and accruals*—(A) *Resumption of prohibited payments*. If a limitation on prohibited payments under paragraph (d) of this section applied to a plan as of a section 436 measurement date (as defined in paragraph (j)(8) of this section), but that limit no longer applies to the plan as of a later section 436 measurement date, then the limitation on prohibited payments under the plan does not apply to benefits with annuity starting dates (as defined in paragraph (j)(2) of this section) that are on or after that later section 436 measurement date. Any amendment to eliminate an optional form of benefit that contains a prohibited payment with respect to an annuity starting date during a period in which the limitations of section 436(d) and paragraph (d) of this section do not apply to the plan is subject to the rules of section 411(d)(6).

(B) *Resumption of benefit accruals*. If a limitation on benefit accruals under paragraph (e) of this section applied to a plan as of a section 436 measurement date, but that limit no longer applies to the plan as of a later section 436 measurement date, then that limitation does not apply to benefit accruals that are based on service on or after that later section 436 measurement date, except to the extent that the plan provides that benefit accruals will not resume when the limitation ceases to apply. The plan must comply with the rules relating to partial years of participation and the prohibition on double proration under Department of Labor regulation 29 CFR 2530.204–2(c) and (d).

(ii) *Restoration of options and missed benefit accruals*—(A) *Option to amend plan*. A plan is permitted to be amended to provide participants who had an annuity starting date within a period during which a limitation under paragraph (d) of this section applied to the plan with the opportunity to make a new election under which the form of benefit previously elected is modified, subject to applicable qualification requirements. A participant who makes

such a new election is treated as having a new annuity starting date under sections 415 and 417. Similarly, a plan is permitted to be amended to provide that any benefit accruals which were limited under the rules of paragraph (e) of this section are credited under the plan when the limitation no longer applies, subject to applicable qualification requirements. Any such plan amendment with respect to a new annuity starting date or crediting of benefit accruals is subject to the requirements of section 436(c) and paragraph (c) of this section.

(B) *Automatic plan provisions.* A plan is permitted to provide that participants who had an annuity starting date within a period during which a limitation under paragraph (d) of this section applied to the plan will be provided with the opportunity to have a new annuity starting date (which would constitute a new annuity starting date under sections 415 and 417) under which the form of benefit previously elected may be modified, subject to applicable qualification requirements, once the limitations of paragraph (d) of this section cease to apply. In addition, subject to the rules of paragraph (c)(3) of this section, a plan is permitted to provide for the automatic restoration of benefit accruals that had been limited under section 436(e) as of the section 436 measurement date that the limitation ceases to apply.

(iii) *Shutdown and other unpredictable contingent event benefits.* If unpredictable contingent event benefits with respect to an unpredictable contingent event that occurs during the plan year are not permitted to be paid after the occurrence of the event because of the limitations of section 436(b) and paragraph (b) of this section, but are permitted to be paid later in the plan year as a result of additional contributions under paragraph (f)(2) of this section or pursuant to the enrolled actuary's certification of the adjusted funding target attainment percentage for the plan year that meets the requirements of paragraph (g)(5)(ii)(B) of this section, then those unpredictable contingent event benefits must automatically become payable, retroactive to the period those benefits would have been payable under the terms of the plan (other than plan terms implementing the requirements of section 436(b)). If the benefits do not become payable during the plan year in accordance with the preceding sentence, then the plan is treated as if it does not provide for those benefits. However, all or any portion of those benefits can be restored pursuant to a plan amendment that meets the requirements of section 436(c) and paragraph (c) of this section and other applicable qualification requirements.

(iv) *Treatment of plan amendments that do not take effect.* If a plan amendment does not take effect as of the effective date of the amendment because of the limitations of section 436(c) and paragraph (c) of this section, but is permitted to take effect later in the plan year as a result of additional contributions under paragraph (f)(2) of this section or pursuant to the enrolled actuary's certification of the adjusted funding target attainment percentage for the plan year that meets the requirements of paragraph (g)(5)(ii)(C) of this section, then the plan amendment must automatically take effect as of the first day of the plan year (or, if later, the original effective date of the amendment). If the plan amendment cannot take effect during the plan year, then it must be treated as if it were never adopted, unless the plan amendment provides otherwise.

(v) *Example.* The following example illustrates the rules of this paragraph (a)(4):

Example. (i) Plan T is a non-collectively bargained defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. As of January 1, 2011, Plan T does not have a funding standard carryover balance or a prefunding balance. Plan T's sponsor is not in bankruptcy. Beginning January 1, 2011, Plan T is subject to the restriction on prohibited payments under paragraph (d)(3) of this section based on a presumed adjusted funding target attainment percentage (AFTAP) of 75%.

(ii) U is a participant in Plan T. Participant U retires on February 1, 2011, and elects to receive benefits in the form of a single sum. Plan T may pay only a portion (generally, 50%) of the prohibited payment. Accordingly, U elects in accordance with paragraph (d)(3)(ii) of this section to receive 50% of U's benefit in a single sum (up to the 2011 PBGC maximum benefit guarantee amount described in paragraph (d)(3)(iii)(C) of this

section) and the remainder as an immediately commencing straight life annuity.

(iii) On March 1, 2011, the enrolled actuary for the Plan certifies that the AFTAP for 2011 is 80%. Accordingly, beginning March 1, 2011, Plan T is no longer subject to the restriction under paragraph (d)(3) of this section.

(iv) Effective March 1, 2011, Plan T is amended to provide that a participant whose benefits were restricted under paragraph (d)(3) of this section with respect to an annuity starting date between January 1, 2011, and February 28, 2011, may elect, within a specified period on or after March 1, 2011, a new annuity starting date and receive the remainder of his or her pension benefits in an accelerated form of payment. Plan T's enrolled actuary determines that the AFTAP, taking into account the amendment, would still be 80%. The amendment is permitted to take effect because Plan T would have an AFTAP of 80% taking into account the amendment and is therefore neither subject to the restriction on plan amendments in paragraph (c) of this section nor the restrictions on prohibited payments under paragraphs (d)(1) and (d)(3) of this section. Accordingly, Participant U may elect, within the specified period and subject to otherwise applicable qualification rules, including spousal consent, to receive the remainder of U's benefits in the form of a single sum on or after March 1, 2011.

(5) *Deemed election to reduce funding balances*—(i) *Limitations on accelerated benefit payments.* If a benefit limitation under paragraph (d)(1) or (d)(3) of this section would (but for this paragraph (a)(5)) apply to a plan, the employer is treated as having made an election under section 430(f) to reduce the prefunding balance or funding standard carryover balance by such amount as is necessary for the adjusted funding target attainment percentage to be at the applicable threshold (60 or 80 percent, as the case may be) in order for the benefit limitation not to apply to the plan. The determination of whether a benefit limitation under paragraph (d) of this section would apply to a plan is based on whether the plan provides for an optional form of benefit that would be limited under section 436(d) and is not based on whether any participant elects payment of benefits in such a form.

(ii) *Other limitations for collectively bargained plans*—(A) *General rule.* In the case of a collectively bargained plan to which a benefit limitation under paragraph (b), (c), or (e) of this section would (but for this paragraph (a)(5)) apply, the employer is treated as having made an election under section 430(f) to reduce the prefunding balance or funding standard carryover balance by such amount as is necessary for the adjusted funding target attainment percentage to be at the applicable threshold (60 or 80 percent, as the case may be) in order for the benefit limitation not to apply to the plan, taking into account the adjustments described in paragraph (g)(2)(iii)(A), (g)(3)(ii)(A), or (g)(5)(i)(B) of this section, whichever applies.

(B) *Collectively bargained plans.* A plan is considered a collectively bargained plan for purposes of this paragraph (a)(5)(ii) if—

(*1*) At least 50 percent of the employees benefiting under the plan (within the meaning of §1.410(b)–3(a)) are members of collective bargaining units for which the benefit levels under the plan are specified under a collective bargaining agreement; or

(*2*) At least 25 percent of the participants in the plan are members of collective bargaining units for which the benefit levels under the plan are specified under a collective bargaining agreement.

(iii) *Exception for insufficient funding balances*—(A) *In general.* Paragraphs (a)(5)(i) and (a)(5)(ii) of this section apply with respect to a benefit limitation for any plan year only if the application of those paragraphs would result in the corresponding benefit limitation not applying for such plan year. Thus, if the plan's prefunding and funding standard carryover balances were reduced to zero and the resulting increase in plan assets taken into account would still not increase the plan's adjusted funding target attainment percentage enough to reach the threshold percentage applicable to the benefit limitation, the deemed election to reduce those balances pursuant to paragraph (a)(5)(i) or (a)(5)(ii) of this section does not apply.

(B) *Presumed adjusted funding target attainment percentage less than 60 percent.* During any period when a plan is presumed to have an adjusted funding target attainment percentage of less than 60 percent as a result of paragraph

(h)(3) of this section, the plan is treated as if the prefunding balance and the funding standard carryover balance are insufficient to increase the adjusted funding target attainment percentage to the threshold percentage of 60 percent. Accordingly, the deemed election to reduce those balances pursuant to paragraphs (a)(5)(i) and (a)(5)(ii) of this section does not apply to the plan.

(iv) *Other rules*—(A) *Date of deemed election*. If an election is deemed to be made pursuant to this paragraph (a)(5), then the plan sponsor is treated as having made that election on the date as of which the applicable benefit limitation would otherwise apply.

(B) *Coordination with section 436 contributions*. The determination of whether one of the benefit limitations described in paragraph (a)(5)(ii)(A) of this section would otherwise apply is made without regard to any contribution described in paragraph (f)(2) of this section. Thus, the requirement to reduce the prefunding balance or funding standard carryover balance under paragraph (a)(5)(ii) of this section cannot be avoided through the use of a section 436 contribution.

(C) *Coordination with elections to offset minimum required contribution*. *See* §1.430(f)–1(d)(1)(ii) for rules on the coordination of elections to offset the minimum required contribution and the deemed election to reduce the prefunding and funding standard carryover balances under this paragraph (a)(5).

(v) *Example*. The following example illustrates the rules of this paragraph (a)(5):

Example. (i) Plan W is a collectively bargained, single employer defined benefit plan sponsored by Sponsor X, with a plan year that is the calendar year and a valuation date of January 1.

(ii) The enrolled actuary for Plan W issues a certification on March 1, 2010, that the 2010 AFTAP is 81%. Sponsor X adopts an amendment on March 25, 2010, to increase benefits under a formula based on participant compensation, with an effective date of May 1, 2010. (Because the formula is based on compensation, the exception in paragraph (c)(4)(i) of this section does not apply.) The plan's enrolled actuary determines that the plan's AFTAP for 2010 would be 75% if the benefits attributable to the plan amendment were taken into account in determining the funding target.

(iii) Because the AFTAP would be below the 80% threshold if the benefits attributable to the plan amendment were taken into account in determining the funding target, Sponsor X is deemed pursuant to paragraph (a)(5)(ii) of this section to have made an election to reduce Plan W's prefunding and funding standard carryover balances by the amount necessary for the AFTAP to reach the 80% threshold (reflecting the increase in funding target attributable to the plan amendment), provided that the amount of those balances is sufficient for this purpose.

(iv) If the deemed election described in paragraph (iii) of this example occurs, the plan amendment takes effect on its effective date (May 1, 2010). See paragraph (f) of this section for other methods to avoid or terminate benefit limitations (where, for example, the amount necessary for a benefit limitation not to apply for a plan year exceeds the sum of the prefunding balance and the funding standard carryover balance).

(6) *Notice requirements*. See section 101(j) of ERISA for rules requiring the plan administrator of a single employer plan to provide a written notice to participants and beneficiaries within 30 days after certain specified dates, which depend on whether the plan has become subject to a restriction described in the ERISA provisions that are parallel to Internal Revenue Code sections 436(b), 436(d), and 436(e) (ERISA sections 206(g)(1), 206(g)(3), and 206(g)(4), respectively).

(b) *Limitation on shutdown benefits and other unpredictable contingent event benefits*—(1) *In general*. Except as otherwise provided in this paragraph (b), a plan satisfies section 436(b) and this paragraph (b) only if it provides that unpredictable contingent event benefits with respect to any unpredictable contingent events occurring during a plan year will not be paid if the adjusted funding target attainment percentage for the plan year is—

(i) Less than 60 percent; or

(ii) 60 percent or more, but would be less than 60 percent if the adjusted funding target attainment percentage were redetermined applying an actuarial assumption that the likelihood of occurrence of the unpredictable contingent event during the plan year is 100 percent.

(2) *Exemption if section 436 contribution is made*. The prohibition on payment of

unpredictable contingent event benefits under paragraph (b)(1) of this section ceases to apply with respect to benefits attributable to an unpredictable contingent event occurring during the plan year upon payment by the plan sponsor of the contribution described in paragraph (f)(2)(iii) of this section with respect to that event. If the prior sentence applies with respect to an unpredictable contingent event, then all benefits with respect to the unpredictable contingent event must be paid, including benefits for periods prior to the contribution. *See* paragraph (f) of this section for additional rules.

(3) *Rules of application*—(i) *Participant-by-participant application*. The limitations of section 436(b) and this paragraph (b) apply on a participant-by-participant basis. Thus, whether payment or commencement of an unpredictable contingent event benefit under a plan is restricted with respect to a participant is determined based on whether the participant satisfies the plan's eligibility requirements (other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability) for such a benefit in a plan year in which the limitations of section 436(b) and this paragraph (b) apply.

(ii) *Multiple contingencies*. In the case of a plan that provides for a benefit that depends upon the occurrence of more than one unpredictable contingent event with respect to a participant, the unpredictable contingent event for purposes of section 436(b) and this paragraph (b) occurs upon the last to occur of those unpredictable contingent events.

(iii) *Cessation of benefits*. Cessation of a benefit under a plan upon the occurrence of a specified event is not an unpredictable contingent event for purposes of section 436(b) and this paragraph (b). Thus, section 436(b) and this paragraph (b) do not prohibit provisions of a plan that provide for cessation, suspension, or reduction of any benefits upon occurrence of any event. However, upon any subsequent recommencement of benefits (including any restoration of benefits), the rules of section 436 and this section will apply.

(4) *Prior unpredictable contingent event*. Unpredictable contingent event benefits attributable to an unpredictable contingent event that occurred within a period during which no limitation under this paragraph (b) applied to the plan are not affected by the limitation described in this paragraph (b) as it applies in a subsequent period. For example, if a plant shutdown occurs in 2010 and the plan's funded status is such that benefits contingent upon that plant shutdown are not subject to the limitation described in this paragraph (b) for that calendar plan year, this paragraph (b) does not apply to restrict payment of those benefits even if another plant shutdown occurs in 2012 that results in the restriction of benefits that are contingent upon that later plant shutdown under this paragraph (b) (where the plan's adjusted funding target attainment percentage for 2012 would be less than 60 percent taking into account the liability attributable to those shutdown benefits).

(c) *Limitations on plan amendments increasing liability for benefits*—(1) *In general*. Except as otherwise provided in this paragraph (c), a plan satisfies section 436(c) and this paragraph (c) only if the plan provides that no amendment to the plan that has the effect of increasing liabilities of the plan by reason of increases in benefits, establishment of new benefits, changing the rate of benefit accrual, or changing the rate at which benefits become nonforfeitable will take effect in a plan year if the adjusted funding target attainment percentage for the plan year is—

(i) Less than 80 percent; or

(ii) 80 percent or more, but would be less than 80 percent if the benefits attributable to the amendment were taken into account in determining the adjusted funding target attainment percentage.

(2) *Exemption if section 436 contribution is made*—(i) *General rule*. The limitations on plan amendments in paragraph (c)(1) of this section cease to apply with respect to an amendment upon payment by the plan sponsor of the contribution described in paragraph (f)(2)(iv) of this section, so that

the amendment is permitted to take effect as of the later of the first day of the plan year or the effective date of the amendment. *See* paragraph (f) of this section for additional rules.

(ii) *Amendments that do not increase funding target.* If the amount of the contribution described in paragraph (f)(2)(iv) of this section is $0 (because the amendment increases benefits solely for future periods), the amendment is permitted to take effect without regard to this paragraph (c). However, *see* §1.430(d)–1(d)(2) for a rule that requires such an amendment to be taken into account in determining the funding target and the target normal cost in certain situations.

(3) *Rules of application regarding pre-existing plan provisions.* If a plan contains a provision that provides for the automatic restoration of benefit accruals that were not permitted to accrue because of the application of section 436(e) and paragraph (e) of this section, the restoration of those accruals is generally treated as a plan amendment that is subject to section 436(c). However, such a provision is permitted to take effect without regard to the limits of section 436(c) and this paragraph (c) if—

(i) The continuous period of the limitation is 12 months or less; and

(ii) The plan's enrolled actuary certifies that the adjusted funding target attainment percentage for the plan would not be less than 60 percent taking into account the restored benefit accruals for the prior plan year.

(4) *Exceptions*—(i) *Benefit increases based on compensation*—(A) *In general.* In accordance with section 436(c)(3), section 436(c) and this paragraph (c) do not apply to any amendment that provides for an increase in benefits under a formula that is not based on a participant's compensation, but only if the rate of increase in benefits does not exceed the contemporaneous rate of increase in average wages of participants covered by the amendment. The determination of the rate of increase in average wages is made by taking into consideration the net increase in average wages from the period of time beginning with the effective date of the most recent benefit increase applicable to all of those participants who are covered by the current amendment and ending on the effective date of the current amendment.

(B) *Application to participants who are not currently employed.* If an amendment applies to both currently employed participants and other participants, all participants to whom the amendment applies are included in determining the increase in average wages of the participants covered by the amendment for purposes of this paragraph (c)(4)(i). For this purpose, participants who are not employees at any time during the period from the effective date of the most recent earlier benefit increase applicable to all of the participants who are covered by the current amendment and ending on the effective date of the current amendment are treated as having no increase or decrease in wages for the period after severance from employment.

(C) *Separate amendments for different plan populations.* In lieu of a single amendment that applies to both currently employed participants and other participants as described in paragraph (c)(4)(i)(B) of this section, the employer can adopt multiple amendments—such as one that increases benefits for participants currently employed on the effective date of the current amendment and another one that increases benefits for other participants. In that case, the two amendments are considered separately in determining the increase in average wages, and the exception in this paragraph (c)(4)(i) applies separately to each amendment. Thus, the increase in benefits for currently employed participants takes effect if it satisfies the exception under this paragraph (c)(4), but the amendment increasing benefits for other participants who received no increase in wages from the employer during the period over which the increase in average wages is separately subject to the rules of this paragraph (c) without regard to the rules of this paragraph (c)(4).

(ii) *Plan provisions providing for accelerated vesting.* To the extent that any amendment provides for (or any pre-existing plan provision results in) a mandatory increase in the vesting of benefits under the Code or ERISA (such as vesting rate increases pursuant to statute, plan termination amendments or

partial terminations under section 411(d)(3), and vesting increases required by the rules for top-heavy plans under section 416), that amendment (or preexisting plan provision) does not constitute an amendment that changes the rate at which benefits become nonforfeitable for purposes of section 436(c) and this paragraph (c). However, this paragraph (c)(4)(ii) applies only to the extent the increase in vesting is necessary to enable the plan to continue to satisfy the requirements for qualified plans.

(iii) *Authority for additional exceptions.* The Commissioner may, in guidance of general applicability, issue additional rules under which other amendments to a plan are not treated as amendments to which section 436(c) and this paragraph (c) apply. See § 601.601(d)(2) relating to objectives and standards for publishing regulations, revenue rulings and revenue procedures in the Internal Revenue Bulletin.

(5) *Rule for determining when an amendment takes effect.* For purposes of section 436(c) and this paragraph (c), in the case of an amendment that increases benefits, the amendment takes effect under a plan on the first date on which any individual who is or could be a participant or beneficiary under the plan would obtain a legal right to the increased benefit if the individual were on that date to satisfy the applicable requirements for entitlement to the benefit (such as the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death, disability, or severance from employment).

(6) *Treatment of mergers, consolidations, and transfers of plan assets into a plan.* [Reserved]

(d) *Limitations on prohibited payments*—(1) *AFTAP less than 60 percent.* A plan satisfies the requirements of section 436(d)(1) and this paragraph (d)(1) only if the plan provides that, if the plan's adjusted funding target attainment percentage for a plan year is less than 60 percent, a participant or beneficiary is not permitted to elect an optional form of benefit that includes a prohibited payment, and the plan will not pay any prohibited payment, with an annuity starting date on or after the applicable section 436 measurement date.

(2) *Bankruptcy.* A plan satisfies the requirements of section 436(d)(2) and this paragraph (d)(2) only if the plan provides that a participant or beneficiary is not permitted to elect an optional form of benefit that includes a prohibited payment, and the plan will not pay any prohibited payment, with an annuity starting date that occurs during any period in which the plan sponsor is a debtor in a case under title 11, United States Code, or similar Federal or State law, except for payments made within a plan year with an annuity starting date that occurs on or after the date on which the enrolled actuary of the plan certifies that the plan's adjusted funding target attainment percentage for that plan year is not less than 100 percent.

(3) *Limited payment if AFTAP at least 60 percent but less than 80 percent*—(i) *In general.* A plan satisfies the requirements of section 436(d)(3) and this paragraph (d)(3) only if the plan provides that, in any case in which the plan's adjusted funding target attainment percentage for a plan year is 60 percent or more but is less than 80 percent, a participant or beneficiary is not permitted to elect the payment of an optional form of benefit that includes a prohibited payment, and the plan will not pay any prohibited payment, with an annuity starting date on or after the applicable section 436 measurement date, unless the present value, determined in accordance with section 417(e)(3), of the portion of the benefit that is being paid in a prohibited payment (which portion is determined under paragraph (d)(3)(iii)(B) of this section) does not exceed the lesser of—

(A) 50 percent of the present value (determined in accordance with section 417(e)(3)) of the benefit payable in the optional form of benefit that includes the prohibited payment; or

(B) 100 percent of the PBGC maximum benefit guarantee amount described in paragraph (d)(3)(iii)(C) of this section.

(ii) *Bifurcation if optional form unavailable*—(A) *Requirement to offer bifurcation.* If an optional form of benefit that is otherwise available under the terms of the plan is not available as of

the annuity starting date because of the application of paragraph (d)(3)(i) of this section, then the plan must permit the participant or beneficiary to elect to—

(*1*) Receive the unrestricted portion of that optional form of benefit (determined under the rules of paragraph (d)(3)(iii)(D) of this section) at that annuity starting date, determined by treating the unrestricted portion of the benefit as if it were the participant's or beneficiary's entire benefit under the plan;

(*2*) Commence benefits with respect to the participant's or beneficiary's entire benefit under the plan in any other optional form of benefit available under the plan at the same annuity starting date that satisfies paragraph (d)(3)(i) of this section; or

(*3*) Defer commencement of the payments to the extent described in paragraph (d)(5) of this section.

(B) *Rules relating to bifurcation.* If the participant or beneficiary elects payment of the unrestricted portion of the benefit as described in paragraph (d)(3)(ii)(A)(*1*) of this section, then the plan must permit the participant or beneficiary to elect payment of the remainder of the participant's or beneficiary's benefits under the plan in any optional form of benefit at that annuity starting date otherwise available under the plan that would not have included a prohibited payment if that optional form applied to the entire benefit of the participant or beneficiary. The rules of §1.417(e)–1 are applied separately to the separate optional forms for the unrestricted portion of the benefit and the remainder of the benefit (the restricted portion).

(C) *Plan alternative that anticipates election of payment that includes a prohibited payment.* With respect to an optional form of benefit that includes a prohibited payment and that is not permitted to be paid under paragraph (d)(3)(i) of this section, for which no additional information from the participant or beneficiary (such as information regarding a social security leveling optional form of benefit) is needed to make that determination, rather than wait for the participant or beneficiary to elect such optional form of benefit, a plan is permitted to provide for separate elections with respect to the restricted and unrestricted portions of that optional form of benefit. However, the rule in the preceding sentence applies only if—

(*1*) The plan applies the rule to all such optional forms; and

(*2*) The plan identifies the option that the bifurcation election replaces.

(iii) *Definitions applicable to limited payment option*—(A) *In general.* The definitions in this paragraph (d)(3)(iii) apply for purposes of this paragraph (d)(3).

(B) *Portion of benefit being paid in a prohibited payment.* If a benefit is being paid in an optional form for which any of the payments is greater than the amount payable under a straight life annuity to the participant or beneficiary (plus any social security supplements described in the last sentence of section 411(a)(9) payable to the participant or beneficiary) with the same annuity starting date, then the portion of the benefit that is being paid in a prohibited payment is the excess of each payment over the smallest payment during the participant's lifetime under the optional form of benefit (treating a period after the annuity starting date and during the participant's lifetime in which no payments are made as a payment of zero).

(C) *PBGC maximum benefit guarantee amount.* The PBGC maximum benefit guarantee amount described in this paragraph (d)(3)(iii)(C) is the present value (determined under guidance prescribed by the Pension Benefit Guaranty Corporation, using the interest and mortality assumptions under section 417(e)) of the maximum benefit guarantee with respect to a participant (based on the participant's age or the beneficiary's age at the annuity starting date) under section 4022 of ERISA for the year in which the annuity starting date occurs.

(D) *Unrestricted portion of the benefit*—(*1*) *General rule.* Except as otherwise provided in this paragraph (d)(3)(iii)(D), the unrestricted portion of the benefit with respect to any optional form of benefit is 50 percent of the amount payable under the optional form of benefit.

(*2*) *Special rule for forms which include social security leveling or a refund of employee contributions.* For an optional

form of benefit that is a prohibited payment on account of a social security leveling feature (as defined in §1.411(d)–3(g)(16)) or a refund of employee contributions feature (as defined in §1.411(d)–3(g)(11)), the unrestricted portion of the benefit is the optional form of benefit that would apply if the participant's or beneficiary's accrued benefit were 50 percent smaller.

(*3*) *Limited to PBGC maximum benefit guarantee amount.* After the application of the preceding rules of this paragraph (d)(3)(iii)(D), the unrestricted portion of the benefit with respect to the optional form of benefit is reduced, to the extent necessary, so that the present value (determined in accordance with section 417(e)) of the unrestricted portion of that optional form of benefit does not exceed the PBGC maximum benefit guarantee amount (described in paragraph (d)(3)(iii)(C) of this section).

(iv) *Other rules*—(A) *One time application.* A plan satisfies the requirements of this paragraph (d)(3) only if the plan provides that, in the case of a participant with respect to whom a prohibited payment (or series of prohibited payments under a single optional form of benefit) is made pursuant to paragraph (d)(3)(i) or (ii) of this section, no additional prohibited payment may be made with respect to that participant during any period of consecutive plan years for which prohibited payments are limited under this paragraph (d).

(B) *Treatment of beneficiaries.* For purposes of this paragraph (d)(3), benefits provided with respect to a participant and any beneficiary of the participant (including an alternate payee, as defined in section 414(p)(8)) are aggregated. If the only benefits paid under the plan with respect to the participant are death benefits payable to the beneficiary, then paragraph (d)(3)(iii)(B) of this section is applied by substituting the lifetime of the beneficiary for the lifetime of the participant. If the accrued benefit of a participant is allocated to such an alternate payee and one or more other persons, then the unrestricted amount under paragraph (d)(3)(iii)(D) of this section is allocated among such persons in the same manner as the accrued benefit is allocated, unless a qualified domestic relations order (as defined in section 414(p)(1)(A)) with respect to the participant or the alternate payee provides otherwise. See paragraphs (j)(2)(ii) and (j)(6)(ii) of this section for other special rules relating to beneficiaries.

(C) *Treatment of annuity purchases and plan transfers.* This paragraph (d)(3)(iv)(C) applies for purposes of applying paragraphs (d)(3)(i) and (iii)(D) of this section. In the case of a prohibited payment described in paragraph (j)(6)(i)(B) of this section (relating to purchase from an insurer), the present value of the portion of the benefit that is being paid in a prohibited payment is the cost to the plan of the irrevocable commitment and, in the case of a prohibited payment described in paragraph (j)(6)(i)(C) of this section (relating to certain plan transfers), the present value of the portion of the benefit that is being paid in a prohibited payment is the present value of the liabilities transferred (determined in accordance with section 414(l)). In addition, the present value of the accrued benefit is substituted for the present value of the benefit payable in the optional form of benefit that includes the prohibited payment in paragraph (d)(3)(i)(A) of this section. (Further, *see* §1.411(d)–4, A–2(a)(3)(ii), for a rule under section 411(d)(6) that applies to an optional form of benefit that includes a prohibited payment described in paragraph (j)(6)(i)(B) of this section.)

(v) *Examples.* The following examples illustrate the rules of this paragraph (d)(3):

Example 1. (i) Plan A has a plan year that is the calendar year, and is subject to the restriction on prohibited payments under paragraph (d)(3) of this section for the 2010 plan year. Participant P is not married, and retires at age 65 during 2010, while the restriction under paragraph (d)(3) of this section applies to Plan A. P's accrued benefit is $10,000 per month, payable commencing at age 65 as a straight life annuity. Plan A provides for an optional single-sum payment (subject to the restrictions under section 436) equal to the present value of the participant's accrued benefit using actuarial assumptions under section 417(e). P's single-sum payment, determined without regard to this paragraph (d), is calculated to be $1,416,000, payable at age 65.

(ii) The PBGC guaranteed monthly benefit for a straight life annuity payable at age 65

in 2010 (for purposes of this example) is assumed to be $4,500. The PBGC maximum benefit guarantee amount at age 65 is assumed to be $637,200 for 2010.

(iii) Because Participant P retires during a period when the restriction in paragraph (d)(3) of this section applies to Plan A, only a portion of the benefit can be paid in the form of a single sum. P elects a single-sum payment. Because a single-sum payment is a prohibited payment, a determination must be made whether the payment can be paid under paragraph (d)(3)(i) of this section. In this case, because the present value of the portion of Participant P's benefit that is being paid in a prohibited payment exceeds the lesser of 50% of the benefit or the PBGC maximum benefit guarantee amount, it cannot be paid under paragraph (d)(3)(i) of this section. Accordingly, the maximum single sum that P can receive is $637,200 (that is, the lesser of 50% of $1,416,000 or $637,200).

(iv) Pursuant to paragraph (d)(3)(ii) of this section, Plan A must offer P the option to bifurcate the benefit into unrestricted and restricted portions. The unrestricted portion is a monthly straight life annuity of $4,500, which can be paid in a single sum of $637,200. If P elects to receive the unrestricted portion of the benefit in the form of a single sum, then, with respect to the $5,500 restricted portion, Plan A must permit P to elect any form of benefit that would otherwise be permitted with respect to the full $10,000 and that is not a prohibited payment. Alternatively, Plan A may provide that P is permitted to elect to defer commencement of the restricted portion, subject to applicable qualification rules.

Example 2. (i) The facts are the same as in *Example 1*. In addition, Plan A provides an optional form of payment (subject to any benefit restrictions under section 436) that consists of a partial payment equal to the total return of employee contributions to the plan accumulated with interest, with an annuity payment for the remainder of the participant's benefit.

(ii) Participant Q is not married, and retires at age 65 during 2010, while Plan A is subject to the restriction under paragraph (d)(3) of this section. Participant Q has an accrued benefit equal to a straight life annuity of $3,000 per month. Under the optional form described in paragraph (i) of this *Example 2*, Q may elect a partial payment of $99,120 (representing the return of employee contributions accumulated with interest), plus a straight life annuity of $2,300 per month. The present value of Participant Q's accrued benefit, using actuarial assumptions under section 417(e), is $424,800.

(iii) Because the present value of the portion of Q's benefit that is being paid in a prohibited payment ($99,120) does not exceed the lesser of 50% of the present value of benefits (50% of $424,800) or 100% of the PBGC maximum benefit guarantee amount ($637,200 at age 65 for 2010), the optional form described in paragraph (i) of this *Example 2* is permitted to be paid under paragraph (d)(3)(i) of this section.

Example 3. (i) The facts are the same as in *Example 1*. In addition, Plan A provides an optional form of payment under a social security leveling option (subject to any benefit restrictions under section 436) that consists of an increased temporary benefit payable until age 62, with reduced payments beginning at age 62. The benefit is structured so that the combination of the participant's pension benefit and Social Security benefit provides an approximately level income for the participant's lifetime. The PBGC maximum benefit guarantee amount at age 55 is assumed to be $362,776 for 2010.

(ii) Participant R retires at age 55 in 2010 and is eligible to receive a level lifetime annuity of $1,200 per month beginning immediately. Instead, Participant R elects to receive a benefit under the social security leveling optional form of payment. Participant R's Social Security benefit payable at age 62 is projected, under the terms specified in Plan A, to be $1,500 per month. The Plan A adjustment factor for the social security leveling option using the minimum present value requirements of section 417(e)(3) is .590 at age 55. Therefore, Participant R's benefit payable from age 55 to age 62 is $2,085 per month ($1,200 + .590 × $1,500), and the benefit payable for Participant's lifetime, beginning after age 62, is $585 per month ($2,085 − $1,500).

(iii) Because the optional form provides some payments which are greater than payments described in paragraph (j)(6)(i)(A) of this section ($1,200), the portion of the benefit that is being paid in a prohibited payment is $1,500 per month which is payable from age 55 to age 62. Using the applicable interest and mortality rates under section 417(e) as in effect for Plan A at the time the benefit commences, the present value of a temporary benefit of $1,500 per month ($2,085 − $585) payable from age 55 to age 62 is $106,417, and the present value of the entire benefit (a temporary benefit of $2,085 per month payable from age 55 to age 62 plus a deferred lifetime benefit of $585 commencing at age 62) is $207,468.

(iv) Because $106,417 is more than 50% of $207,468 (and because 50% of Participant R's benefit is less than $362,776, which is the PBGC maximum guaranteed benefit amount at age 55 for 2010), Participant R can only receive 50% of the benefit in the form of the social security leveling option. Pursuant to paragraph (d)(3)(ii) of this section, Plan A must offer Participant R the option to bifurcate the benefit into unrestricted and restricted portions. Participant R elects to receive the restricted portion of the early retirement benefit as a level lifetime annuity of $600 commencing at age 55.

(v) Participant R elects to receive the unrestricted portion of the early retirement benefit in the social security leveling form of payment. This portion of the benefit is determined under the social security leveling form of payment as if Participant R's benefit was one-half of the early retirement benefit, or $600. However, using a monthly level lifetime benefit of $600 and a monthly social security benefit of $1,500, Participant R would have a negative benefit after age 62 ($600 + .590 × $1,500 is only $1,485; offsetting $1,500 at age 62 would produce a negative amount). Plan A provides that in this situation, the benefit under the social security leveling option is an actuarially equivalent monthly annuity payable until age 62, with zero payable thereafter. Using the actuarial equivalence factor of .590 at age 55, the plan administrator determines that the unrestricted portion of Participant R's benefit is $1,463 per month, payable from age 55 to age 62 ($600 + .590 × $1,463 = $1,463 payable until age 62; $1,463 − $1,463 = zero payable after age 62).

(vi) Combining the unrestricted and restricted portions of the benefit, Participant R will receive a total of $2,063 per month from age 55 to age 62 ($1,463 from the unrestricted portion of the benefit plus $600 from the restricted portion of the benefit), and $600 per month beginning at age 62 (zero from the unrestricted portion of the benefit plus $600 from the restricted portion of the benefit).

(4) *Exception for cessation of benefit accruals.* This paragraph (d) does not apply to a plan for a plan year if the terms of the plan, as in effect for the period beginning on September 1, 2005, provided for no benefit accruals with respect to any participants. If a plan that is described in this paragraph (d)(4) provides for benefit accruals during any time on or after September 1, 2005 (treating benefit increases pursuant to a plan amendment as benefit accruals), this paragraph (d)(4) ceases to apply for the plan as of the date any benefits accrue under the plan (or the date the amendment takes effect). For example, the exception in this paragraph (d)(4) does not apply to a plan after the plan increases benefits to take into account increases in the limitations under section 415(b) on or after September 1, 2005.

(5) *Right to delay commencement.* If a participant or beneficiary requests a distribution in an optional form of benefit that includes a prohibited payment that is not permitted to be paid under paragraph (d)(1), (d)(2), or (d)(3) of this section, the participant retains the right to delay commencement of benefits in accordance with the terms of the plan and applicable qualification requirements (such as sections 411(a)(11) and 401(a)(9)).

(6) *Plan alternative for special optional forms.* A plan is permitted to offer optional forms of benefit that are solely available during the period in which paragraph (d)(1), (d)(2), or (d)(3) of this section applies to limit prohibited payments under the plan. For example, a plan may permit participants or beneficiaries who commence benefits during the period in which paragraph (d)(1) of this section (or paragraph (d)(2) of this section) applies to limit prohibited payments under the plan to elect, within a specified period after the date on which that paragraph ceases to apply to limit prohibited payments under the plan, to receive the remaining benefit in the form of a single-sum payment equal to the present value of the remaining benefit, but only to the extent then permitted under this paragraph (d). As another example, during a period when paragraph (d)(3) of this section applies to a plan, the plan may permit participants and beneficiaries to elect payment in an optional form of benefit that provides for the current payment of the unrestricted portion of the benefit, with a delayed commencement for the restricted portion of the benefit (subject to other applicable qualification requirements, such as sections 411(a)(11) and 401(a)(9)), or may satisfy paragraph (d)(3)(i) of this section by permitting participants and beneficiaries to elect an optional form of benefit that combines an unsubsidized single-sum payment for over 50 percent of the accrued benefit with a subsidized early retirement life annuity for the remainder of the accrued benefit. Any such optional forms must satisfy this paragraph (d) and applicable qualification requirements, including satisfaction of section 417(e) and section 415 (at each annuity starting date).

(7) *Exception for distributions permitted without consent of the participant under section 411(a)(11).* [Reserved]

(e) *Limitation on benefit accruals for plans with severe funding shortfalls*—(1)

In general. Except as otherwise provided in this paragraph (e), a plan satisfies the requirements of section 436(e) and this paragraph (e) only if it provides that, in any case in which the plan's adjusted funding target attainment percentage for a plan year is less than 60 percent, benefit accruals under the plan will cease as of the applicable section 436 measurement date. If a plan is required to cease benefit accruals under this paragraph (e), then the plan is not permitted to be amended in a manner that would increase the liabilities of the plan by reason of an increase in benefits or establishment of new benefits. The preceding sentence applies regardless of whether an amendment would otherwise be permissible under paragraph (c)(2) or (c)(3) of this section.

(2) *Exemption if section 436 contribution is made.* The prohibition on additional benefit accruals under a plan described in paragraph (e)(1) of this section ceases to apply with respect to a plan year, effective as of the first day of the plan year, upon payment by the plan sponsor of the contribution described in paragraph (f)(2)(v) of this section. See paragraph (f) of this section for additional rules.

(3) *Special rule under section 203 of the Worker, Retiree, and Employer Recovery Act of 2008.* [Reserved]

(f) *Methods to avoid or terminate benefit limitations*—(1) *In general.* This paragraph (f) sets forth rules relating to employer contributions and other methods to avoid or terminate the application of section 436 limitations under a plan for a plan year. In general, there are four methods a plan sponsor may utilize to avoid or terminate one or more of the benefit limitations under this section for a plan year. Two of these methods (where the plan sponsor elects to reduce the prefunding balance or funding standard carryover balance and where the plan sponsor makes additional contributions under section 430 for the prior plan year within the time period provided by section 430(j)(1) that are not added to the prefunding balance) involve increasing the amount of plan assets which are taken into account in determining the adjusted funding target attainment percentage. The other two methods (making a contribution that is specifically designated as a current year contribution to avoid or terminate application of a benefit limitation under paragraph (b), (c), or (e) of this section, and providing security under section 436(f)(1)) are described in paragraphs (f)(2) and (f)(3) of this section, respectively.

(2) *Current year contributions to avoid or terminate benefit limitations*—(i) *General rules*—(A) *Amount of contribution*—(*1*) *In general.* This paragraph (f)(2) sets forth rules regarding contributions to avoid or terminate the application of section 436 limitations under a plan for a plan year that apply to unpredictable contingent event benefits, plan amendments that increase liabilities for benefits, and benefit accruals.

(*2*) *Interest adjustment.* Any contribution made by a plan sponsor pursuant to this paragraph (f)(2) on a date other than the valuation date for the plan year must be adjusted with interest at the plan's effective interest rate under section 430(h)(2)(A) for the plan year. If the plan's effective interest rate for the plan year has not been determined at the time of the contribution, then this interest adjustment must be made using the highest of the three segment rates as applicable for the plan year under section 430(h)(2)(C). In such a case, if the effective interest rate for the plan year under section 430(h)(2)(A) is subsequently determined to be less than that highest rate, the excess is recharacterized as an employer contribution taken into account under section 430 for the current plan year.

(B) *Timing requirement for section 436 contributions.* Any contribution described in this paragraph (f)(2) must be paid before the unpredictable contingent event benefits are permitted to be paid, the plan amendment is permitted to take effect, or the benefit accruals are permitted to resume. In addition, any contribution described in this paragraph (f)(2) must be paid during the plan year.

(C) *Prefunding balance or funding standard carryover balance may not be used.* No prefunding balance or funding standard carryover balance under section 430(f) may be used as a contribution described in this paragraph (f)(2). However, a plan sponsor is permitted

to elect to reduce the funding standard carryover balance or the prefunding balance in order to increase the adjusted funding target attainment percentage for a plan year. See paragraph (a)(5) of this section for a rule mandating such a reduction in certain situations.

(ii) *Section 436 contributions separate from minimum required contributions*—(A) *In general.* The contributions described in this paragraph (f)(2) are contributions described in sections 436(b)(2), 436(c)(2), and 436(e)(2), and are separate from any minimum required contributions under section 430. Thus, if a plan sponsor makes a contribution described in this paragraph (f)(2) for a plan year but does not make the minimum required contribution for the plan year, the plan fails to satisfy the minimum funding requirements under section 430 for the plan year. In addition, a contribution described in this paragraph (f)(2) is disregarded in determining the maximum addition to the prefunding balance under section 430(f)(6) and §1.430(f)–1(b)(1)(ii).

(B) *Designation requirement.* Any contribution made by a plan sponsor pursuant to this paragraph (f)(2) must be designated as such at the time the contribution is used to avoid or terminate the limitations under this paragraph (f)(2), including designation of the benefits or amendments to which the limits do not apply because of the contribution. Except as specifically provided in paragraph (f)(2)(i)(A)(*2*), (g) or (h) of this section, such a contribution cannot be subsequently recharacterized with respect to any plan year as a contribution to satisfy a minimum required contribution obligation, or otherwise. The designation must be made in accordance with the rules and procedures that otherwise apply to elections under §1.430(f)–1(f) with respect to the prefunding and funding standard carryover balances.

(C) *Requirement to recertify AFTAP.* If the plan's enrolled actuary has already certified the adjusted funding target attainment percentage for the plan year, a plan sponsor is treated as making the contribution described in paragraph (f)(2)(iii)(B), (f)(2)(iv)(B), or (f)(2)(v) of this section for the plan year only after the plan's enrolled actuary certifies an updated adjusted funding target attainment percentage for the plan year that takes into account the increased liability for the unpredictable contingent event benefits, the plan amendments, or restored accruals, and the associated section 436 contribution, under the rules of paragraph (h)(4)(v) of this section. See also paragraph (g)(4)(i) of this section for a requirement to modify the presumed adjusted funding target attainment percentage to take the liability for the unpredictable contingent event benefits or plan amendments, and the associated section 436 contribution, into account (if the contribution described in paragraph (f)(2)(iii)(B), (f)(2)(iv)(B), or (f)(2)(v) of this section is made before the plan's enrolled actuary certifies the adjusted funding target attainment percentage for the plan year).

(iii) *Contribution for unpredictable contingent event benefits.* In the case of a contribution to avoid or terminate the application of the limitation on benefits attributable to an unpredictable contingent event under section 436(b)—

(A) In the event that the adjusted funding target attainment percentage for the plan year determined without taking into account the liability attributable to the unpredictable contingent event benefits is less than 60 percent, the amount of the contribution under section 436(b)(2) is equal to the amount of the increase in the funding target of the plan for the plan year if the benefits attributable to the unpredictable contingent event were included in the determination of the funding target.

(B) In the event that the adjusted funding target attainment percentage for the plan year determined without taking into account the liability attributable to the unpredictable contingent event benefits is 60 percent or more, the amount of the contribution under section 436(b)(2) is the amount that would be sufficient to result in an adjusted funding target attainment percentage for the plan year of 60 percent if the contribution (and any prior section 436 contributions made for the plan year) were included as part of the plan assets and the funding target were to take into account the adjustments described in paragraph (g)(2)(iii)(A),

(g)(3)(ii)(A), or (g)(5)(i)(B) of this section, whichever applies.

(iv) *Contribution for plan amendments increasing liability for benefits.* In the case of a contribution to avoid or terminate the application of the limitation on benefits attributable to a plan amendment under section 436(c)—

(A) In the event that the adjusted funding target attainment percentage for the plan year determined without taking into account the liability attributable to the plan amendment is less than 80 percent, the amount of the contribution under section 436(c)(2) is equal to the amount of the increase in the funding target of the plan for the plan year if the liabilities attributable to the amendment were included in the determination of the funding target.

(B) In the event that the adjusted funding target attainment percentage for the plan year determined without taking into account the liability attributable to the plan amendment is 80 percent or more, the amount of the contribution under section 436(c)(2) is the amount that would be sufficient to result in an adjusted funding target attainment percentage for the plan year of 80 percent if the contribution (and any prior section 436 contributions made for the plan year) were included as part of the plan assets and the funding target were to take into account the adjustments described in paragraph (g)(2)(iii)(A), (g)(3)(ii)(A), or (g)(5)(i)(B) of this section, whichever applies.

(v) *Contribution required for continued benefit accruals.* In the case of a contribution to avoid or terminate the application of the limitation on accruals under section 436(e), the amount of the contribution under section 436(e)(2) is equal to the amount sufficient to result in an adjusted funding target attainment percentage for the plan year of 60 percent if the contribution (and any prior section 436 contributions made for the plan year) were included as part of the plan assets and the funding target were to take into account the adjustments described in paragraph (g)(2)(iii)(A) or (g)(5)(i)(B) of this section, whichever applies.

(3) *Security to increase adjusted funding target attainment percentage*—(i) *In general.* For purposes of avoiding benefit limitations under section 436, a plan sponsor may provide security in the form described in paragraph (f)(3)(ii) of this section. In such a case, the adjusted funding target attainment percentage for the plan year is determined by treating as an asset of the plan any security provided by a plan sponsor by the valuation date for the plan year in a form meeting the requirements of paragraph (f)(3)(ii) of this section. However, this security is not taken into account as a plan asset for any other purpose, including section 430.

(ii) *Form of security.* The forms of security permitted under paragraph (f)(3)(i) of this section are limited to—

(A) A bond issued by a corporate surety company that is an acceptable surety for purposes of section 412 of ERISA; or

(B) Cash, or United States obligations which mature in 3 years or less, held in escrow by a bank or an insurance company.

(iii) *Enforcement.* Any form of security provided under paragraph (f)(3)(i) of this section must provide—

(A) That it will be paid to the plan upon the earliest of—

(*1*) The plan termination date as defined in section 4048 of ERISA;

(*2*) If there is a failure to make a payment of the minimum required contribution for any plan year beginning after the security is provided, the due date for the payment under section 430(j)(1) or 430(j)(3); or

(*3*) If the plan's adjusted funding target attainment percentage is less than 60 percent (without regard to any security provided under this paragraph (f)(3)) for a consecutive period of 7 plan years, the valuation date for the last plan year in the 7-year period; and

(B) That the plan administrator must notify the surety, bank, or insurance company that issued or holds the security of any event described in paragraph (f)(3)(iii)(A) of this section within 10 days of its occurrence.

(iv) *Release of security.* The form of security is permitted to provide that it will be released (and any amounts thereunder will be refunded to the plan sponsor together with any interest accrued thereon) as provided in the agreement governing the security, but such release is not permitted until the

plan's enrolled actuary has certified that the plan's adjusted funding target attainment percentage for a plan year is at least 90 percent (without regard to any security provided under this paragraph (f)(3)) or until replacement security has been provided in accordance with paragraph (f)(3)(vi) of this section.

(v) *Contribution of security to plan.* Any security provided under this paragraph (f)(3) that is subsequently turned over to the plan (whether pursuant to the enforcement mechanism of paragraph (f)(3)(iii) of this section or after its release under paragraph (f)(3)(iv) of this section) is treated as a contribution by the plan sponsor taken into account under section 430 when contributed and, if turned over pursuant to paragraph (f)(3)(iii) of this section, is not a contribution under paragraph (f)(2) of this section.

(vi) *Replacement security.* If security has been provided to a plan pursuant to this paragraph (f)(3), the plan sponsor may provide new security to the plan and subsequently or simultaneously have the original security released, but only if—

(A) The new security is in a form that satisfies the requirements of paragraph (f)(3)(ii) of this section;

(B) The amount of the new security is no less than the amount of the original security, determined at the time the original security is released; and

(C) The period described in paragraph (f)(3)(iii)(A)(*3*) of this section with respect to the new security is the same as the period that applied under that paragraph to the original security.

(4) *Examples.* The following examples illustrate the rules of this paragraph (f):

Example 1. (i) Plan Z is a non-collectively bargained defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. Plan Z's sponsor is not in bankruptcy, and Plan Z did not purchase any annuities in 2009 or 2010. As of January 1, 2011, Plan Z does not have a funding standard carryover balance or a prefunding balance, and is not in at-risk status. As of that date, Plan Z has plan assets (and adjusted plan assets) of $2,000,000 and a funding target (and an adjusted funding target) of $2,550,000. On March 1, 2011, the enrolled actuary for the plan certifies that the AFTAP as of January 1, 2011, is 78.43%. The effective interest rate for Plan Z for the 2011 plan year is 5.5%.

(ii) On May 1, 2011, the plan sponsor amends Plan Z to increase benefits. The enrolled actuary for the plan determines that the present value, as of January 1, 2011, of the increase in the funding target due to the amendment is $400,000. Because the AFTAP prior to the plan amendment is less than 80%, Plan Z is subject to the restriction on plan amendments in paragraph (c) of this section, and the amendment cannot take effect unless the employer utilizes one of the methods described in paragraph (f) of this section to avoid benefit limitations.

(iii) In order for the amendment to be permitted to take effect, the plan sponsor makes a contribution described in paragraph (f)(2) of this section. Because the AFTAP prior to the amendment was less than 80%, the provisions of paragraph (f)(2)(iv)(A) of this section apply. The amount of the contribution as of January 1, 2011, needed to avoid the restriction on plan amendments under paragraph (c) of this section is equal to the amount of the increase in funding target attributable to the amendment, or $400,000. Under the provisions of paragraph (f)(2)(iv)(A) of this section, this contribution is required even though, if the contribution were included as part of the plan assets and the liabilities attributable to the plan amendment were included in the funding target, the AFTAP would be 81.36% (that is, adjusted plan assets of $2,000,000 plus the contribution of $400,000 as of January 1, 2011; divided by the adjusted funding target of $2,550,000 increased to reflect the additional $400,000 in the funding target attributable to the plan amendment).

(iv) However, because the contribution is not paid until May 1, 2011, the necessary contribution amount must be adjusted to reflect interest from the valuation date to the date of the contribution, at Plan Z's effective interest rate for the 2011 plan year. The amount of the required contribution after adjustment is $407,203, determined as $400,000 increased for 4 months of compound interest at an effective annual interest rate of 5.5%.

(v) A contribution of $407,203 is made on May 1, 2011, and is designated as a contribution under paragraph (f)(2) of this section with respect to the May 1, 2011, plan amendment. Accordingly, the contribution is not applied toward minimum funding requirements under section 430, and is not eligible for inclusion in the prefunding balance under §1.430(f)–1(b)(1). Since this contribution meets the requirements of paragraph (f)(2) of this section, the plan amendment takes effect in accordance with its terms.

Example 2. (i) The facts are the same as in *Example 1*, except that the plan is in at-risk status under section 430(i). The funding target determined under section 430(i) is $2,600,000, and the funding target determined without regard to section 430(i) is $2,550,000.

(ii) On May 1, 2011, the plan sponsor amends Plan Z to increase benefits. The plan's enrolled actuary determines that the present value as of January 1, 2011 of the increase in the funding target due to the amendment (taking into account the at-risk status of the plan) is $440,000. Because the AFTAP prior to the plan amendment is 78.43% (determined taking into account the at-risk status of Plan Z), Plan Z is subject to the restriction on plan amendments in paragraph (c) of this section, and the amendment cannot take effect unless the employer utilizes one of the methods described in this paragraph (f) to avoid benefit limitations.

(iii) In order for this amendment to be permitted to take effect, the plan sponsor makes a contribution described in paragraph (f)(2) of this section. Because the AFTAP prior to the amendment was less than 80%, the provisions of paragraph (f)(2)(iv)(A) of this section apply. The amount of the contribution as of January 1, 2011, needed to avoid the restriction on plan amendments under paragraph (c) of this section is equal to the amount of the increase in funding target attributable to the amendment, or $440,000. Under the provisions of paragraph (f)(2)(iv)(A) of this section, this contribution is required even though, if the contribution were included as part of the plan assets and the liability attributable to the plan amendment were included in the funding target, the AFTAP would exceed 80%.

(iv) However, because the contribution is not paid until May 1, 2011, the necessary contribution amount must be adjusted to reflect interest from the valuation date to the date of the contribution, at Plan Z's effective interest rate for the 2011 plan year. The amount of the required contribution after adjustment is $447,923, determined as $440,000 increased for 4 months of compound interest at an effective annual interest rate of 5.5%.

(v) A contribution of $447,923 is made on May 1, 2011, and is designated as a contribution under paragraph (f)(2) of this section with respect to the May 1, 2011, plan amendment. Accordingly, the contribution is not applied toward minimum funding requirements under section 430, and is not eligible for inclusion in the prefunding balance under §1.430(f)–1(b)(1). Since this contribution meets the requirements of paragraph (f)(2) of this section, the plan amendment takes effect in accordance with its terms.

Example 3. (i) The facts are the same as in *Example 1,* except that the enrolled actuary for the plan does not issue the certification of the 2011 AFTAP until September 1, 2011. Prior to October 1, 2010, the enrolled actuary had certified the 2010 AFTAP to be 82%. Other than this amendment, no other amendment or unpredictable contingent event has occurred that requires a recertification. As of May 1, 2011, the plan's effective interest rate for the 2011 plan year has not yet been determined. The highest of the three segment rates applicable to the 2011 plan year under section 430(h)(2)(C) is 6%.

(ii) Because the enrolled actuary has not certified the actual AFTAP as of January 1, 2011, and the amendment is scheduled to take effect after April 1, 2011, the rules of paragraph (h)(2)(iii) of this section apply. Accordingly, the AFTAP for 2011 (prior to reflecting the effect of the amendment) is presumed to be 10 percentage points lower than the 2010 AFTAP, or 72%. Because this presumed AFTAP is less than 80%, the restriction on plan amendments in paragraph (c) of this section applies, and the plan amendment cannot take effect.

(iii) In order to allow the plan amendment to take effect, the plan sponsor decides to make a contribution under paragraph (f)(2) of this section on May 1, 2011. Because the presumed AFTAP was less than 80% prior to reflecting the plan amendment, the rules of paragraph (f)(2)(iv)(A) of this section apply, and the amount of the contribution under section 436(c)(2) is the amount of the increase in the funding target for the year if the plan amendment were included in the determination of the funding target. Accordingly, an additional contribution of $400,000 is required as of January 1, 2011, to avoid the restriction on plan amendments under paragraph (c) of this section.

(iv) However, since the contribution is not made until May 1, 2011, the amount of the required contribution must be adjusted to reflect interest from the valuation date to the date of the contribution. Since the effective interest rate has not yet been determined, the interest adjustment is based on the highest of the three segment rates applicable for the 2011 plan year under section 430(h)(2)(C), or 6%. The amount of the required contribution after adjustment is $407,845, determined as $400,000 increased for 4 months of compound interest at the highest segment interest rate for 2011, or 6%.

(v) A contribution of $407,845 is made on May 1, 2011, and is designated as a contribution under paragraph (f)(2) of this section with respect to the May 1, 2011, plan amendment. Accordingly, the contribution is not applied toward minimum funding requirements under section 430, and is not eligible for inclusion in the prefunding balance under §1.430(f)–1(b)(1). Since this contribution meets the requirements of paragraph (f)(2) of this section, the plan amendment takes effect in accordance with its terms.

(vi) After the plan's effective interest rate for 2011 has been determined to be 5.5%, the amount of excess interest previously contributed is recharacterized as an employer contribution taken into account under section 430 for 2011 (because that rate for the year is less than 6%).

(g) *Rules of operation for periods prior to and after certification*—(1) *In general.* Section 436(h) and paragraph (h) of this section set forth a series of presumptions that apply before the enrolled actuary for a plan issues a certification of the plan's adjusted funding target attainment percentage for the plan year. This paragraph (g) sets forth rules for the application of limitations under sections 436(b), 436(c), 436(d), and 436(e) prior to and during the period those presumptions apply to the plan, and describes the interaction of those presumptions with plan operations after the plan's enrolled actuary has issued a certification of the plan's adjusted funding target attainment percentage for the plan year. Paragraph (g)(2) of this section sets forth rules that apply to periods during which a presumption under section 436(h) and paragraph (h) of this section applies. Paragraph (g)(3) of this section sets forth rules that apply to periods during which no presumptions under section 436(h) and paragraph (h) of this section apply but which are prior to the enrolled actuary's certification of the plan's adjusted funding target attainment percentage for the plan year. Paragraph (g)(4) of this section sets forth rules for modifying the plan's presumed adjusted funding target attainment percentage in certain situations. Paragraph (g)(5) of this section sets forth rules that apply after the enrolled actuary's certification of the plan's adjusted funding target attainment percentage for a plan year. Paragraph (g)(6) of this section sets forth examples illustrating the rules in this paragraph (g).

(2) *Periods prior to certification during which a presumption applies*—(i) *Plan must follow presumptions.* A plan must provide that, for any period during which a presumption under section 436(h) and paragraph (h)(1), (2), or (3) of this section applies to the plan, the limitations applicable under section 436 and paragraphs (b), (c), (d), and (e) of this section are applied to the plan as if the adjusted funding target attainment percentage for the year were the presumed adjusted funding target attainment percentage determined under the rules of section 436(h) and paragraph (h)(1), (2), or (3) of this section, as applicable, updated to take into account certain unpredictable contingent event benefits and plan amendments in accordance with section 436 and the rules of this paragraph (g).

(ii) *Determination of amount of reduction in balances*—(A) *In general.* During the period described in this paragraph (g)(2), the rules of paragraph (a)(5) of this section (relating to the deemed election to reduce the funding standard carryover balance and the prefunding balance) must be applied based on the presumed adjusted funding target attainment percentage. This paragraph (g)(2)(ii) provides rules for the determination of the reduction that applies as of the first day of the plan year, and, in certain circumstances, that applies later in the plan year. Paragraph (g)(2)(iii) of this section provides additional rules that apply with respect to unpredictable contingent event benefits or plan amendments, which rules must be applied prior to the application of paragraph (g)(2)(iv) of this section relating to section 436 contributions. The reapplication of the rules under this paragraph (g)(2) regarding the deemed election in paragraph (a)(5) of this section may require an additional reduction in the prefunding and funding standard carryover balances if the amount of the reduction in those balances that is necessary to reach the applicable threshold to avoid the application of a section 436 limitation exceeds the amount that was initially reduced. Prior reductions of the prefunding and funding standard carryover balances continue to apply.

(B) *Reduction in balances at the first day of plan year*—*(1) Plans with a certified AFTAP for the prior plan year.* If section 436(h)(1) and paragraph (h)(1) of this section apply to determine the presumed adjusted funding target attainment percentage as of the first day of the current plan year based on the plan's enrolled actuary certification of the adjusted funding target attainment percentage for the prior plan year made during that prior plan year, then, in order to determine the amount of the reduction (if any) in the funding standard carryover balance and prefunding balance under this paragraph (g)(2)(ii), a presumed adjusted

funding target must be established as of the first day of the plan year, and that amount is then compared to the interim value of adjusted plan assets as of that date. For this purpose, the interim value of adjusted plan assets is equal to the value of adjusted plan assets (within the meaning of paragraph (j)(1)(ii) of this section) as of the first day of the plan year, determined without regard to future contributions and future elections with respect to the plan's prefunding and funding standard carryover balances under section 430(f) (for example, elections to add to the prefunding balance for the prior plan year, elections to use the prefunding and funding standard carryover balances to offset the minimum required contribution for a year, and elections (including deemed elections under paragraph (a)(5) of this section) to reduce the prefunding and funding standard carryover balances for the current plan year), and the presumed adjusted funding target is equal to the interim value of adjusted plan assets for the plan year divided by the presumed adjusted funding target attainment percentage. As provided in §1.430(f)–1(e)(1), the rules of §1.430(f)–1(d)(1)(ii) apply for purposes of determining the amount of the prefunding balance or the funding standard carryover balance that is available for reduction.

(*2*) *Plans with presumed AFTAP deemed under 60 percent.* If paragraph (g)(2)(ii)(B)(*1*) of this section does not apply to the plan for a plan year and the last day of the plan year is on or after the first day of the 10th month of the plan year, such that the presumed adjusted funding target attainment percentage for the prior plan year is conclusively presumed to be less than 60 percent under section 436(h)(2) and paragraph (h)(3) of this section, then no reduction in the funding standard carryover balance and prefunding balance is required under this paragraph (g)(2)(ii)(B). However, see paragraph (g)(2)(iv)(A) of this section for rules for determining the amount of a section 436 contribution that would permit unpredictable contingent event benefits to be paid in such a case.

(*3*) *Treatment of short plan years.* If paragraph (g)(2)(ii)(B)(*1*) of this section does not apply to the plan for a plan year but the last day of the plan year is before the first day of the 10th month of the plan year, such that section 436(h)(2) and paragraph (h)(3) of this section did not apply for that plan year, then paragraph (g)(2)(ii)(B)(*1*) of this section must be applied as of the first day of the next plan year based on the presumed adjusted funding target attainment percentage as of that last day of the prior short plan year.

(C) *Change in presumed AFTAP later in the plan year.* If the presumed adjusted funding target attainment percentage for the plan year changes during the year, the rules regarding the deemed election to reduce the prefunding and funding standard carryover balances described in paragraph (a)(5) of this section must be reapplied based on the new presumed adjusted funding target attainment percentage. This will typically occur on the first day of the 4th month of a plan year, but could happen at a different date if the enrolled actuary certifies the adjusted funding target attainment percentage for the prior plan year during the current plan year. In order to determine the amount of any reduction in the prefunding and funding standard carryover balances that would apply in such a situation, a new presumed adjusted funding target must be established, which is then compared to the updated interim value of adjusted plan assets. For this purpose, the updated interim value of adjusted plan assets for the plan year is determined as the interim value of adjusted plan assets as of the first day of the plan year updated to take into account contributions for the prior plan year and section 430(f) elections with respect to the plan's prefunding and funding standard carryover balances made before the date of the change in the presumed adjusted funding target attainment percentage, and the new presumed adjusted funding target is equal to the updated interim value of adjusted plan assets divided by the new presumed adjusted funding target attainment percentage.

(D) *Plans funded below the threshold.* If, after application of paragraph (g)(2)(ii)(B) and (C) of this section, the

presumed adjusted funding target attainment percentage under this paragraph (g)(2)(ii) is less than the 60 percent threshold under section 436(e), then no benefit accruals are permitted under the plan unless the plan sponsor makes a section 436 contribution as provided in paragraph (g)(2)(iv)(A) of this section. *See* paragraph (g)(5)(ii) of this section for rules that apply on and after the date the enrolled actuary for the plan issues a certification of the adjusted funding target attainment percentage of the plan for the current plan year.

(iii) *Calculation of inclusive presumed AFTAP for application to unpredictable contingent event benefits and plan amendments*—(A) *Requirement to calculate inclusive presumed AFTAP.* For purposes of applying the limitations under paragraphs (b) and (c) of this section during the period described in this paragraph (g)(2), an inclusive presumed adjusted funding target attainment percentage must be calculated. The inclusive presumed adjusted funding target attainment percentage is the ratio (expressed as a percentage) of the interim value of adjusted plan assets (updated to take into account contributions for the prior plan year, any prior section 436 contributions made for the plan year to the extent not previously taken into account in the interim value of adjusted plan assets for the plan year, and section 430(f) elections with respect to the plan's prefunding and funding standard carryover balances made before the date of the unpredictable contingent event or the date the plan amendment would take effect) to the inclusive presumed adjusted funding target. The inclusive presumed adjusted funding target is calculated as the presumed adjusted funding target determined under paragraph (g)(2)(ii)(B) or (C) of this section, increased to take into account—

(*1*) The unpredictable contingent event benefits or plan amendment;

(*2*) Any unpredictable contingent event benefits that are permitted to be paid as a result of any unpredictable contingent event that occurred, or plan amendment that has taken effect, in the prior plan year to the extent not taken into account in the prior plan year adjusted funding target attainment percentage; and

(*3*) Any other unpredictable contingent event benefits that are permitted to be paid as a result of any unpredictable contingent event that occurred, or plan amendment that has taken effect, in the current plan year to the extent not previously taken into account in the presumed adjusted funding target for the plan year.

(B) *Mandatory reduction for collectively bargained plans.* During the period described in this paragraph (g)(2), the rules of paragraph (a)(5)(ii) of this section (relating to the deemed election to reduce the funding standard carryover balance and the prefunding balance) must be applied by treating the inclusive presumed adjusted funding target attainment percentage determined under this paragraph (g)(2)(iii) as if it were the adjusted funding target attainment percentage.

(C) *Optional reduction for plans that are not collectively bargained plans.* A plan sponsor of a plan that is not a collectively bargained plan (and, thus, is not required to reduce the funding standard carryover balance and the prefunding balance under the rules of paragraph (a)(5)(ii) of this section) is permitted to elect to reduce those balances in order to increase the updated interim value of adjusted plan assets that is used to determine the inclusive presumed adjusted funding target attainment percentage under this paragraph (g)(2)(iii).

(D) *Plans funded below the threshold.* If, after application of paragraph (g)(2)(iii)(B) and (C) of this section, the inclusive presumed adjusted funding target attainment percentage determined under this paragraph (g)(2)(iii) is less than the applicable threshold under section 436(b) or 436(c), then the plan is not permitted to provide any benefits attributable to the unpredictable contingent event, nor is the plan amendment permitted to take effect, unless the plan sponsor makes a section 436 contribution as provided in paragraph (g)(2)(iv) of this section. *See* paragraph (g)(5)(ii) of this section for rules that apply on and after the date the enrolled actuary for the plan issues a certification of the adjusted funding

target attainment percentage of the plan for the current plan year.

(E) *Plans funded at or above the threshold*. If, after application of paragraph (g)(2)(iii)(B) or (C) of this section, the inclusive presumed adjusted funding target attainment percentage is greater than or equal to the applicable threshold under section 436(b) or 436(c), then the plan is not permitted to limit the payment of unpredictable contingent event benefits described in paragraph (b) of this section, nor is the plan permitted to restrict a plan amendment increasing benefit liabilities described in paragraph (c) of this section from taking effect, based on an expectation that the limitations under paragraph (b) or (c) of this section will apply following the enrolled actuary's certification of the adjusted funding target attainment percentage for the plan year.

(iv) *Section 436 contributions*—(A) *Plans with presumed AFTAP below 60 percent*—(*1*) *Unpredictable contingent event benefits*. If the presumed adjusted funding target attainment percentage for a plan is less than 60 percent, then unpredictable contingent event benefits are permitted to be paid as a result of an unpredictable contingent event occurring during the period described in this paragraph (g)(2) if the plan sponsor makes the section 436 contribution described in paragraph (f)(2)(iii)(A) of this section.

(*2*) *Plan amendments*. If the presumed adjusted funding target attainment percentage for a plan is less than 60 percent, then no plan amendment increasing plan liabilities is permitted to take effect during the period described in this paragraph (g)(2). See paragraph (e)(1) of this section.

(*3*) *Benefit accruals*. If the presumed adjusted funding target attainment percentage for a plan year of less than 60 percent is determined based on the plan's enrolled actuary certification of the adjusted funding target attainment percentage for the prior plan year made during that prior plan year (as opposed to being presumed to be less than 60 percent under the rules of section 436(h)(2) and paragraph (h)(3) of this section because the actuary has not certified the adjusted funding target attainment percentage for the prior plan year before the first day of the 10th month of the prior plan year), then benefits are permitted to accrue if the plan sponsor makes a section 436 contribution in the amount necessary to bring the ratio of the updated interim value of adjusted plan assets to the presumed adjusted funding target up to 60 percent, as described in paragraph (f)(2)(v) of this section.

(B) *Plan amendments for plans with presumed AFTAP below 80 percent*. If the presumed adjusted funding target attainment percentage for a plan is less than 80 percent, but is not less than 60 percent, then a plan amendment increasing plan liabilities is permitted to take effect during the period described in this paragraph (g)(2) if the plan sponsor makes a section 436 contribution described in paragraph (f)(2)(iv)(A) of this section.

(C) *Contributions required to reach threshold*. If a plan is described in paragraph (g)(2)(iii)(D) of this section and neither paragraph (g)(2)(iv)(A) nor (B) of this section apply to the plan, then unpredictable contingent event benefits are permitted to be paid or the plan amendment is permitted to become effective during the period this paragraph (g)(2) applies to the plan only if the plan sponsor makes a section 436 contribution in the amount necessary to bring the ratio of the updated interim value of adjusted plan assets to the inclusive presumed adjusted funding target up to the applicable threshold under section 436(b) or (c), as described in paragraph (f)(2)(iii)(B) or (f)(2)(iv)(B) of this section. This paragraph (g)(2)(iv)(C) applies, for example, if an unpredictable contingent event occurs in the case of a plan with a presumed adjusted funding target attainment percentage of more than 60 percent where taking into account the unpredictable contingent event benefit in the inclusive presumed adjusted funding target would cause the ratio of the interim value of adjusted plan assets to the inclusive presumed adjusted funding target to be less than 60 percent.

(v) *Bankruptcy of plan sponsor*. Pursuant to section 436(d)(2), during any period in which the plan sponsor of a plan is a debtor in a case under title 11, United States Code, or any similar

Federal or State law (as described in paragraph (d)(2) of this section), no prohibited payment within the meaning of paragraph (j)(6) of this section may be paid if the plan's enrolled actuary has not yet certified the plan's adjusted funding target attainment percentage for the plan year to be at least 100 percent. Thus, the presumption rules of paragraph (h) of this section do not apply for purposes of section 436(d)(2) and this paragraph (g)(2)(v).

(3) *Periods prior to certification during which no presumption applies*—(i) *Prohibited payments and benefit accruals*. If no presumptions under section 436(h) apply to a plan during a period and the plan's enrolled actuary has not yet issued the certification of the plan's actual adjusted funding target attainment percentage for the plan year, the plan is not permitted to limit prohibited payments under paragraph (d) of this section or the accrual of benefits under paragraph (e) of this section based on an expectation that those paragraphs will apply to the plan once an actuarial certification is issued. However, see paragraph (g)(2)(v) of this section for a restriction on prohibited payments during any period in which the plan sponsor of a plan is a debtor in a case under title 11, United States Code, or any similar Federal or State law.

(ii) *Unpredictable contingent event benefits and plan amendments increasing benefit liability*—(A) *In general*. If no presumptions under section 436(h) apply to a plan during a period and the plan's enrolled actuary has not yet issued a certification of the plan's adjusted funding target attainment percentage for the plan year, the limitations on unpredictable contingent event benefits under paragraph (b) of this section and plan amendments increasing benefit liabilities under paragraph (c) of this section must be applied during that period by following the rules of paragraphs (g)(2)(iii) of this section, based on the inclusive presumed adjusted funding target determined using the prior plan year adjusted funding target attainment percentage. Thus, whether unpredictable contingent event benefits are permitted to be paid or a plan amendment is permitted to take effect during a plan year is determined by calculating the ratio of the interim value of adjusted plan assets to the inclusive presumed adjusted funding target, where the inclusive presumed adjusted funding target is determined by dividing the interim value of adjusted plan assets by the prior plan year adjusted funding target attainment percentage and then adding the adjustments described in paragraphs (g)(2)(iii)(A)(*1*), (*2*) and (*3*) of this section. If, after application of paragraphs (g)(2)(iii)(B) and (C) of this section, that ratio is less than the applicable threshold under section 436(b) or 436(c), then the plan is not permitted to provide any benefits attributable to the unpredictable contingent event, nor is the plan amendment permitted to take effect, unless the plan sponsor makes the contribution described in paragraph (g)(2)(iv)(C) of this section.

(B) *Recharacterization of contributions made to avoid benefit limitations*. In any case where, pursuant to paragraph (g)(3)(ii)(A) of this section, the plan sponsor makes section 436 contributions to avoid the application of the applicable benefit limitation, to the extent those contributions would not be needed to permit the payment of the unpredictable contingent event benefits or for the plan amendment to go into effect based on a subsequent certification of the adjusted funding target attainment percentage for the current plan year that takes into account the increase in the liability attributable to the unpredictable contingent event benefits or plan amendment, the excess section 436 contributions are recharacterized as employer contributions taken into account under section 430 for the current plan year.

(4) *Modification of the presumed AFTAP*—(i) *Section 436 contributions*. If, in accordance with the rules of paragraph (g)(2)(iv) of this section, unpredictable contingent event benefits are permitted to be paid, or a plan amendment takes effect, during the plan year because the plan sponsor makes a contribution described in paragraph (f)(2)(iii)(B) or (f)(2)(iv)(B) of this section, then the presumed adjusted funding target must be adjusted to reflect

any increase in the funding target attributable to the unpredictable contingent event benefits or the plan amendment and the interim value of plan assets must be increased by the present value of the contribution. Similarly, if benefit accruals are permitted to resume in a plan year because the plan sponsor makes the contribution described in paragraph (f)(2)(v) of this section, then the presumed adjusted funding target must be adjusted to reflect any increase in the funding target attributable to the benefit accruals for the prior plan year and the interim value of adjusted plan assets must be increased by the present value of the contribution. The adjustment to the presumed adjusted funding target is made as of the date of the contribution, and that date is a section 436 measurement date.

(ii) *Modification of the presumed AFTAP for reduction in balances.* If a plan's funding standard carryover balance or prefunding balance is reduced under the rules of paragraph (g)(2) or (g)(3) of this section, then the presumed adjusted funding target attainment percentage for the plan year is increased to reflect the higher interim value of adjusted plan assets resulting from the reduction in the funding standard carryover balance or prefunding balance. The date of the event that causes the reduction is a section 436 measurement date.

(5) *Periods after certification of AFTAP*—(i) *Plan must follow certified AFTAP*—(A) *In general.* The rules of paragraphs (g)(2) and (g)(3) of this section no longer apply for a plan year on and after the date the enrolled actuary for the plan issues a certification of the adjusted funding target attainment percentage of the plan for the current plan year, provided that the certification is issued before the first day of the 10th month of the plan year. For example, the plan must provide that the limitations on prohibited payments apply for distributions with annuity starting dates on and after the date of that certification using the certified adjusted funding target attainment percentage of the plan for the plan year. Similarly, the plan must provide that any prohibition on accruals under paragraph (e) of this section as a result of the enrolled actuary's certification that the adjusted funding target attainment percentage of the plan for the plan year is less than 60 percent is effective as of the date of the certification and that any prohibition on accruals ceases to be effective on the date the enrolled actuary issues a certification that the adjusted funding target attainment percentage of the plan for the plan year is at least 60 percent.

(B) *Unpredictable contingent events and plan amendments.* In the case of a plan that has been issued a certification of the plan's adjusted funding target attainment percentage for a plan year by the plan's enrolled actuary, the plan sponsor must comply with the requirements of paragraphs (b) and (c) of this section for an unpredictable contingent event that occurs or a plan amendment that takes effect on or after the date of the enrolled actuary's certification. Thus, the plan administrator must determine if the adjusted funding target attainment percentage would be at or above the applicable threshold if it were modified to take into account—

(*1*) The unpredictable contingent event or plan amendment;

(*2*) Any other unpredictable contingent event benefits that were permitted to be paid as a result of any unpredictable contingent event that occurred, and any other plan amendment that took effect, earlier during the plan year to the extent not taken into account in the certified adjusted funding target attainment percentage for the plan year; and

(*3*) Any earlier section 436 contributions made for the plan year to the extent those contributions were not taken into account in the certified adjusted funding target attainment percentage.

(C) *Application of rule for deemed election to reduce funding balances.* After the adjusted funding target attainment percentage for a plan year is certified by the plan's enrolled actuary, the deemed election to reduce the prefunding and funding standard carryover balances under paragraph (a)(5) of this section must be reapplied based on the actual funding target for the year

(provided the certification is issued before the first day of the 10th month of the plan year). The reapplication of the rules under this paragraph (g)(5) regarding the deemed election in paragraph (a)(5) of this section may require an additional reduction in the prefunding and funding standard carryover balances if the amount of the reduction in the prefunding and funding standard carryover balances that is necessary to reach the applicable threshold to avoid the application of a section 436 limitation exceeds the amount that was initially reduced. Prior reductions of the prefunding and funding standard carryover balances continue to apply.

(ii) *Applicability to prior periods*—(A) *In general.* Except as otherwise provided in this paragraph (g)(5)(ii), the enrolled actuary's certification of the adjusted funding target attainment percentage for the plan for the plan year does not affect prior periods. For example, the certification does not affect the application of the limitation under paragraph (d) of this section for distributions with annuity starting dates before the certification or the application of the limitation under paragraph (e) of this section prior to the date of that certification. *See* paragraph (a)(4) of this section for rules relating to the period of time after benefits cease to be limited. Except as otherwise provided in this paragraph (g)(5)(ii), the enrolled actuary's certification of the adjusted funding target attainment percentage for the plan for the plan year does not affect the application of the limitation under paragraph (b) or (c) of this section to unpredictable contingent event benefits, or a plan amendment that increases the liability for benefits, where the unpredictable contingent event occurs or the amendment takes effect during the periods to which paragraphs (g)(2) and (g)(3) of this section apply.

(B) *Special rule for unpredictable contingent event benefits.* If a plan does not pay benefits attributable to an unpredictable contingent event because of the application of paragraph (g)(2)(iii)(D) or (g)(3)(ii)(A) of this section, then the plan must pay the benefits attributable to that event that were not previously paid if such benefits would be permitted under the rules of section 436 based on a certified adjusted funding target attainment percentage for the plan year that takes into account the increase in the funding target that would be attributable to those unpredictable contingent event benefits.

(C) *Special rule for plan amendments that increase liability.* If a plan amendment does not take effect because of the application of paragraph (g)(2)(iii)(D) or (g)(3)(ii)(A) of this section, the plan amendment must go into effect if it would be permitted under the rules of section 436 based on a certified actual adjusted funding target attainment percentage for the plan year that takes into account the increase in the funding target attributable to the plan amendment, unless the plan amendment provides otherwise.

(D) *Ordering rule for multiple unpredictable contingent events or plan amendments.* [Reserved]

(6) *Examples.* The following examples illustrate the rules of this paragraph (g). Unless otherwise indicated, these examples are based on the following facts: each plan has a plan year that is the calendar year and a valuation date of January 1; section 436 applies to the plan beginning in 2008; the plan has no funding standard carryover balance; the plan sponsor is not in bankruptcy; no annuity purchases have been made from the plan; and the plan offers a lump sum form of payment. No plan is in at-risk status for the years discussed in the examples. The examples read as follows:

Example 1. (i) The plan's certified AFTAP as of January 1, 2010, is 75%. As of January 1, 2011, Plan A has assets of $3,300,000 and a prefunding balance of $300,000. Beginning on January 1, 2011, Plan A's AFTAP for 2011 is presumed to be 75%, under the rules of paragraph (h) of this section and based on the certified AFTAP for 2010.

(ii) Based on Plan A's presumed AFTAP of 75%, Plan A would continue to be subject to the restriction on prohibited payments in paragraph (d)(3) of this section as of January 1, 2011. However, under the provisions of paragraph (a)(5) of this section, if the prefunding balance is large enough, Plan A's sponsor is deemed to elect to reduce the prefunding balance to the extent needed to avoid this restriction.

(iii) The amount needed to avoid the restriction in paragraph (d)(3) of this section is determined by comparing the presumed adjusted funding target for Plan A with the interim value of adjusted plan assets as of the valuation date. The interim value of adjusted plan assets for Plan A is $3,000,000 (that is, the asset value of $3,300,000 reduced by the prefunding balance of $300,000). The presumed adjusted funding target for Plan A is the interim value of the adjusted plan assets divided by the presumed AFTAP, or $4,000,000 (that is, $3,000,000 divided by 75%).

(iv) In order to avoid the restriction on prohibited payments in paragraph (d)(3) of this section, Plan A's presumed AFTAP must be increased to 80%. This requires an increase in Plan A's adjusted plan assets of $200,000 (that is, 80% of the presumed adjusted funding target of $4,000,000, minus the interim value of the adjusted plan assets of $3,000,000). Plan A's prefunding balance as of January 1, 2011, is reduced by $200,000 under the deemed election provisions of paragraph (a)(5) of this section. Accordingly, Plan A's prefunding balance is $100,000 (that is, $300,000 minus $200,000) and the interim value of adjusted plan assets is increased to $3,200,000 (that is, $3,300,000 minus the reduced prefunding balance of $100,000). Pursuant to paragraph (g)(4)(ii) of this section, the presumed adjusted funding target attainment percentage for Plan A is redetermined as 80% and Plan A must pay the full amount of the accelerated benefit distributions elected by participants with an annuity starting date of January 1, 2011, or later.

Example 2. (i) The facts are the same as in *Example 1.* As of April 1, 2011, the enrolled actuary for Plan A has not certified the 2011 AFTAP. Therefore, beginning April 1, 2011, Plan A's AFTAP is presumed to be reduced by 10 percentage points to 70%, in accordance with paragraph (h)(2) of this section. Under the provisions of paragraph (g)(2)(ii)(B) of this section, the deemed election to reduce the prefunding and funding standard carryover balances described in paragraph (a)(5) of this section must be reapplied based on the new presumed AFTAP.

(ii) In accordance with paragraph (g)(2)(ii)(C) of this section, a new presumed adjusted funding target must be determined based on the new presumed AFTAP and must be compared to an updated interim value of adjusted plan assets. The new presumed adjusted funding target is $3,200,000 divided by the new presumed AFTAP of 70%, or $4,571,429.

(iii) In order to avoid the restriction on prohibited payments in paragraph (d)(3) of this section, Plan A's presumed AFTAP must be increased to 80%. This requires an additional increase in Plan A's adjusted plan assets of $457,143 (that is, 80% of the new presumed adjusted funding target of $4,571,429, minus the updated interim value of the adjusted plan assets of $3,200,000 reflecting the deemed reduction in Plan A's prefunding balance).

(iv) Plan A's remaining prefunding balance as of January 1, 2011, is only $100,000, which is not enough to avoid the restriction on prohibited payments under paragraph (d)(3) of this section. Accordingly, unless Plan A's sponsor utilizes one of the methods described in paragraph (f) of this section to avoid the restriction, Plan A is subject to the restriction on prohibited payments in paragraph (d)(3) of this section and cannot pay accelerated benefit distributions elected by participants with an annuity starting date of April 1, 2011, or later.

(v) Plan A's prefunding balance remains at $100,000 because, under paragraph (a)(5)(iii) of this section, the deemed reduction rules do not apply if the prefunding balance is not large enough to increase the adjusted value of plan assets enough to avoid the restriction. However, the earlier deemed reduction of $200,000 continues to apply because all elections (including deemed elections) to reduce a plan's funding standard carryover balance or prefunding balance are irrevocable and must be unconditional in accordance with paragraph (g)(2)(ii)(A) of this section.

Example 3. (i) The facts are the same as in *Example 1.* On July 1, 2011, the enrolled actuary for Plan A calculates the actual adjusted funding target as $3,700,000 as of January 1, 2011. Therefore, the 2011 AFTAP would have been 81.08% without reducing the prefunding balance (that is, plan assets of $3,300,000 minus the prefunding balance of $300,000, divided by the adjusted funding target of $3,700,000), and Plan A would not have been subject to the restrictions under paragraph (d)(3) of this section.

(ii) However, paragraph (g)(5)(i)(C) of this section requires that any prior reductions in the prefunding or funding standard carryover balances continue to apply, and so Plan A's prefunding balance remains at the reduced amount of $100,000 as of January 1, 2011. The enrolled actuary certifies that the 2011 AFTAP is 86.49% (that is, plan assets of $3,300,000 reduced by the prefunding balance of $100,000, divided by the adjusted funding target of $3,700,000).

Example 4. (i) Plan B is a collectively bargained plan with assets of $2,500,000 and a prefunding balance of $150,000 as of January 1, 2011. On August 14, 2010, the enrolled actuary for Plan B certified the AFTAP for 2010 to be 83%. No unpredictable contingent events giving rise to unpredictable contingent event benefits occurred during 2010 and no plan amendments took effect in 2010 that were not taken into account in the certified AFTAP.

(ii) On January 10, 2011, Plan B's sponsor amends the plan to increase benefits effective on February 1, 2011. The amendment would increase Plan B's funding target by

$350,000. Under the rules of paragraph (g)(3) of this section, the determination of whether the amendment is permitted to take effect is based on a comparison of the inclusive presumed adjusted funding target with the updated interim value of adjusted plan assets.

(iii) Plan B's interim value of adjusted plan assets as of the valuation date is $2,350,000 (that is, $2,500,000 minus the prefunding balance of $150,000). Prior to reflecting the amendment, Plan B's presumed adjusted funding target as of January 1, 2011, is $2,831,325, which is equal to the interim value of adjusted plan assets as of the valuation date of $2,350,000, divided by the presumed AFTAP of 83%. Increasing Plan B's presumed adjusted funding target by $350,000 to reflect the amendment results in an inclusive presumed adjusted funding target of $3,181,325 and would result in a presumed AFTAP of 73.87% (that is, the interim value of adjusted plan assets as of the valuation date of $2,350,000 divided by the inclusive presumed adjusted funding target of $3,181,325).

(iv) Because Plan B's presumed AFTAP was over 80% prior to taking the amendment into account but would be less than 80% if the amendment were taken into account, section 436(c) and paragraph (c) of this section prohibit the plan amendment from taking effect unless the adjusted plan assets are increased so that the inclusive presumed AFTAP would be increased to 80%. This would require an additional amount of $195,060 (that is, 80% of the inclusive presumed adjusted funding target of $3,181,325 less the interim value of adjusted plan assets of $2,350,000).

(v) Plan B's prefunding balance of $150,000 is not large enough for Plan B to avoid the restriction on plan amendments, and therefore the deemed election to reduce the prefunding balance under paragraph (a)(5) of this section does not apply, and the amendment cannot take effect unless the plan sponsor makes a contribution described in paragraph (f)(2) of this section.

Example 5. (i) The facts are the same as in *Example 4*, except that Plan B's sponsor decides to make a contribution on February 1, 2011, to avoid the benefit limitation as provided in paragraph (f)(2) of this section. As of February 1, 2011, Plan B's effective interest rate for the 2011 plan year has not yet been determined. Pursuant to paragraph (f)(2)(i)(A)(*2*) of this section, Plan B's effective interest rate for 2011 is treated as 6.25%, which is the largest of the three segment interest rates applicable to the 2011 plan year, as provided in paragraph (f)(2)(i)(A)(*2*) of this section.

(ii) The amount of the contribution as of January 1, 2011, needed to avoid the restriction on plan amendments under paragraph (c) of this section is $195,060. However, because the contribution is not paid until February 1, 2011, the necessary contribution amount must be adjusted to reflect interest that would otherwise have accrued between the valuation date and the date of the contribution, at Plan B's effective interest rate for the 2011 plan year. The amount of the required contribution after adjustment is $196,048, determined as $195,060 increased for one month of compound interest at an effective annual interest rate of 6.25%.

(iii) In accordance with paragraph (g)(4)(i) of this section, the inclusive presumed AFTAP as of February 1, 2011, is 80 percent.

Example 6. (i) The facts are the same as in *Example 5*. As of April 1, 2011, the enrolled actuary for the plan has not certified the 2011 AFTAP. Beginning April 1, 2011, Plan A's presumed AFTAP is equal to be 70%, 10 percentage points lower than the inclusive presumed AFTAP as of February 1, 2011, in accordance with paragraphs (g)(2)(iii)(A) and (h)(2) of this section. On July 1, 2011, the enrolled actuary for the plan calculates the actual adjusted funding target, prior to taking the plan amendment into account, as $2,700,000, and determines the actual effective interest rate for 2011 to be 5.25%. On this basis, the actual AFTAP for 2011 (prior to taking the amendment into account) as 87.04% (that is, adjusted assets of $2,350,000 divided by the adjusted funding target of $2,700,000). Reflecting the $350,000 increase in funding target due to the plan amendment would increase the adjusted funding target to $3,050,000 and would decrease Plan B's AFTAP to 77.05%.

(ii) Based on the calculated adjusted funding target, the amount that was necessary to avoid the benefit restriction under paragraph (c) of this section was $90,000 (that is, 80% of the adjusted funding target reflecting the plan amendment (or $3,050,000), minus the adjusted value of plan assets of $2,350,000). This amount must be adjusted for interest between the valuation date and the date the contribution was made using the effective interest rate for Plan B. Therefore, the amount required on the payment date of February 1, 2011, was $90,385 (that is, $90,000 adjusted for compound interest for one month at Plan B's effective interest rate of 5.25% per year).

(iii) Under paragraph (g)(3)(ii)(B) of this section, the contribution made on February 1, 2011, is recharacterized as an employer contribution under section 430 to the extent that it exceeded the amount necessary to avoid application of the restriction on plan amendments under paragraph (c) of this section. Therefore, $105,663 (that is, the $196,048 actual contribution paid on February 1, 2011, minus the $90,385 required contribution based on the actual AFTAP) is recharacterized as an employer contribution under section 430 for the 2011 plan year. As such, it may be applied toward the minimum required contribution for 2011, or the plan sponsor can elect to credit the contribution to Plan B's

prefunding balance to the extent that the contributions for the 2011 plan year exceed the minimum required contribution.

(iv) This recharacterization applied only because the 436 contribution was made during a period prior to the certification of Plan B's actual AFTAP for 2011 and during which no presumption applied (that is, when section 436 is applied based on the 2010 AFTAP, which was high enough that no restrictions applied for 2010). If the contribution had been made during a time when the presumptions applied (for instance, after April 1, 2011, when the presumed AFTAP was under 80%) then the only portion of the 436 contribution that would be recharacterized as an employer contribution under section 430 would be the portion of the interest adjustment attributable to the difference between the highest segment rate (6.25%) and the plan's actual effective interest rate (5.25%), in accordance with paragraph (f)(2)(i)(A)(*2*) of this section.

(v) After reflecting the plan amendment and the present value of the portion of the section 436 contribution that is not recharacterized as an employer contribution under section 430, the adjusted assets as of January 1, 2011, for purposes of section 436 are $2,440,000 ($2,350,000 plus $90,000) and the inclusive adjusted funding target is $3,050,000. Accordingly, the enrolled actuary certifies the inclusive AFTAP for 2011 as 80% ($2,440,00 ÷ $3,050,000). Note that assets for section 430 purposes are not increased to reflect the section 436 contribution as of January 1, 2011.

Example 7. (i) The facts are the same as in *Example 6*, except that on July 1, 2011, the enrolled actuary for Plan B calculates the actual adjusted funding target (before reflecting the plan amendment) as $3,000,000 and certifies the actual AFTAP as 78.33% prior to reflecting the plan amendment (that is, adjusted plan assets of $2,350,000 divided by the actual adjusted funding target of $3,000,000). Based on the provisions of paragraph (c) of this section, because the AFTAP prior to reflecting the amendment is less than 80%, the contribution required to avoid the restriction on plan amendments would have been the amount equal to the increase in funding target due to the plan amendment, or $350,000.

(ii) However, according to paragraph (g)(5)(ii)(A) of this section, the enrolled actuary's certification of the 2011 AFTAP does not affect the application of the limitation under paragraph (c) of this section to the amendment, because the amendment to Plan B took effect prior to the date of the certification. Therefore, it is not necessary for Plan B's sponsor to contribute an additional amount in order for the plan amendment to remain in effect regardless of the extent to which the certified AFTAP for the plan year is less than the presumed inclusive AFTAP.

(h) *Presumed underfunding for purposes of benefit limitations*—(1) *Presumption of continued underfunding*—(i) *In general*. This paragraph (h)(1) applies to a plan for a plan year if a limitation under paragraph (b), (c), (d), or (e) of this section applied to the plan on the last day of the preceding plan year. If this paragraph (h)(1) applies to a plan, the first day of the plan year is a section 436 measurement date and the presumed adjusted funding target attainment percentage for the plan is the percentage under paragraph (h)(1)(ii) or (iii) of this section, whichever applies to the plan, beginning on that first day of the plan year and ending on the date specified in paragraph (h)(1)(iv) of this section.

(ii) *Rule where preceding year certification issued during preceding year*—(A) *General rule*. In any case in which the plan's enrolled actuary has issued a certification under paragraph (h)(4) of this section of the adjusted funding target attainment percentage for the plan year preceding the current plan year before the first day of the current plan year, the presumed adjusted funding target attainment percentage of the plan for the current plan year is equal to the prior plan year adjusted funding target attainment percentage until it is changed under paragraph (h)(1)(iv) of this section.

(B) *Special rule for late certifications*. If the certification of the adjusted funding target attainment percentage for the prior plan year occurred after the first day of the 10th month of that prior plan year, the plan is treated as if no such certification was made, unless the certification took into account the effect of any unpredictable contingent event benefits that are permitted to be paid based on unpredictable contingent events that occurred, and any plan amendments that became effective, during the prior plan year but before the certification (and any associated section 436 contributions).

(iii) *No certification for preceding year issued during preceding year*—(A) *Deemed percentage continues*. In any case in which the plan's enrolled actuary has not issued a certification under paragraph (h)(4) of this section of the adjusted funding target attainment percentage of the plan for the plan year

preceding the current plan year during that prior plan year, the presumed adjusted funding target attainment percentage of the plan for the current plan year is equal to the presumed adjusted funding target attainment percentage that applied on the last day of the preceding plan year until the presumed adjusted funding target attainment percentage is changed under paragraph (h)(1)(iii)(B) or (h)(1)(iv) of this section. Thus, if the prior plan year was a 12-month plan year (so that the last day of the plan year was after the first day of the 10th month of the plan year and the rules of section 436(h)(2) and paragraph (h)(3) of this section applied to the plan for that plan year), then the presumed adjusted funding target attainment percentage for the current plan year is presumed to be less than 60 percent. By contrast, if the prior plan year was less than 9 months, the presumed adjusted funding target attainment percentage for the current plan year is the presumed adjusted funding target attainment percentage at the last day of the preceding plan year.

(B) *Enrolled actuary's certification in following year*. In any case in which the plan's enrolled actuary has issued the certification under paragraph (h)(4) of this section of the adjusted funding target attainment percentage of the plan for the plan year preceding the current plan year on or after the first day of the current plan year, the date of that prior plan year certification is a new section 436 measurement date for the current plan year. In such a case, the presumed adjusted funding target attainment percentage for the current plan year is equal to the prior plan year adjusted funding target attainment percentage (reduced by 10 percentage points if paragraph (h)(2)(iv) of this section applies to the plan) until it is changed under paragraph (h)(1)(iv) of this section. The rules of paragraph (h)(1)(ii)(B) of this section apply for purposes of determining whether the enrolled actuary has issued a certification of the adjusted funding target attainment percentage for the prior plan year during the current plan year.

(iv) *Duration of use of presumed adjusted funding target attainment percentage*. If this paragraph (h)(1) applies to a plan for a plan year, the presumed adjusted funding target attainment percentage determined under this paragraph (h)(1) applies until the earliest of—

(A) The first day of the 4th month of the plan year if paragraph (h)(2) of this section applies;

(B) The first day of the 10th month of the plan year if paragraph (h)(3) of this section applies;

(C) The date of a change in the presumed adjusted funding target attainment percentage under paragraph (g)(4) of this section; or

(D) The date the enrolled actuary issues a certification under paragraph (h)(4) of this section of the adjusted funding target attainment percentage for the plan year.

(2) *Presumption of underfunding beginning on first day of 4th month for certain underfunded plans*—(i) *In general*. This paragraph (h)(2) applies to a plan for a plan year if—

(A) The enrolled actuary for the plan has not issued a certification of the adjusted funding target attainment percentage for the plan year before the first day of the 4th month of the plan year; and

(B) The plan's adjusted funding target attainment percentage for the preceding plan year was either—

(*1*) At least 60 percent but less than 70 percent; or

(*2*) At least 80 percent but less than 90 percent.

(ii) *Special rule for first plan year a plan is subject to section 436*. This paragraph (h)(2) also applies to a plan for the first effective plan year if—

(A) The enrolled actuary for the plan has not issued a certification of the adjusted funding target attainment percentage for the plan year before the first day of the 4th month of the plan year; and

(B) The prior plan year adjusted funding target attainment percentage is at least 70 percent but less than 80 percent.

(iii) *Presumed adjusted funding target attainment percentage*. If this paragraph (h)(2) applies to a plan for a plan year and the date of the enrolled actuary's certification of the adjusted funding target attainment percentage under paragraph (h)(4) of this section for the prior plan year (taking into account

the special rules for late certifications under paragraph (h)(1)(ii)(B) of this section) occurred before the first day of the 4th month of the current plan year, then, commencing on the first day of the 4th month of the current plan year—

(A) The presumed adjusted funding target attainment percentage of the plan for the plan year is reduced by 10 percentage points; and

(B) The first day of the 4th month of the plan year is a section 436 measurement date.

(iv) *Certification for prior plan year.* If this paragraph (h)(2) applies to a plan and the date of the enrolled actuary's certification of the adjusted funding target attainment percentage under paragraph (h)(4) of this section for the prior plan year (taking into account the rules for late certifications under paragraph (h)(1)(ii)(B) of this section) occurs on or after the first day of the 4th month of the current plan year, then, commencing on the date of that prior plan year certification—

(A) The presumed adjusted funding target attainment percentage of the plan for the current plan year is equal to 10 percentage points less than the prior plan year adjusted funding target attainment percentage; and

(B) The date of the prior plan year certification is a section 436 measurement date.

(v) *Duration of use of presumed adjusted funding target attainment percentage.* If this paragraph (h)(2) applies to a plan for a plan year, the presumed adjusted funding target attainment percentage determined under this paragraph (h)(2) applies until the earliest of—

(A) The first day of the 10th month of the plan year if paragraph (h)(3) of this section applies;

(B) The date of a change in the presumed adjusted funding target attainment percentage under paragraph (g)(4) of this section; or

(C) The date the enrolled actuary issues a certification under paragraph (h)(4) of this section of the adjusted funding target attainment percentage for the plan year.

(3) *Presumption of underfunding beginning on first day of 10th month.* In any case in which no certification of the specific adjusted funding target attainment percentage for the current plan year under paragraph (h)(4) of this section is made with respect to the plan before the first day of the 10th month of the plan year, then, commencing on the first day of the 10th month of the current plan year—

(i) The presumed adjusted funding target attainment percentage of the plan for the plan year is presumed to be less than 60 percent; and

(ii) The first day of the 10th month of the plan year is a section 436 measurement date.

(4) *Certification of AFTAP*—(i) *Rules generally applicable to certifications*—(A) *In general.* The enrolled actuary's certification referred to in this section must be made in writing, must be signed and dated to show the date of the signature, must be provided to the plan administrator, and, except as otherwise provided in paragraph (h)(4)(ii) of this section, must certify the plan's adjusted funding target attainment percentage for the plan year. Except in the case of a range certification described in paragraph (h)(4)(ii) of this section, the certification must set forth the value of plan assets, the prefunding balance, the funding standard carryover balance, the value of the funding target used in the determination, the aggregate amount of annuity purchases included in the adjusted value of plan assets and the adjusted funding target, the unpredictable contingent event benefits permitted to be paid for unpredictable contingent events that occurred during the current plan year that were taken into account for the current plan year (including any associated section 436 contributions), the plan amendments that took effect in the current plan year that were taken into account for the current plan year (including any associated section 436 contributions), any benefit accruals that were restored for the plan year (including any section 436 contributions), and any other relevant factors. The actuarial assumptions and funding methods used in the calculation for the certification must be the actuarial assumptions and funding methods used for the plan for purposes of determining the minimum required

contributions under section 430 for the plan year.

(B) *Determination of plan assets.* For purposes of making any determination of the adjusted funding target attainment percentage under this section, the determination is not permitted to include in plan assets contributions that have not been made to the plan by the certification date. Thus, the enrolled actuary's certification of the adjusted funding target attainment percentage for a plan year cannot take into account contributions that are expected to be made after the certification date. Notwithstanding the foregoing, for plan years beginning before January 1, 2009, the enrolled actuary's certification of the adjusted funding target attainment percentage is permitted to take into account employer contributions for the prior plan year that are reasonably expected to be made for that prior plan year but have not been contributed by the date of the enrolled actuary's certification. See paragraphs (h)(4)(iii) and (v) of this section for rules relating to changes in the certified percentage.

(ii) *Special rules for certification within range*—(A) *In general.* Under this paragraph (h)(4)(ii), the plan's enrolled actuary is permitted to certify during a plan year that the plan's adjusted funding target attainment percentage for that plan year either is less than 60 percent, is 60 percent or higher (but is less than 80 percent), is 80 percent or higher, or is 100 percent or higher. If the enrolled actuary has issued such a range certification for a plan year and the enrolled actuary subsequently issues a certification of the specific adjusted funding target attainment percentage for the plan before the end of that plan year, then the certification of the specific adjusted funding target attainment percentage is treated as a change in the applicable percentage to which paragraph (h)(4)(iii) of this section applies.

(B) *Effect of range certification before certification of specific percentage.* If a plan's enrolled actuary issues a range certification pursuant to this paragraph (h)(4)(ii), then, for purposes of this section (including application of the limitations of sections 436(b) and (c), contributions described in sections 436(b)(2), 436(c)(2), and 436(e)(2), and the mandatory reduction of the prefunding and funding standard carryover balances under paragraph (a)(5) of this section), the plan is treated as having a certified percentage at the smallest value within the applicable range until a certification of the plan's specific adjusted funding target attainment percentage for the plan year has been issued under paragraph (h)(4)(i) of this section. However, if the plan's enrolled actuary has issued a range certification for the plan year but does not issue a certification of the specific adjusted funding target attainment percentage for the plan by the last day of that plan year, the adjusted funding target attainment percentage for the plan is retroactively deemed to be less than 60 percent as of the first day of the 10th month of the plan year.

(C) *Effect of range certification on and after certification of specific percentage.* Once the certification of the specific adjusted funding target attainment percentage is issued by the plan's enrolled actuary, the certified percentage applies for all purposes of this section on and after the date of that certification. If the plan sponsor made section 436 contributions to avoid application of a benefit limitation during the period a range certification was in effect, those section 436 contributions are recharacterized as employer contributions under section 430 to the extent the contributions exceed the amount necessary to avoid application of a limitation based on the specific adjusted funding target attainment percentage as certified by the plan's enrolled actuary on or before the last day of the plan year.

(iii) *Change of certified percentage*—(A) *Application of new percentage.* If the enrolled actuary for the plan provides a certification of the adjusted funding target attainment percentage of the plan for the plan year under this paragraph (h)(4) (including a range certification) and that certified percentage is superseded by a subsequent determination of the adjusted funding target attainment percentage for that plan year, then, except to the extent provided in paragraph (h)(4)(iv)(B) of this section, that later percentage must be applied for the portion of the plan year

beginning on the date of the earlier certification. The subsequent determination could be the correction of a prior incorrect certification or it could be an update of a prior correct certification to take into account subsequent facts under the rules of paragraph (h)(4)(v) of this section. The implications of such a change depend on whether the change is a material change or an immaterial change. *See* paragraph (h)(4)(iv) of this section.

(B) *Material change*. A change in a plan's certified adjusted funding target attainment percentage constitutes a material change for a plan year if plan operations with respect to benefits that are addressed by section 436, taking into account any actual contributions and elections under section 430(f) made by the plan sponsor based on the prior certified percentage, would have been different based on the subsequent determination of the plan's adjusted funding target attainment percentage for the plan year. A change in a plan's adjusted funding target attainment percentage for a plan year can be a material change even if the only impact of the change occurs in the following plan year under the rules for determining the presumed adjusted funding target attainment percentage in that following year.

(C) *Immaterial change*. In general, an immaterial change is any change in an adjusted funding target attainment percentage for a plan year that is not a material change. In addition, subject to the requirement to recertify the adjusted funding target attainment percentage in paragraph (h)(4)(v)(B) of this section, a change in adjusted funding target attainment percentage is deemed to be an immaterial change if it merely reflects a change in the funding target for the plan year or the value of the adjusted plan assets after the date of the enrolled actuary's certification resulting from—

(*1*) Additional contributions for the preceding year that are made by the plan sponsor;

(*2*) The plan sponsor's election to reduce the prefunding balance or funding standard carryover balance;

(*3*) The plan sponsor's election to apply the prefunding balance or funding standard carryover balance to offset the prior plan year's minimum required contribution;

(*4*) A change in funding method or actuarial assumptions, where such change required actual approval of the Commissioner (rather than deemed approval);

(*5*) Unpredictable contingent event benefits which are permitted to be paid because the employer makes the section 436 contribution described in paragraph (f)(2)(iii)(A) of this section;

(*6*) Unpredictable contingent event benefits which are permitted to be paid because the plan's enrolled actuary determines that the increase in the funding target attributable to the occurrence of the unpredictable contingent event would not cause the plan's adjusted funding target attainment percentage to fall below 60 percent;

(*7*) A plan amendment which takes effect because the employer makes the section 436 contribution described in paragraph (f)(2)(iv)(A) of this section, the liability for which was not taken into account in the certification of the adjusted funding target attainment percentage;

(*8*) A plan amendment which takes effect because the plan's enrolled actuary determines that the increase in the funding target attributable to the plan amendment would not cause the plan's adjusted funding target attainment percentage to fall below 80 percent, the liability for which was not taken into account in the certification of the adjusted funding target attainment percentage; or

(*9*) Any other event prescribed in guidance published in the Internal Revenue Bulletin.

(iv) *Effect of change in percentage*—(A) *Material change*. In the case of a material change, if the plan's prior operations were in accordance with the prior certification of the adjusted funding target attainment percentage for the plan year (rather than the actual adjusted funding target attainment percentage for the plan year), then the plan will not have satisfied the requirements of section 401(a)(29) and section 436. Even if the plan's prior operations were in accordance with the subsequent certification of the adjusted funding target attainment percentage, the plan will not have satisfied the

qualification requirements of section 401(a) because the plan will not have been operated in accordance with its terms during the period of time the prior certification applied. In addition, in the case of a material change, the rules requiring application of a presumed adjusted funding target attainment percentage under paragraphs (h)(1) through (h)(3) of this section continue to apply from and after the date of the prior certification until the date of the subsequent certification.

(B) *Immaterial change.* An immaterial change in the adjusted funding target attainment percentage applies prospectively only and does not change the inapplicability of the presumptions under paragraphs (h)(1), (2), and (3) of this section prior to the date of the later certification.

(v) *Rules relating to updated certification*—(A) *In general.* This paragraph (h)(4)(v) sets forth rules relating to updates of an actuary's certification of the plan's adjusted funding target attainment percentage for a plan year. Paragraphs (h)(4)(v)(B) and (D) of this section require that an updated adjusted funding target attainment percentage be certified in certain situations. Even if the updated adjusted funding target attainment percentage is not required to be certified, plan administrators may request that the actuary prepare an updated certification of the adjusted funding target attainment percentage, as described in paragraphs (h)(4)(v)(C) and (E) of this section. Any updated adjusted funding target attainment percentage determined under this paragraph (h)(4)(v) will apply beginning as of the date of the event that gave rise to the need for the update which is a section 436 measurement date. Thus, pursuant to this paragraph (h)(4)(v), the updated funding target attainment percentage applies thereafter for all purposes of section 436, including application with respect to unpredictable contingent events occurring on or after the measurement date (but not for unpredictable contingent events that occurred before such measurement date or for benefits with annuity starting dates before that measurement date). The updated adjusted funding target attainment percentage will continue to apply for the remainder of the plan year and will be used for the presumed adjusted funding target attainment percentage for the next plan year, unless there is a later updated certification of adjusted funding target attainment percentage for the plan year.

(B) *Requirement to recertify AFTAP if plan sponsor contributes to threshold.* If, during the plan year, unpredictable contingent event benefits are permitted to be paid, a plan amendment takes effect, or benefits are permitted to accrue because the plan sponsor makes a contribution described in paragraph (f)(2)(iii)(B), (f)(2)(iv)(B), or (f)(2)(v) of this section, then, in accordance with paragraph (f)(2)(ii)(C) of this section, the plan's enrolled actuary must issue an updated certification of the adjusted funding target attainment percentage that takes into account such contribution as well as the liability for unpredictable contingent event benefits that are permitted to be paid, plan amendments that take effect during the plan year, and restored benefits.

(C) *Optional recertification of AFTAP after other unpredictable contingent event or plan amendment.* Except as provided in paragraph (h)(4)(v)(D) of this section, if, during a plan year, unpredictable contingent event benefits are permitted to be paid, or a plan amendment takes effect, because either the plan sponsor makes a contribution described in paragraph (f)(2)(iii)(A) or (f)(2)(iv)(A) of this section, or the plan's enrolled actuary determines that the increase in the funding target attributable to the occurrence of the unpredictable contingent event or the plan amendment would not cause the plan's adjusted funding target attainment percentage to fall below the applicable 60 percent or 80 percent threshold (taking into account the occurrence of all previous unpredictable contingent event benefits and plan amendments to the extent not already reflected in the certified adjusted funding target attainment percentage for the plan year (or update)), then the plan administrator may request that the plan actuary issue an updated certification of the adjusted funding target attainment percentage that takes into account the

unpredictable contingent event benefits or plan amendments and any associated section 436 contribution.

(D) *Requirement to recertify AFTAP after deemed immaterial change.* If a change in the adjusted funding target attainment percentage as a result of one of the items listed in paragraph (h)(4)(iii)(C) of this section would be a material change, then the change is treated as an immaterial change only if the plan's enrolled actuary recertifies the adjusted funding target attainment percentage for the plan year as soon as practicable after the event that gives rise to the change.

(E) *Optional recertification after other immaterial change.* If a change in the adjusted funding target attainment percentage is immaterial, then the plan administrator may request that the plan actuary issue an updated certification of the adjusted funding target attainment percentage that takes into account the unpredictable contingent event benefits or plan amendments and any associated section 436 contribution.

(5) *Examples of rules of paragraphs (h)(1), (h)(2), and (h)(3) of this section.* The following examples illustrate the rules of paragraphs (h)(1), (h)(2), and (h)(3) of this section. Unless otherwise indicated, the examples in this section are based on the information in this paragraph (h)(5). Each plan is a noncollectively bargained defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. The plan year is subject to section 436 in 2008. The plan does not have a funding standard carryover balance or a prefunding balance as of any of the dates mentioned, and the plan sponsor does not elect to utilize any of the methods in paragraph (f) of this section to avoid applicable benefit restrictions. No range certification under paragraph (h)(4) of this section has been issued. The plan sponsor is not in bankruptcy. The examples read as follows:

Example 1. (i) On July 15, 2010, the adjusted funding target attainment percentage (''AFTAP'') for Plan T for 2010 is certified to be 65%. Based on this AFTAP, Plan T is subject to the restriction on prohibited payments in paragraph (d)(3) of this section for the remainder of 2010.

(ii) Beginning January 1, 2011, Plan T's AFTAP for 2011 is presumed to be equal to the AFTAP for 2010, or 65%, under the provisions of paragraph (h)(1)(ii) of this section. Accordingly, the restriction on prohibited payments in paragraph (d)(3) of this section continues to apply.

(iii) On March 1, 2011, the enrolled actuary for the plan certifies that the actual AFTAP for 2011 is 80%. Therefore, beginning March 1, 2011, Plan T is no longer subject to the restriction under paragraph (d)(3) of this section, and so Plan T resumes paying the full amount of any prohibited payments elected by participants with an annuity starting date of March 1, 2011, or later.

Example 2. (i) The facts are the same as in *Example 1*, except that the enrolled actuary for the plan does not certify the AFTAP for 2011 until June 1, 2011, when it is certified to be 66%.

(ii) Beginning January 1, 2011, Plan T's AFTAP for 2011 is presumed to be equal to the AFTAP for 2010, or 65%, under the provisions of paragraph (h)(1)(ii) of this section. Accordingly, the restriction on prohibited payments in paragraph (d)(3) of this section continues to apply.

(iii) Pursuant to paragraph (h)(2)(iv) of this section, beginning April 1, 2011, the AFTAP for 2011 is presumed to be 55% (10 percentage points less than the AFTAP for 2010). Plan T is subject to the restriction on prohibited payments under paragraph (d)(1) of this section for annuity starting dates on or after April 1, 2011. In addition, Plan T is subject to the restriction on unpredictable contingent event benefits under paragraph (b) of this section for unpredictable contingent events occurring on or after April 1, 2011 and benefits are required to be frozen on and after April 1, 2011 under paragraph (e) of this section.

(iv) Once the enrolled actuary for the plan certifies that the AFTAP for 2011 for Plan T is 66%, Plan T is no longer subject to the restriction under paragraph (d)(1) of this section, but it is subject to the restriction under paragraph (d)(3) of this section. Plan T must resume paying prohibited payments, as restricted under paragraph (d)(3) of this section, for participants who elect benefits in accelerated forms of payment and who have an annuity starting date of June 1, 2011, or later. In addition, Plan T must provide benefits for any unpredictable contingent event occurring on or after January 1, 2011, to the extent permitted under paragraph (b) of this section. Similarly, Plan T is no longer subject to the restriction on benefit accruals under paragraph (e) of this section, and benefit accruals resume under Plan T beginning June 1, 2011, unless Plan T provides otherwise.

Example 3. (i) The facts are the same as in *Example 1*, except that the enrolled actuary for the plan does not certify the 2011 AFTAP until November 15, 2011. Beginning October 1, 2011, Plan T is conclusively presumed to have

an AFTAP of less than 60%, in accordance with the provisions of paragraph (h)(3) of this section. Accordingly, Plan T is subject to the restrictions in paragraphs (b), (d)(1), and (e) of this section commencing on October 1, 2011.

(ii) On November 15, 2011, the enrolled actuary for the plan certifies that the AFTAP for 2011 is 72%. However, because the certification occurred after September 30, 2011, the certification does not constitute a new section 436 measurement date, and Plan T continues to be subject to the restrictions on unpredictable contingent event benefits, prohibited payments, and benefit accruals under paragraphs (b), (d)(1), and (e) of this section.

(iii) Beginning January 1, 2012, the 2012 AFTAP for Plan T is presumed to be equal to the 2011 AFTAP of 72%. Because the presumed 2012 AFTAP is between 70% and 80% and, therefore, paragraph (h)(2) of this section (which provides for a 10 percentage point reduction in a plan's AFTAP in certain cases) will not apply, the presumed AFTAP will remain at 72% until the plan's enrolled actuary certifies the AFTAP for 2012 or until paragraph (h)(3) of this section applies on the first day of the 10th month of the plan year. Because the presumed AFTAP is 72%, Plan T is no longer subject to the restrictions on prohibited payments under paragraph (d)(1) of this section, and Plan T must provide benefits for any unpredictable contingent event occurring on or after January 1, 2012, to the extent permitted under paragraph (b) of this section and must resume paying prohibited payments, as restricted under paragraph (d)(3) of this section, that are elected by participants with annuity starting dates on or after January 1, 2012. Similarly, Plan T is no longer subject to the restriction on benefit accruals under paragraph (e) of this section, and benefit accruals resume under Plan T beginning January 1, 2012, unless Plan T provides otherwise.

Example 4. (i) The facts are the same as in *Example 3,* except that the enrolled actuary for the plan does not issue a certification of the AFTAP for 2011 for Plan T until February 1, 2012.

(ii) Beginning on January 1, 2012, the presumptions in paragraph (h)(1)(iii) of this section apply for the 2012 plan year. Because the enrolled actuary for the plan has not certified the AFTAP for 2011, the presumed AFTAP as of October 1, 2011, continues to apply for the period beginning January 1, 2012. Therefore, the AFTAP as of January 1, 2012, is presumed to be less than 60%, and Plan T continues to be subject to the restrictions on unpredictable contingent event benefits under paragraph (b) of this section, prohibited payments under paragraph (d)(1) of this section, and benefit accruals under paragraph (e) of this section.

(iii) On February 1, 2012, the enrolled actuary for the plan certifies that the AFTAP for 2011 for Plan T is 65%. Because the enrolled actuary for the plan has not issued a certification of the AFTAP for 2012, the provisions of paragraph (h)(1)(iii)(B) of this section apply. Accordingly, the certification date for the 2011 AFTAP (February 1, 2012) is a section 436 measurement date and 65% is the presumed AFTAP for 2012 beginning on that date.

(iv) Because the presumed AFTAP is over 60% but less than 80%, the full restriction on prohibited payments under paragraph (d)(1) of this section no longer applies; however, the partial restriction on prohibited payments under paragraph (d)(3) of this section applies beginning on February 1, 2012. Therefore, Plan T must pay a portion of the prohibited payments elected by participants with annuity starting dates on or after February 1, 2012. Furthermore, based on the presumed AFTAP of 65%, the restriction on unpredictable contingent event benefits under paragraph (b) of this section ceases to apply for events occurring on or after February 1, 2012, to the extent permitted under paragraph (b) of this section and the restriction on benefit accruals under paragraph (e) of this section no longer applies so that, unless Plan T provides otherwise, benefit accruals will resume as of February 1, 2012.

Example 5. (i) The facts are the same as in *Example 3,* except that the enrolled actuary for the plan does not issue a certification of the actual AFTAP for Plan T as of January 1, 2011, until May 1, 2012.

(ii) Beginning on January 1, 2012, the presumptions in paragraph (h)(1)(iii) of this section apply for the 2012 plan year. Because the enrolled actuary for the plan has not certified the actual AFTAP as of January 1, 2011, the presumed AFTAP as of October 1, 2011, continues to apply for the period beginning January 1, 2012. Therefore, the AFTAP as of January 1, 2012, is presumed to be less than 60%, and Plan T continues to be subject to the restrictions on unpredictable contingent event benefits under paragraph (b) of this section, on prohibited payments under paragraph (d)(1) of this section, and on benefit accruals under paragraph (e) of this section.

(iii) Since the enrolled actuary for the plan has not issued a certification of the actual AFTAP as of January 1, 2011, the rules of paragraph (h)(1)(iii) of this section apply beginning April 1, 2012, and the AFTAP is presumed to remain less than 60%. Plan T continues to be subject to the restrictions on unpredictable contingent event benefits under paragraph (b) of this section, on prohibited payments under paragraph (d)(1) of this section, and on benefit accruals under paragraph (e) of this section.

(iv) On May 1, 2012, the enrolled actuary for the plan certifies that the actual AFTAP for 2011 for Plan T is 65%. Because the enrolled actuary for the plan has not issued a

certification of the actual AFTAP as of January 1, 2012, the provisions of paragraph (h)(2)(iv) of this section apply. Accordingly, on May 1, 2012, the 2012 AFTAP is presumed to be 10 percentage points less than the 2011 AFTAP, or 55%, so that the restrictions under paragraphs (b), (d), and (e) of this section continue to apply.

Example 6. (i) The enrolled actuary for Plan V certifies the plan's AFTAP for 2010 to be 69%. Based on this AFTAP, Plan V is subject to the restriction in paragraph (d)(3) of this section, and can only pay a portion (generally 50%) of the prohibited payments otherwise due to plan participants who commence benefits while the restriction is in effect. The enrolled actuary for the plan does not issue a certification of the AFTAP for 2011 until June 1, 2011.

(ii) Beginning January 1, 2011, Plan V's 2011 AFTAP is presumed to be equal to the 2010 AFTAP, or 69%, under the provisions of paragraph (h)(1)(ii) of this section. Accordingly, the restriction on prohibited payments in paragraph (d)(3) of this section continues to apply from January 1, 2011, through March 31, 2011, and Plan T may only pay a portion of the prohibited payments otherwise due to participants who commence benefit payments during this period.

(iii) Beginning April 1, 2011, the provisions of paragraph (h)(2)(ii) of this section apply. Under those provisions, the AFTAP beginning April 1, 2011, is presumed to be 10 percentage points lower than the presumed 2011 AFTAP, or 59%. Because Plan V's presumed AFTAP for 2011 is less than 60%, the restrictions on unpredictable contingent event benefits under paragraph (b) of this section, on the payment of accelerated benefit distributions under paragraph (d)(1) of this section, and on benefit accruals under paragraph (e) of this section apply. Accordingly, Plan V cannot pay any unpredictable contingent event benefits for events occurring on or after April 1, 2011, or prohibited payments to participants with an annuity starting date on or after April 1, 2011, and benefit accruals cease as of April 1, 2011.

(iv) On June 1, 2011, Plan V's enrolled actuary certifies that the plan's AFTAP for 2011 is 71%. Therefore, the restrictions on unpredictable contingent event benefits, prohibited payments, and benefit accruals in paragraphs (b), (d)(1), and (e) of this section no longer apply, but the partial restriction on benefit payments in paragraph (d)(3) of this section does apply. Accordingly, Plan V begins paying unpredictable contingent event benefits for events occurring on or after January 1, 2011, to the extent permitted under paragraph (b) of this section and a portion of the prohibited payments elected by participants with an annuity starting date on or after June 1, 2011. Benefit accruals previously restricted under paragraph (e) of this section resume effective June 1, 2011, unless Plan V provides otherwise.

(v) Participants who were not able to elect an accelerated form of payment during the period from April 1, 2011, through May 31, 2011, would be able to elect a new annuity starting date with a partial distribution of accelerated benefits effective June 1, 2011, if Plan V contained a preexisting provision permitting such an election after the restriction in paragraph (d)(1) of this section no longer applies. This is permitted because, under paragraph (a)(4)(ii)(B) of this section, a preexisting provision of this type is not considered a plan amendment and is therefore not subject to the plan amendment restriction in paragraph (c) of this section even though Plan V's AFTAP for 2011 is less than 80%.

(vi) Benefit accruals for the period beginning April 1, 2011, through May 31, 2011, would be automatically restored if Plan V contained a preexisting provision to retroactively restore benefit accruals restricted under paragraph (e) of this section after the restriction no longer applies. This is permitted because under paragraph (a)(4)(ii)(B) of this section, a preexisting provision of this type is not considered to be a plan amendment and is therefore not subject to the plan amendment restriction in paragraph (c) of this section even though Plan V's AFTAP for 2011 is less than 80%, because the period of the restriction did not exceed 12 months.

(6) *Examples of rules of paragraph (h)(4) of this section.* The following examples illustrate the rules of paragraph (h)(4) of this section:

Example 1. (i) Plan Y is a non-collectively bargained defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. Plan Y does not have a funding standard carryover balance or a prefunding balance. Plan Y's sponsor is not in bankruptcy. In June of 2010, the actual AFTAP for 2010 for Plan Y is certified as 65%. On the last day of the 2010 plan year, Plan Y is subject to the restrictions in paragraph (d)(3) of this section.

(ii) The enrolled actuary for the plan issues a range certification on March 21, 2011, certifying that the AFTAP for 2011 is at least 60% and less than 80%. Because the certification was issued before the first day of the 4th month of the plan year, the 10 percentage point reduction in the presumed AFTAP under paragraph (h)(2) of this section does not apply. In addition, because the enrolled actuary for the plan has certified that the AFTAP is within this range, Plan Y is not subject to the full restriction on accelerated benefit payments in paragraph (d)(1) of this section or the restriction on benefit accruals under paragraph (e) of this section.

(iii) On August 1, 2011, the enrolled actuary for the plan certifies that the actual AFTAP as of January 1, 2011, is 75.86%. This AFTAP falls within the previously certified range. Thus, the change is immaterial under paragraph (h)(4)(iii) of this section and the new certification does not change the applicability or inapplicability of the restrictions in this section.

Example 2. (i) The facts are the same as in *Example 1*, except that the plan sponsor makes an additional contribution for the 2010 plan year on September 1, 2011, that is not added to the prefunding balance. Reflecting this contribution, the enrolled actuary for the plan issues a revised certification stating that the AFTAP for 2011 is 81%, and Plan Y is no longer subject to the restriction on accelerated benefit payments under paragraph (d)(3) of this section on that date.

(ii) Although the revised certification changes the applicability of the restriction under paragraph (d)(3) of this section, the change is not a material change under paragraph (h)(4)(iii)(C)(*1*) of this section because the AFTAP changed only because of additional contributions for the preceding year made by the plan sponsor after the date of the enrolled actuary's initial certification.

(i) [Reserved]

(j) *Definitions.* For purposes of this section—

(1) *Adjusted funding target attainment percentage*—(i) *In general.* Except as otherwise provided in this paragraph (j)(1), the *adjusted funding target attainment percentage* for a plan year is the fraction (expressed as a percentage)—

(A) The numerator of which is the adjusted plan assets for the plan year described in paragraph (j)(1)(ii) of this section; and

(B) The denominator of which is the adjusted funding target for the plan year described in paragraph (j)(1)(iii) of this section.

(ii) *Adjusted plan assets*—(A) *General rule.* The adjusted plan assets for a plan year is generally determined by—

(*1*) Subtracting the plan's funding standard carryover balance and prefunding balance as of the valuation date from the value of plan assets for the plan year under section 430(g) (but treating the resulting value as zero if it is below zero); and

(*2*) Increasing the resulting value by the aggregate amount of purchases of annuities for participants and beneficiaries (other than participants who, at the time of the purchase, were highly compensated employees as defined in section 414(q), which definition includes highly compensated former employees under §1.414(q)–1T, Q&A–4) which were made by the plan during the preceding 2 plan years, to the extent not included in plan assets for purposes of section 430.

(B) *Special rule for plans that are fully funded without regard to subtraction of funding balances from plan assets.* If for a plan year the value of plan assets determined without subtracting the funding standard carryover balance and the prefunding balance is not less than 100 percent of the plan's funding target determined under section 430 without regard to section 430(i), then the adjusted value of plan assets used in the calculation of the adjusted funding target attainment percentage for the plan year is determined without subtracting the plan's funding standard carryover balance and prefunding balance from the value of plan assets for the plan year.

(C) *Special rule for plans with section 436 contributions.* If an employer makes a contribution described in paragraph (f)(2) of this section after the valuation date in order to avoid or terminate limitations under section 436, then the present value of that contribution (determined using the effective interest rate under section 430(h)(2)(A) for the plan year) is permitted to be added to the plan assets as of the valuation date for purposes of determining or redetermining the adjusted funding target attainment percentage for a plan year, but only if the liability for the benefits, amendment, or accruals that would have been limited (but for the contribution) is included in determining the adjusted funding target for the plan year.

(D) *Transition rule.* Paragraph (j)(1)(ii)(B) of this section is applied to plan years beginning after 2007 and before 2011 by substituting for ''100 percent'' the applicable percentage determined in accordance with the following table:

In the case of a plan year beginning in calendar year:	The applicable percentage is:
2008	92
2009	94
2010	96

(E) *Limitation on transition rule.* Paragraph (j)(1)(ii)(D) of this section does

not apply with respect to the current plan year unless, for each plan year beginning after December 31, 2007, and before the current plan year, the value of plan assets determined without subtracting the funding standard carryover balance and the prefunding balance is not less than the product of—

(*1*) The applicable percentage determined under paragraph (j)(1)(ii)(D) of this section for that plan year; and

(*2*) The funding target (determined without regard to the at-risk rules of section 430(i)) for that plan year.

(iii) *Adjusted funding target*—(A) *In general*. Except as otherwise provided in this paragraph (j)(1)(iii), the adjusted funding target equals the funding target for the plan year, determined in accordance with the rules set forth in §1.430(d)–1, but without regard to the at-risk rules under section 430(i), increased by the aggregate amount of purchases of annuities that were added to assets for purposes of determining the plan's adjusted plan assets under paragraph (j)(1)(ii)(A)(*2*) of this section. The definition of adjusted funding target for a plan maintained by a commercial airline for which the plan sponsor has made the election described in section 402(a)(1) of Pension Protection Act of 2006 (PPA '06), Public Law 109–280 (120 Stat. 780), is the same as if it did not make such an election.

(B) *Adjusted funding target after updated certification*. After the plan's enrolled actuary prepares an updated certification of the adjusted funding target attainment percentage under paragraph (h)(4)(v) of this section, the adjusted funding target will also be updated to reflect unpredictable contingent event benefits and plan amendments not already taken into account.

(iv) *Plans with zero adjusted funding target*. If the adjusted funding target for the plan year is zero, then the adjusted funding target attainment percentage for the plan year is 100 percent.

(v) *Plans with end of year valuation dates*. [Reserved]

(vi) *Special rule for plans that are the result of a merger*. [Reserved]

(vii) *Special rule for plans that are involved in a spinoff*. [Reserved]

(2) *Annuity starting date*—(i) *General rule*. The term *annuity starting date* means, as applicable—

(A) The first day of the first period for which an amount is payable as an annuity as described in section 417(f)(2)(A)(i);

(B) In the case of a benefit not payable in the form of an annuity, the annuity starting date is the annuity starting date for the qualified joint and survivor annuity that is payable under the plan at the same time as the benefit that is not payable as an annuity;

(C) In the case of an amount payable under a retroactive annuity starting date, the benefit commencement date (instead of the date determined under paragraphs (j)(2)(i)(A) and (B) of this section);

(D) The date of the purchase of an irrevocable commitment from an insurer to pay benefits under the plan; and

(E) The date of any transfer to another plan described in paragraph (j)(6)(i)(C) of this section.

(ii) *Special rule for beneficiaries*. If a participant commences benefits at an annuity starting date (as defined in paragraph (j)(2)(i) of this section) and, after the death of the participant, payments continue to a beneficiary, the annuity starting date for the payments to the participant constitutes the annuity starting date for payments to the beneficiary, except that a new annuity starting date occurs (determined by applying paragraph (j)(2)(i)(A), (B), and (C) of this section to the payments to the beneficiary) if the amounts payable to all beneficiaries of the participant in the aggregate at any future date can exceed the monthly amount that would have been paid to the participant had he or she not died.

(3) *First effective plan year*. The *first effective plan year* for a plan is the first plan year to which section 436 applies to the plan under paragraph (k)(1) or (k)(2) of this section.

(4) *Funding target*. In general, the *funding target* means the funding target under §1.430(d)–1, without regard to the at-risk rules under section 430(i) and §1.430(i)–1. However, solely for purposes of sections 436(b)(2)(A) and (c)(2)(A), the funding target means the funding target under §1.430(i)–1 if the plan is in at-risk status for the plan year.

(5) *Prior plan year adjusted funding target attainment percentage*—(i) *In general*. Except as otherwise provided in

this paragraph (j)(5), the *prior plan year adjusted funding target attainment percentage* is the adjusted funding target attainment percentage determined under paragraph (j)(1) of this section for the immediately preceding plan year.

(ii) *Special rules*—(A) *Special rule for new plans*. In the case of a plan established during the plan year that was not the result of a merger or spinoff, the adjusted funding target attainment percentage is equal to 100 percent for plan years before the plan was established. Except as otherwise provided in paragraph (j)(5)(ii)(B) of this section, a plan that has a predecessor plan in accordance with §1.415(f)–1(c) is not a plan established during the plan year under this paragraph (j)(5)(ii)(A). Instead, if the plan has a predecessor plan, the adjusted funding target attainment percentage for the prior plan year is the adjusted funding target attainment percentage for the prior plan year for the predecessor plan (and that predecessor plan's adjusted funding target attainment percentage is treated as equal to 100 percent on any date on which it is terminated, other than in a distress termination).

(B) *Special rules for plans that are the result of a merger*. [Reserved]

(C) *Special rules for plans that are involved in a spinoff*. [Reserved]

(iii) *Special rules for 2007 plan year*—(A) *General determination of 2007 adjusted funding target attainment percentage*. In the case of the first plan year beginning in 2008, except as otherwise provided in this paragraph (j)(5), the adjusted funding target attainment percentage for the immediately preceding plan year (the 2007 plan year) is determined as the fraction (expressed as a percentage)—

(*1*) The numerator of which is the value of plan assets determined under paragraph (j)(5)(iii)(B) of this section increased by the aggregate amount of purchases of annuities for participants and beneficiaries (other than participants who, at the time of the purchase, were highly compensated employees as defined in section 414(q), which definition includes highly compensated former employees under §1.414(q)–1T, Q&A–4 which were made by the plan during the preceding 2 plan years, to the extent not included in plan assets under section 412(c)(2) (as in effect prior to amendment by PPA '06); and

(*2*) The denominator of which is the plan's current liability determined pursuant to section 412(l)(7) (as in effect prior to amendment by PPA '06) on the valuation date for the 2007 plan year increased by the aggregate amount of purchases of annuities that were added to the plan assets under the rules of paragraph (j)(5)(iii)(A)(*1*) of this section.

(B) *General determination of value of plan assets*—(*1*) *In general*. The value of plan assets for purposes of this paragraph (j)(5)(iii) is determined under section 412(c)(2) as in effect for the 2007 plan year, except that the value of plan assets prior to subtracting the plan's funding standard account credit balance described in paragraph (j)(5)(iii)(B)(*2*) of this section must be adjusted so that the value of plan assets is neither less than 90 percent of the fair market value of plan assets nor greater than 110 percent of the fair market value of plan assets on the valuation date for that plan year.

(*2*) *Subtraction of credit balance*. If a plan has a funding standard account credit balance as of the valuation date for the 2007 plan year, that balance is subtracted from the value of plan assets described in paragraph (j)(5)(iii)(B)(*1*) of this section as of that valuation date. However, the subtraction does not apply if the value of plan assets prior to adjustment under paragraph (j)(5)(iii)(B)(*1*) of this section is greater than or equal to 90 percent of the plan's current liability as of the valuation date for the 2007 plan year.

(*3*) *Effect of funding standard carryover balance reduction for 2007 plan year*. Notwithstanding paragraph (j)(5)(iii)(B)(*2*) of this section, if, for the first plan year beginning in 2008, the employer has made an election to reduce some or all of the funding standard carryover balance as of the first day of that year in accordance with §1.430(f)–1(e), then the present value (determined as of the valuation date for the 2007 plan year using the valuation interest rate for that plan year) of the amount so reduced is not treated as part of the funding standard account credit balance when that balance is subtracted

from the asset value under paragraph (j)(5)(iii)(B)(*2*) of this section.

(C) *Plan with end-of-year valuation date*. With respect to the first plan year beginning in 2008, if the plan had a valuation date under section 412 that was the last day of the plan year for each of the plan years beginning in 2006 and 2007, the adjusted funding target attainment percentage for the 2007 plan year may be determined as the fraction (expressed as a percentage)—

(*1*) The numerator of which is the value of plan assets determined under paragraph (j)(5)(iii)(D) of this section increased by the aggregate amount of purchases of annuities for participants and beneficiaries (other than participants who, at the time of the purchase, were highly compensated employees as defined in section 414(q), which definition includes highly compensated former employees under §1.414(q)–1T, Q&A–4 which were made by the plan during the preceding 2 plan years, to the extent not included in plan assets under section 412(c)(2) (as in effect prior to amendment by PPA '06); and

(*2*) The denominator of which is the plan's current liability determined pursuant to section 412(l)(7) (as in effect prior to amendment by PPA '06) on the valuation date for the second plan year that begins before 2008 (the 2006 plan year), including the increase in current liability for the 2006 plan year, increased by the aggregate amount of purchases of annuities that were added to the plan assets under the rules of paragraph (j)(5)(iii)(C)(*1*) of this section.

(D) *Special asset determinations for 2006 adjusted funding target attainment percentage*—(*1*) *General rule*. If the adjusted funding target attainment percentage for the 2007 plan year is determined under the rules of paragraph (j)(5)(iii)(C) of this section, then the value of plan assets is determined as the value of plan assets under section 412(c)(2) as in effect for the 2006 plan year, adjusted as provided in this paragraph (j)(5)(iii)(D).

(*2*) *Inclusion of contributions for 2006*. Contributions made for the 2006 plan year are taken into account in determining the value of plan assets, regardless of whether those contributions are made during the plan year or after the end of the plan year and within the period specified under section 412(c)(10) (as in effect prior to amendment by PPA '06).

(*3*) *Restriction to 90–110 percent corridor*. The value of plan assets taking into account the amount of contributions made for the 2006 plan year is increased or decreased, as necessary, so that it is neither less than 90 percent of the fair market value of plan assets nor greater than 110 percent of the fair market value of plan assets on the valuation date for the 2006 plan year (taking into account assets attributable to contributions for the 2006 plan year).

(*4*) *Subtraction of credit balance*. The plan's funding standard account credit balance as of the end of the 2006 plan year is generally subtracted from the value of plan assets determined after application of paragraph (j)(5)(iii)(D)(*3*) of this section. However, this subtraction does not apply if the value of plan assets is greater than or equal to 90 percent of the plan's current liability determined under section 412(l)(7) (as in effect prior to amendment by PPA '06) on the valuation date for the 2006 plan year.

(E) *Special rules for mergers and spinoffs*. Rules similar to the rules of paragraph (j)(5)(ii) of this section apply for purposes of determining the adjusted funding target attainment percentage for the 2007 plan year in the case of a newly established plan, a plan that is the result of a merger of two plans, or a plan that is in involved in a spinoff.

(6) *Prohibited payment*—(i) *General rule*. The term *prohibited payment* means—

(A) Any payment for a month that is in excess of the monthly amount paid under a straight life annuity (plus any social security supplements described in the last sentence of section 411(a)(9)) to a participant or beneficiary whose annuity starting date occurs during any period that a limitation under paragraph (d) of this section is in effect;

(B) Any payment for the purchase of an irrevocable commitment from an insurer to pay benefits;

(C) Any transfer of assets and liabilities to another plan maintained by the same employer (or by any member of

the employer's controlled group) that is made in order to avoid or terminate the application of section 436 benefit limitations; and

(D) Any other amount that is identified as a prohibited payment by the Commissioner in revenue rulings and procedures, notices, and other guidance published in the Internal Revenue Bulletin (*see* §601.601(d)(2) relating to objectives and standards for publishing regulations, revenue rulings and revenue procedures in the Internal Revenue Bulletin).

(ii) *Special rule for beneficiaries.* In the case of a beneficiary that is not an individual, the amount that is a prohibited payment is determined by substituting for the amount in paragraph (j)(1)(i)(A) of this section the monthly amount payable in installments over 240 months that is actuarially equivalent to the benefit payable to the beneficiary.

(7) *Section 436 contributions. Section 436 contributions* are the contributions described in paragraph (f)(2) of this section that are made in order to avoid the application of section 436 limitations under a plan for a plan year.

(8) *Section 436 measurement date.* A *section 436 measurement date* is the date that is used to determine when the limitations of sections 436(d) and 436(e) apply or cease to apply, and is also used for calculations with respect to applying the limitations of paragraphs (b) and (c) of this section. *See* paragraphs (h)(1)(i), (h)(2)(iii)(B), (h)(2)(iv)(B), and (h)(3)(i) of this section regarding section 436 measurement dates that result from application of the presumptions under paragraph (h) of this section.

(9) *Unpredictable contingent event.* An *unpredictable contingent event benefit* means any benefit or increase in benefits to the extent the benefit or increase would not be payable but for the occurrence of an unpredictable contingent event. For this purpose, an *unpredictable contingent event* means a plant shutdown (whether full or partial) or similar event, or an event (including the absence of an event) other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability. For example, if a plan provides for an unreduced early retirement benefit upon the occurrence of an event other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability, then that unreduced early retirement benefit is an unpredictable contingent event benefit to the extent of any portion of the benefit that would not be payable but for the occurrence of the event, even if the remainder of the benefit is payable without regard to the occurrence of the event. Similarly, if a plan includes a benefit payable upon the presence (including the absence) of circumstances specified in the plan (other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability), but not upon a severance from employment that does not include those circumstances, that benefit is an unpredictable contingent event benefit.

(10) *Examples.* The following examples illustrate the rules of this paragraph (j):

Example 1. (i) Plan S is a non-collectively bargained defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. The first effective plan year is 2008. Plan S is not in at-risk status for 2008.

(ii) As of January 1, 2008, Plan S has a value of plan assets (equal to the market value of assets) of $2,100,000 and a funding standard carryover balance of $200,000. During 2006, assets from Plan S were used to purchase a total of $100,000 in annuities for employees other than highly compensated employees. No annuities were purchased during 2007. On May 1, 2008, the enrolled actuary for the plan determines that the funding target as of January 1, 2008, is $2,500,000.

(iii) The adjusted value of assets for Plan S as of January 1, 2008, is $2,000,000 (that is, plan assets of $2,100,000, plus annuity purchases of $100,000, and minus the funding standard carryover balance of $200,000). The adjusted funding target is $2,600,000 (that is, the funding target of $2,500,000, increased by the annuity purchases of $100,000).

(iv) Based on the above adjusted plan assets and adjusted funding target, the adjusted funding target attainment percentage (AFTAP) as of January 1, 2008, would be 76.92%. Since the AFTAP is less than 80% but is at least 60%, Plan S is subject to the restrictions in paragraph (d)(3) of this section.

Example 2. (i) The facts are the same as in *Example 1*, except that it is reasonable to expect that the plan sponsor will make a contribution of $80,000 to Plan S for the 2007 plan year by September 15, 2008. This amount is in excess of the minimum required contribution for 2007. The plan sponsor elects to reduce the funding standard carryover balance by $80,000.

(ii) Because it is reasonable to expect that the $80,000 will be contributed by the plan sponsor, that amount is taken into account when the enrolled actuary certifies the 2008 AFTAP under the special rule in paragraph (h)(4)(i)(B) of this section for plan years beginning before 2009. Accordingly, the enrolled actuary for the plan certifies the 2008 AFTAP as 80% (that is, adjusted plan assets of $2,080,000, reflecting the $80,000 in contributions receivable, divided by the adjusted funding target of $2,600,000).

(iii) The ability to take contributions into account before they are actually paid to the plan is available only for plan years beginning before 2009. Furthermore, if the employer does not actually make the contribution and the difference between the incorrect certification and the corrected AFTAP constitutes a material change, the plan will have violated section 401(a)(29) or will not have been operated in accordance with its terms.

Example 3. (i) Plan R is a defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. Section 436 applies to Plan R for 2008. The valuation interest rate for the 2007 plan year for Plan R is 7%. The fair market value of assets of Plan R as of January 1, 2007, is $1,000,000. The actuarial value of assets of Plan R as of January 1, 2007, is $1,200,000. The current liability of Plan R as of January 1, 2007, is $1,500,000. The funding standard account credit balance as of January 1, 2007, is $80,000. The funding standard carryover balance of Plan R is $50,000 as of the beginning of the 2008 plan year. The sponsor of Plan R, Sponsor T, elects in 2008 to reduce the funding standard carryover balance in accordance with §1.430(f)–1 by $45,000. No annuities were purchased using plan assets during 2005 or 2006.

(ii) Pursuant to paragraph (j)(5)(iii)(B)(*1*) of this section, the asset value used to determine the AFTAP for the 2007 plan year is limited to 110% of the fair market value of assets on January 1, 2007, or $1,100,000 (110% of $1,000,000).

(iii) Pursuant to paragraph (j)(5)(iii)(B)(*2*) of this section, the funding standard account credit balance as of January 1, 2007, is subtracted from the asset value used to determine the AFTAP for the 2007 plan year. However, pursuant to paragraph (j)(5)(iii)(B)(*3*) of this section, the present value of the amount by which Sponsor T elected to reduce the funding standard carryover balance in 2008 is not subtracted.

(iv) The present value, determined at an interest rate of 7%, of the $45,000 reduction in the funding standard carryover balance elected by Sponsor T in 2008 is $42,056. Thus, $42,056 is not subtracted from the 2007 plan year asset value. Accordingly, the funding standard account credit balance that is subtracted from the 2007 plan year asset value is $37,944 (that is, $80,000 less $42,056).

(v) Thus, the asset value that is used to determine the FTAP for the 2007 plan year is $1,100,000 less $37,944, or $1,062,056. Accordingly, for purposes of this section, the FTAP for the 2007 plan year for Plan R is 70.8% (that is, $1,062,056 divided by $1,500,000).

Example 4. (i) Plan T is a non-collectively bargained defined benefit plan that was established prior to 2007. Plan T has a plan year that is the calendar year and a valuation date of January 1. The first effective plan year is 2008; the plan met the conditions of paragraph (j)(1)(ii)(E) of this section for 2008. As of January 1, 2009, Plan T has a value of plan assets (equal to the market value of assets) of $3,000,000, a funding standard carryover balance of $150,000, and a prefunding balance of $50,000. During 2007 and 2008, assets from Plan T were used to purchase a total of $400,000 in annuities for employees other than highly compensated employees. The funding target for Plan T (without regard to the at-risk rules of section 430(i)) is $3,200,000 as of January 1, 2009.

(ii) The plan's funding status is calculated in accordance with paragraph (j)(1)(ii)(B) of this section to determine whether the special rule for fully-funded plans applies to Plan T. Accordingly, the value of plan assets determined without subtracting the funding standard carryover balance and the prefunding balance is 93.75% of the plan's funding target ($3,000,000 ÷ $3,200,000). The applicable transitional percentage in paragraph (j)(1)(ii)(D) of this section is 94% for 2009. Because the percentage calculated above is less than 94%, the transition rule does not apply to Plan T.

(iii) Accordingly, the January 1, 2009, AFTAP for Plan T is calculated without reflecting the special rule in paragraph (j)(1)(ii)(B) of this section. The AFTAP as of January 1, 2009, is calculated by dividing the adjusted assets by the adjusted funding target. For this purpose, the value of assets is increased by the annuities purchased for nonhighly compensated employees during 2007 and 2008, and decreased by the funding standard carryover balance and the prefunding balance as of January 1, 2009, resulting in an adjusted asset value of $3,200,000 (that is, $3,000,000 + $400,000 − $150,000 − $50,000). The funding target is increased by the annuities purchased for nonhighly compensated employees during

2007 and 2008, resulting in an adjusted funding target of $3,600,000 (that is, $3,200,000 + $400,000). The AFTAP for Plan T for 2009 is therefore $3,200,000 ÷ $3,600,000, or 88.89%.

(k) *Effective/applicability dates*—(1) *Statutory effective date*. Section 436 generally applies to plan years beginning on or after January 1, 2008. The applicability of section 436 for purposes of determining the minimum required contribution is delayed for certain plans in accordance with sections 104 through 106 of PPA '06.

(2) *Collectively bargained plan exception*—(i) *In general*. In the case of a collectively bargained plan that is maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before January 1, 2008, section 436 does not apply to plan years beginning before the earlier of—

(A) January 1, 2010; or

(B) The later of—

(*1*) The date on which the last such collective bargaining agreement relating to the plan terminates (determined without regard to any extension thereof agreed to after August 17, 2006); or

(*2*) The first day of the first plan year to which section 436 would (but for this paragraph (k)(2)) apply.

(ii) *Treatment of certain plan amendments*. For purposes of this paragraph (k)(2), any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement added by section 436 is not treated as a termination of the collective bargaining agreement.

(iii) *Treatment of plans with both collectively bargained and non-collectively bargained employees*. In the case of a plan with respect to which a collective bargaining agreement applies to some, but not all, of the plan participants, the plan is considered a collectively bargained plan for purposes of this paragraph (k)(2) if it is considered a collectively bargained plan under the rules of paragraph (a)(5)(ii)(B) of this section.

(3) *Effective date/applicability date of regulations*. This section applies to plan years beginning on or after January 1, 2010. For plan years beginning before January 1, 2010, plans are permitted to rely on the provisions set forth in this section for purposes of satisfying the requirements of section 436.

[T.D. 9467, 74 FR 53061, Oct. 15, 2009, as amended by T.D. 9732, 80 FR 54400, Sept. 9, 2015]

§§ 1.437–1.440 [Reserved]

FINDING AIDS

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The OMB control numbers for chapter I of title 26 were consolidated into §§ 601.9000 and 602.101 at 50 FR 10221, Mar. 14, 1985. At 61 FR 58008, Nov. 12, 1996, § 601.9000 was removed. Section 602.101 is reprinted below for the convenience of the user.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

§ 602.101 OMB Control numbers.

(a) *Purpose*. This part collects and displays the control numbers assigned to collections of information in Internal Revenue Service regulations by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1980. The Internal Revenue Service intends that this part comply with the requirements of §§ 1320.7(f), 1320.12, 1320.13, and 1320.14 of 5 CFR part 1320 (OMB regulations implementing the Paperwork Reduction Act), for the display of control numbers assigned by OMB to collections of information in Internal Revenue Service regulations. This part does not display control numbers assigned by the Office of Management and Budget to collections of information of the Bureau of Alcohol, Tobacco, and Firearms.

(b) *Display*.

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1.50B–1	1545–0895
1.50B–2	1545–0895
1.50B–3	1545–0895

CFR part or section where identified and described	Current OMB control No.
1.50B–4	1545–0895
1.50B–5	1545–0895
1.51–1	1545–0219
	1545–0241
	1545–0244
	1545–0797
1.52–2	1545–0219
1.52–3	1545–0219
1.56–1	1545–0123
1.56(g)–1	1545–1233
1.56A–1	1545–0227
1.56A–2	1545–0227
1.56A–3	1545–0227
1.56A–4	1545–0227
1.56A–5	1545–0227
1.57–5	1545–0227
1.58–1	1545–0175
1.58–9(c)(5)(iii)(B)	1545–1093
1.58–9(e)(3)	1545–1093
1.59–1	1545–1903
1.61–2	1545–0771
1.61–2T	1545–0771
1.61–4	1545–0187
1.61–15	1545–0074
1.62–2	1545–1148
1.63–1	1545–0074
1.66–4	1545–1770
1.67–2T	1545–0110
1.67–3	1545–1018
1.67–3T	1545–0118
1.71–1T	1545–0074
1.72–4	1545–0074
1.72–6	1545–0074
1.72–9	1545–0074
1.72–17	1545–0074
1.72–17A	1545–0074
1.72–18	1545–0074
1.74–1	1545–1100
1.79–2	1545–0074
1.79–3	1545–0074
1.83–2	1545–0074
1.83–5	1545–0074
1.83–6	1545–1448
1.103–10	1545–0123
	1545–0940
1.103–15AT	1545–0720
1.103–18	1545–1226
1.103(n)–2T	1545–0874
1.103(n)–4T	1545–0874
1.103A–2	1545–0720
1.105–4	1545–0074
1.105–5	1545–0074
1.105–6	1545–0074
1.108–4	1545–1539
1.108–5	1545–1421
1.108–7	1545–2155
1.108(i)–1	1545–2147
1.108(i)–2	1545–2147
1.110–1	1545–1661
1.117–5	1545–0869
1.118–2	1545–1639
1.119–1	1545–0067
1.120–3	1545–0057
1.121–1	1545–0072
1.121–2	1545–0072
1.121–3	1545–0072
1.121–4	1545–0072
	1545–0091
1.121–5	1545–0072
1.127–2	1545–0768
1.132–1T	1545–0771
1.132–2	1545–0771
1.132–2T	1545–0771
1.132–5	1545–0771
1.132–5T	1545–0771
	1545–1098
1.132–9(b)	1545–1676
1.141–1	1545–1451
1.141–12	1545–1451
1.142–2	1545–1451
1.142(f)(4)–1	1545–1730
1.148–0	1545–1098
1.148–1	1545–1098
1.148–2	1545–1098
	1545–1347
1.148–3	1545–1098
	1545–1347
1.148–4	1545–1098
	1545–1347
1.148–5	1545–1098
	1545–1490
1.148–6	1545–1098
	1545–1451
1.148–7	1545–1098
	1545–1347
1.148–8	1545–1098
1.148–11	1545–1098
	1545–1347
1.149(e)–1	1545–0720
1.150–1	1545–1347
1.151–1	1545–0074
1.152–3	1545–0071
	1545–1783
1.152–4	1545–0074
1.152–4T	1545–0074
1.162–1	1545–0139
1.162–2	1545–0139
1.162–3	1545–0139
1.162–4	1545–0139
1.162–5	1545–0139
1.162–6	1545–0139
1.162–7	1545–0139
1.162–8	1545–0139
1.162–9	1545–0139
1.162–10	1545–0139
1.162–11	1545–0139
1.162–12	1545–0139
1.162–13	1545–0139
1.162–14	1545–0139
1.162–15	1545–0139
1.162–16	1545–0139
1.162–17	1545–0139
1.162–18	1545–0139
1.162–19	1545–0139
1.162–20	1545–0139
1.162–24	1545–2115
1.162–27	1545–1466
1.163–5	1545–0786
	1545–1132
1.163–8T	1545–0995
1.163–10T	1545–0074
1.163–13	1545–1491
1.163(d)–1	1545–1421
1.165–1	1545–0177
1.165–2	1545–0177
1.165–3	1545–0177
1.165–4	1545–0177
1.165–5	1545–0177
1.165–6	1545–0177
1.165–7	1545–0177
1.165–8	1545–0177
1.165–9	1545–0177
1.165–10	1545–0177
1.165–11	1545–0074

CFR part or section where identified and described	Current OMB control No.
	1545–0177
	1545–0786
1.165–12	1545–0786
1.166–1	1545–0123
1.166–2	1545–1254
1.166–4	1545–0123
1.166–10	1545–0123
1.167(a)–5T	1545–1021
1.167(a)–7	1545–0172
1.167(a)–11	1545–0152
	1545–0172
1.167(a)–12	1545–0172
1.167(d)–1	1545–0172
1.167(e)–1	1545–0172
1.167(f)–11	1545–0172
1.167(l)–1	1545–0172
1.168(d)–1	1545–1146
1.168(f)(8)–1T	1545–0923
1.168(i)–1	1545–1331
1.168–5	1545–0172
1.169–4	1545–0172
1.170–1	1545–0074
1.170–2	1545–0074
1.170–3	1545–0123
1.170A–1	1545–0074
1.170A–2	1545–0074
1.170A–4(A)(b)	1545–0123
1.170A–8	1545–0074
1.170A–9	1545–0052
	1545–0074
1.170A–11	1545–0074
	1545–0123
	1545–1868
1.170A–12	1545–0020
	1545–0074
1.170A–13	1545–0074
	1545–0754
	1545–0908
	1545–1431
1.170A–13(f)	1545–1464
1.170A–14	1545–0763
1.171–4	1545–1491
1.171–5	1545–1491
1.172–1	1545–0172
1.172–13	1545–0863
1.173–1	1545–0172
1.174–3	1545–0152
1.174–4	1545–0152
1.175–3	1545–0187
1.175–6	1545–0152
1.177–1	1545–0172
1.179–2	1545–1201
1.179–3	1545–1201
1.179–5	1545–0172
	1545–1201
1.179B–1T	1545–2076
1.179C–1	1545–2103
1.179C–1T	1545–2103
1.180–2	1545–0074
1.181–1	1545–2059
1.181–2	1545–2059
1.181–3	1545–2059
1.182–6	1545–0074
1.183–1	1545–0195
1.183–2	1545–0195
1.183–3	1545–0195
1.183–4	1545–0195
1.190–3	1545–0074
1.194–2	1545–0735
1.194–4	1545–0735
1.195–1	1545–1582
1.197–1T	1545–1425
1.197–2	1545–1671
1.199–6	1545–1966
1.213–1	1545–0074
1.215–1T	1545–0074
1.217–2	1545–0182
1.243–3	1545–0123
1.243–4	1545–0123
1.243–5	1545–0123
1.248–1	1545–0172
1.261–1	1545–1041
1.263(a)–1	1545–2248
1.263(a)–3	1545–2248
1.263(a)–5	1545–1870
1.263(e)–1	1545–0123
1.263A–1	1545–0987
1.263A–1T	1545–0187
1.263A–2	1545–0987
1.263A–3	1545–0987
1.263A–8(b)(2)(iii)	1545–1265
1.263A–9(d)(1)	1545–1265
1.263A–9(f)(1)(ii)	1545–1265
1.263A–9(f)(2)(iv)	1545–1265
1.263A–9(g)(2)(iv)(C)	1545–1265
1.263A–9(g)(3)(iv)	1545–1265
1.265–1	1545–0074
1.265–2	1545–0123
1.266–1	1545–0123
1.267(f)–1	1545–0885
1.268–1	1545–0184
1.274–1	1545–0139
1.274–2	1545–0139
1.274–3	1545–0139
1.274–4	1545–0139
1.274–5	1545–0771
1.274–5A	1545–0139
	1545–0771
1.274–5T	1545–0074
	1545–0172
	1545–0771
1.274–6	1545–0139
	1545–0771
1.274–6T	1545–0074
	1545–0771
1.274–7	1545–0139
1.274–8	1545–0139
1.279–6	1545–0123
1.280C–4	1545–1155
1.280F–3T	1545–0074
1.280G–1	1545–1851
1.281–4	1545–0123
1.302–4	1545–0074
1.305–3	1545–0123
1.305–5	1545–1438
1.307–2	1545–0074
1.312–15	1545–0172
1.316–1	1545–0123
1.331–1	1545–0074
1.332–4	1545–0123
1.332–6	1545–2019
1.336–2	1545–2125
1.336–4	1545–2125
1.337(d)–1	1545–1160
1.337(d)–2	1545–1160
	1545–1774
1.337(d)–4	1545–1633
1.337(d)–5	1545–1672
1.337(d)–6	1545–1672
1.337(d)–7	1545–1672
1.338–2	1545–1658
1.338–5	1545–1658
1.338–10	1545–1658
1.338–11	1545–1990

CFR part or section where identified and described	Current OMB control No.
1.338(h)(10)–1	1545–1658
1.338(i)–1	1545–1990
1.341–7	1545–0123
1.351–3	1545–2019
1.355–5	1545–2019
1.362–2	1545–0123
1.362–4	1545–2247
1.367(a)–1T	1545–0026
1.367(a)–2T	1545–0026
1.367(a)–3	1545–0026
	1545–1478
1.367(a)–3T	1545–2183
1.367(a)–6T	1545–0026
1.367(a)–7	1545–2183
1.367(a)–7T	1545–2183
1.367(a)–8	1545–1271
	1545–2056
	1545–2183
1.367(b)–1	1545–1271
1.367(b)–3T	1545–1666
1.367(d)–1T	1545–0026
1.367(e)–1	1545–1487
1.367(e)–2	1545–1487
1.368–1	1545–1691
1.368–3	1545–2019
1.371–1	1545–0123
1.371–2	1545–0123
1.374–3	1545–0123
1.381(b)–1	1545–0123
1.381(c)(4)–1	1545–0123
	1545–0152
	1545–0879
1.381(c)(5)–1	1545–0123
	1545–0152
1.381(c)(6)–1	1545–0123
	1545–0152
1.381(c)(8)–1	1545–0123
1.381(c)(10)–1	1545–0123
1.381(c)(11)–1(k)	1545–0123
1.381(c)(13)–1	1545–0123
1.381(c)(17)–1	1545–0045
1.381(c)(22)–1	1545–1990
1.381(c)(25)–1	1545–0045
1.382–1T	1545–0123
1.382–2	1545–0123
1.382–2T	1545–0123
1.382–3	1545–1281
	1545–1345
1.382–4	1545–1120
1.382–6	1545–1381
1.382–8	1545–1434
1.382–9	1545–1120
	1545–1260
	1545–1275
	1545–1324
1.382–11	1545–2019
1.382–91	1545–1260
	1545–1324
1.383–1	1545–0074
	1545–1120
1.401–1	1545–0020
	1545–0197
	1545–0200
	1545–0534
	1545–0710
1.401(a)–11	1545–0710
1.401(a)–20	1545–0928
1.401(a)–31	1545–1341
1.401(a)–50	1545–0710
1.401(a)(9)–1	1545–1573
1.401(a)(9)–3	1545–1466
1.401(a)(9)–4	1545–1573
1.401(a)(9)–6	1545–2234
1.401(a)(31)–1	1545–1341
1.401(b)–1	1545–0197
1.401(f)–1	1545–0710
1.401(k)–1	1545–1039
	1545–1069
	1545–1669
	1545–1930
1.401(k)–2	1545–1669
1.401(k)–3	1545–1669
1.401(k)–4	1545–1669
1.401(m)–3	1545–1699
1.401–12(n)	1545–0806
1.401–14	1545–0710
1.402(c)–2	1545–1341
1.402(f)–1	1545–1341
	1545-1632
1.402A–1	1545–1992
1.403(b)–1	1545–0710
1.403(b)–3	1545–0996
1.403(b)–7	1545–1341
1.403(b)–10	1545–2068
1.404(a)–4	1545–0710
1.404(a)–12	1545–0710
1.404A–2	1545–0123
1.404A–6	1545–0123
1.408–2	1545–0390
1.408–5	1545–0747
1.408–6	1545–0203
	1545–0390
1.408–7	1545–0119
1.408(q)–1	1545–1841
1.408A–2	1545–1616
1.408A–4	1545–1616
1.408A–5	1545–1616
1.408A–7	1545–1616
1.410(a)–2	1545–0710
1.410(d)–1	1545–0710
1.411(a)–11	1545–1471
	1545–1632
1.411(d)–4	1545–1545
1.411(d)–6	1545–1477
1.412(b)–5	1545–0710
1.412(c)(1)–2	1545–0710
1.412(c)(2)–1	1545–0710
1.412(c)(3)–2	1545–0710
1.414(c)–5	1545–0797
1.414(r)–1	1545–1221
1.415–2	1545–0710
1.415–6	1545–0710
1.417(a)(3)–1	1545–0928
1.417(e)–1	1545–1471
	1545–1724
1.417(e)–1T	1545–1471
1.419A(f)(6)–1	1545–1795
1.422–1	1545–0820
1.430(f)–1	1545–2095
1.430(g)–1	1545–2095
1.430(h)(2)–1	1545–2095
1.432(e)(9)–1T	1545–2260
1.436–1	1545–2095
1.441–2	1545–1748
1.442–1	1545–0074
	1545–0123
	1545–0134
	1545–0152
	1545–0820
	1545–1748
1.443–1	1545–0123
1.444–3T	1545–1036
1.444–4	1545–1591
1.446–1	1545–0074

CFR part or section where identified and described	Current OMB control No.
	1545–0152
1.446–4(d)	1545–1412
1.448–1(g)	1545–0152
1.448–1(h)	1545–0152
1.448–1(i)	1545–0152
1.448–2	1545–1855
1.448–2T	1545–0152
	1545–1855
1.451–1	1545–0091
1.451–4	1545–0123
1.451–5	1545–0074
1.451–6	1545–0074
1.451–7	1545–0074
1.453–1	1545–0152
1.453–2	1545–0152
1.453–8	1545–0152
	1545–0228
1.453–10	1545–0152
1.453A–1	1545–0152
	1545–1134
1.453A–2	1545–0152
	1545–1134
1.453A–3	1545–0963
1.454–1	1545–0074
1.455–2	1545–0152
1.455–6	1545–0123
1.456–2	1545–0123
1.456–6	1545–0123
1.456–7	1545–0123
1.457–8	1545–1580
1.458–1	1545–0879
1.458–2	1545–0152
1.460–1	1545–1650
1.460–6	1545–1031
	1545–1572
	1545–1732
1.461–1	1545–0074
1.461–2	1545–0096
1.461–4	1545–0917
1.461–5	1545–0917
1.463–1T	1545–0916
1.465–1T	1545–0712
1.466–1T	1545–0152
1.466–4	1545–0152
1.468A–3	1545–1269
	1545–1378
	1545–1511
1.468A–3(h), 1.468A–7, and 1.468A–8(d)	1545–2091
1.468A–4	1545–0954
1.468A–7	1545–0954
	1545–1511
1.468A–8	1545–1269
1.468B–1	1545–1631
1.468B–1(j)	1545–1299
1.468B–2(k)	1545–1299
1.468B–2(l)	1545–1299
1.468B–3(b)	1545–1299
1.468B–3(e)	1545–1299
1.468B–5(b)	1545–1299
1.468B–9	1545–1631
1.469–1	1545–1008
1.469–2T	1545–0712
	1545–1091
1.469–4T	1545–0985
	1545–1037
1.469–7	1545–1244
1.471–2	1545–0123
1.471–5	1545–0123
1.471–6	1545–0123
1.471–8	1545–0123
1.471–11	1545–0123
	1545–0152

CFR part or section where identified and described	Current OMB control No.
1.472–1	1545–0042
	1545–0152
1.472–2	1545–0152
1.472–3	1545–0042
1.472–5	1545–0152
1.472–8	1545–0028
	1545–0042
	1545–1767
1.475(a)–4	1545–1945
1.475(b)–4	1545–1496
1.481–4	1545–0152
1.481–5	1545–0152
1.482–1	1545–1364
1.482–4	1545–1364
1.482–7	1545–1364
	1545–1794
1.482–9(b)	1545–2149
1.501(a)–1	1545–0056
	1545–0057
1.501(c)(3)–1	1545–0056
1.501(c)(9)–5	1545–0047
1.501(c)(17)–3	1545–0047
1.501(e)–1	1545–0814
1.501(r)–3	1545–0047
1.501(r)–4	1545–0047
1.501(r)–6	1545–0047
1.503(c)–1	1545–0047
	1545–0052
1.505(c)–1T	1545–0916
1.507–1	1545–0052
1.507–2	1545–0052
1.508–1	1545–0052
	1545–0056
1.509(a)–3	1545–0047
1.509(a)–4	1545–2157
1.509(a)–5	1545–0047
1.509(c)–1	1545–0052
1.512(a)–1	1545–0687
1.512(a)–4	1545–0047
	1545–0687
1.521–1	1545–0051
	1545–0058
1.527–2	1545–0129
1.527–5	1545–0129
1.527–6	1545–0129
1.527–9	1545–0129
1.528–8	1545–0127
1.533–2	1545–0123
1.534–2	1545–0123
1.542–3	1545–0123
1.545–2	1545–0123
1.545–3	1545–0123
1.547–2	1545–0045
	1545–0123
1.547–3	1545–0123
1.551–4	1545–0074
1.552–3	1545–0099
1.552–4	1545–0099
1.552–5	1545–0099
1.556–2	1545–0704
1.561–1	1545–0044
1.561–2	1545–0123
1.562–3	1545–0123
1.563–2	1545–0123
1.564–1	1545–0123
1.565–1	1545–0043
	1545–0123
1.565–2	1545–0043
1.565–3	1545–0043
1.565–5	1545–0043
1.565–6	1545–0043
1.585–1	1545–0123

CFR part or section where identified and described	Current OMB control No.
1.585–3	1545–0123
1.585–8	1545–1290
1.586–2	1545–0123
1.593–1	1545–0123
1.593–6	1545–0123
1.593–6A	1545–0123
1.593–7	1545–0123
1.595–1	1545–0123
1.597–2	1545–1300
1.597–4	1545–1300
1.597–6	1545–1300
1.597–7	1545–1300
1.611–2	1545–0099
1.611–3	1545–0007
	1545–0099
	1545–1784
1.612–4	1545–0074
1.612–5	1545–0099
1.613–3	1545–0099
1.613–4	1545–0099
1.613–6	1545–0099
1.613–7	1545–0099
1.613A–3	1545–0919
1.613A–3(e)	1545–1251
1.613A–3(l)	1545–0919
1.613A–5	1545–0099
1.613A–6	1545–0099
1.614–2	1545–0099
1.614–3	1545–0099
1.614–5	1545–0099
1.614–6	1545–0099
1.614–8	1545–0099
1.617–1	1545–0099
1.617–3	1545–0099
1.617–4	1545–0099
1.631–1	1545–0007
1.631–2	1545–0007
1.641(b)–2	1545–0092
1.642(c)–1	1545–0092
1.642(c)–2	1545–0092
1.642(c)–5	1545–0074
1.642(c)–6	1545–0020
	1545–0074
	1545–0092
1.642(g)–1	1545–0092
1.642(i)–1	1545–0092
1.645–1	1545–1578
1.663(b)–2	1545–0092
1.664–1	1545–0196
1.664–1(a)(7)	1545–1536
1.664–1(c)	1545–2101
1.664–2	1545–0196
1.664–3	1545–0196
1.664–4	1545–0020
	1545–0196
1.665(a)–0A through	
1.665(g)–2A	1545–0192
1.666(d)–1A	1545–0092
1.671–4	1545–1442
1.671–5	1545–1540
1.701–1	1545–0099
1.702–1	1545–0074
1.703–1	1545–0099
1.704–2	1545–1090
1.706–1	1545–0074
	1545–0099
	1545–0134
1.706–1T	1545–0099
1.706–4(f)	1545–0123
1.707–3(c)(2)	1545–1243
1.707–5(a)(7)(ii)	1545–1243
1.707–6(c)	1545–1243
1.707–8	1545–1243
1.708–1	1545–0099
1.732–1	1545–0099
	1545–1588
1.736–1	1545–0074
1.743–1	1545–0074
	1545–1588
1.751–1	1545–0074
	1545–0099
	1545–0941
1.752–2	1545–1905
1.752–5	1545–1090
1.752–7	1545–1843
1.754–1	1545–0099
1.755–1	1545–0099
1.761–2	1545–1338
1.801–1	1545–0123
	1545–0128
1.801–3	1545–0123
1.801–5	1545–0128
1.801–8	1545–0128
1.804–4	1545–0128
1.811–2	1545–0128
1.812–2	1545–0128
1.815–6	1545–0128
1.818–4	1545–0128
1.818–5	1545–0128
1.818–8	1545–0128
1.819–2	1545–0128
1.821–1	1545–1027
1.821–3	1545–1027
1.821–4	1545–1027
1.822–5	1545–1027
1.822–6	1545–1027
1.822–8	1545–1027
1.822–9	1545–1027
1.823–2	1545–1027
1.823–5	1545–1027
1.823–6	1545–1027
1.825–1	1545–1027
1.826–1	1545–1027
1.826–2	1545–1027
1.826–3	1545–1027
1.826–4	1545–1027
1.826–6	1545–1027
1.831–3	1545–0123
1.831–4	1545–0123
1.832–4	1545–1227
1.832–5	1545–0123
1.848–2(g)(8)	1545–1287
1.848–2(h)(3)	1545–1287
1.848–2(i)(4)	1545–1287
1.851–2	1545–1010
1.851–4	1545–0123
1.852–1	1545–0123
1.852–4	1545–0123
	1545–0145
1.852–6	1545–0123
	1545–0144
1.852–7	1545–0074
1.852–9	1545–0074
	1545–0123
	1545–0144
	1545–0145
	1545–1783
1.852–11	1545–1094
1.853–3	1545–2035
1.853–4	1545–2035
1.854–2	1545–0123
1.855–1	1545–0123
1.856–2	1545–0123
	1545–1004

CFR part or section where identified and described	Current OMB control No.
1.856–6	1545–0123
1.856–7	1545–0123
1.856–8	1545–0123
1.857–8	1545–0123
1.857–9	1545–0074
1.858–1	1545–0123
1.860–2	1545–0045
1.860–4	1545–0045
	1545–1054
	1545–1057
1.860E–1	1545–1675
1.860E–2(a)(5)	1545–1276
1.860E–2(a)(7)	1545–1276
1.860E–2(b)(2)	1545–1276
1.860G–2	1545–2110
1.861–2	1545–0089
1.861–3	1545–0089
1.861–4	1545–1900
1.861–8	1545–0126
1.861–8(e)(6) and (g)	1545–1224
1.861–9T	1545–0121
	1545–1072
1.861–18	1545–1594
1.863–1	1545–1476
1.863–3	1545–1476
	1545–1556
1.863–3A	1545–0126
1.863–4	1545–0126
1.863–7	1545–0132
1.863–8	1545–1718
1.863–9	1545–1718
1.864–4	1545–0126
1.871–1	1545–0096
1.871–6	1545–0795
1.871–7	1545–0089
1.871–10	1545–0089
	1545–0165
1.874–1	1545–0089
1.881–4	1545–1440
1.882–4	1545–0126
1.883–0	1545–1677
1.883–1	1545–1677
1.883–2	1545–1677
1.883–3	1545–1677
1.883–4	1545–1677
1.883–5	1545–1677
1.884–0	1545–1070
1.884–1	1545–1070
1.884–2	1545–1070
1.884–2T	1545–0126
	1545–1070
1.884–4	1545–1070
1.884–5	1545–1070
1.892–1T	1545–1053
1.892–2T	1545–1053
1.892–3T	1545–1053
1.892–4T	1545–1053
1.892–5T	1545–1053
1.892–6T	1545–1053
1.892–7T	1545–1053
1.897–2	1545–0123
	1545–0902
1.897–3	1545–0123
1.897–5T	1545–0902
1.897–6T	1545–0902
1.901–2	1545–0746
1.901–2A	1545–0746
1.901–3	1545–0122
1.902–1	1545–0122
	1545–1458
1.904–1	1545–0121
	1545–0122
1.904–2	1545–0121
	1545–0122
1.904–3	1545–0121
1.904–4	1545–0121
1.904–5	1545–0121
1.904–7	1545–2104
1.904–7T	1545–2104
1.904(f)–1	1545–0121
	1545–0122
1.904(f)–2	1545–0121
1.904(f)–3	1545–0121
1.904(f)–4	1545–0121
1.904(f)–5	1545–0121
1.904(f)–6	1545–0121
1.904(f)–7	1545–1127
1.905–2	1545–0122
1.905–3T	1545–1056
1.905–4T	1545–1056
1.905–5T	1545–1056
1.911–1	1545–0067
	1545–0070
1.911–2	1545–0067
	1545–0070
1.911–3	1545–0067
	1545–0070
1.911–4	1545–0067
	1545–0070
1.911–5	1545–0067
	1545–0070
1.911–6	1545–0067
	1545–0070
1.911–7	1545–0067
	1545–0070
1.913–13	1545–0067
1.921–1T	1545–0190
	1545–0884
	1545–0935
	1545–0939
1.921–2	1545–0884
1.921–3T	1545–0935
1.923–1T	1545–0935
1.924(a)–1T	1545–0935
1.925(a)–1T	1545–0935
1.925(b)–1T	1545–0935
1.926(a)–1T	1545–0935
1.927(a)–1T	1545–0935
1.927(b)–1T	1545–0935
1.927(d)–1	1545–0884
1.927(d)–2T	1545–0935
1.927(e)–1T	1545–0935
1.927(e)–2T	1545–0935
1.927(f)–1	1545–0884
1.931–1	1545–0074
	1545–0123
1.934–1	1545–0782
1.935–1	1545–0074
	1545–0087
	1545–0803
1.936–1	1545–0215
	1545–0217
1.936–4	1545–0215
1.936–5	1545–0704
1.936–6	1545–0215
1.936–7	1545–0215
1.936–10(c)	1545–1138
1.937–1	1545–1930
1.952–2	1545–0126
1.953–2	1545–0126
1.954–1	1545–1068
1.954–2	1545–1068
1.955–2	1545–0123
1.955–3	1545–0123

CFR part or section where identified and described	Current OMB control No.
1.955A–2	1545–0755
1.955A–3	1545–0755
1.956–1	1545–0704
1.956–2	1545–0704
1.959–1	1545–0704
1.959–2	1545–0704
1.960–1	1545–0122
1.962–2	1545–0704
1.962–3	1545–0704
1.962–4	1545–0704
1.964–1	1545–0126
	1545–0704
	1545–1072
	1545–2104
1.964–3	1545–0126
1.970–2	1545–0126
1.985–2	1545–1051
	1545–1131
1.985–3	1545–1051
1.988–0	1545–1131
1.988–1	1545–1131
1.988–2	1545–1131
1.988–3	1545–1131
1.988–4	1545–1131
1.988–5	1545–1131
1.988–6	1545–1831
1.992–1	1545–0190
	1545–0938
1.992–2	1545–0190
	1545–0884
	1545–0938
1.992–3	1545–0190
	1545–0938
1.992–4	1545–0190
	1545–0938
1.993–3	1545–0938
1.993–4	1545–0938
1.994–1	1545–0938
1.995–5	1545–0938
1.1001–1	1545–1902
1.1012–1	1545–0074
	1545–1139
1.1014–4	1545–0184
1.1015–1	1545–0020
1.1017–1	1545–1539
1.1031(d)–1T	1545–1021
1.1033(a)–2	1545–0184
1.1033(g)–1	1545–0184
1.1034–1	1545–0072
1.1039–1	1545–0184
1.1041–1T	1545–0074
1.1041–2	1545–1751
1.1042–1T	1545–0916
1.1044(a)–1	1545–1421
1.1045–1	1545–1893
1.1060–1	1545–1658
	1545–1990
1.1071–1	1545–0184
1.1071–4	1545–0184
1.1081–4	1545–0028
	1545–0046
	1545–0123
1.1081–11	1545–2019
1.1082–1	1545–0046
1.1082–2	1545–0046
1.1082–3	1545–0046
	1545–0184
1.1082–4	1545–0046
1.1082–5	1545–0046
1.1082–6	1545–0046
1.1083–1	1545–0123
1.1092(b)–1T	1545–0644
1.1092(b)–2T	1545–0644
1.1092(b)–3T	1545–0644
1.1092(b)–4T	1545–0644
1.1092(b)–5T	1545–0644
1.1211–1	1545–0074
1.1212–1	1545–0074
1.1221–2	1545–1480
1.1231–1	1545–0177
	1545–0184
1.1231–2	1545–0177
	1545–0184
1.1231–2	1545–0074
1.1232–3	1545–0074
1.1237–1	1545–0184
1.1239–1	1545–0091
1.1242–1	1545–0184
1.1243–1	1545–0123
1.1244(e)–1	1545–0123
	1545–1447
1.1245–1	1545–0184
1.1245–2	1545–0184
1.1245–3	1545–0184
1.1245–4	1545–0184
1.1245–5	1545–0184
1.1245–6	1545–0184
1.1247–1	1545–0122
1.1247–2	1545–0122
1.1247–4	1545–0122
1.1247–5	1545–0122
1.1248–7	1545–0074
1.1248(f)–2	1545–2183
1.1248(f)–3T	1545–2183
1.1250–1	1545–0184
1.1250–2	1545–0184
1.1250–3	1545–0184
1.1250–4	1545–0184
1.1250–5	1545–0184
1.1251–1	1545–0184
1.1251–2	1545–0074
	1545–0184
1.1251–3	1545–0184
1.1251–4	1545–0184
1.1252–1	1545–0184
1.1252–2	1545–0184
1.1254–1(c)(3)	1545–1352
1.1254–4	1545–1493
1.1254–5(d)(2)	1545–1352
1.1258–1	1545–1452
1.1272–3	1545–1353
1.1273–2(f)(9)	1545–1353
1.1273–2(h)(2)	1545–1353
1.1274–3(d)	1545–1353
1.1274–5(b)	1545–1353
1.1274A–1(c)	1545–1353
1.1275–2	1545–1450
1.1275–3	1545–0887
	1545–1353
	1545–1450
1.1275–4	1545–1450
1.1275–6	1545–1450
1.1287–1	1545–0786
1.1291–9	1545–1507
1.1291–10	1545–1304
	1545–1507
1.1294–1T	1545–1002
	1545–1028
1.1295–1	1545–1555
1.1295–3	1545–1555
1.1298–3	1545–1507
1.1301–1	1545–1662
1.1311(a)–1	1545–0074
1.1361–1	1545–0731

CFR part or section where identified and described	Current OMB control No.
	1545–1591
	1545–2114
1.1361–3	1545–1590
1.1361–5	1545–1590
1.1362–1	1545–1308
1.1362–2	1545–1308
1.1362–3	1545–1308
1.1362–4	1545–1308
1.1362–5	1545–1308
1.1362–6	1545–1308
1.1362–7	1545–1308
1.1362–8	1545–1590
1.1363–2	1545–1906
1.1366–1	1545–1613
1.1367–1(f)	1545–1139
1.1368–1(f)(2)	1545–1139
1.1368–1(f)(3)	1545–1139
1.1368–1(f)(4)	1545–1139
1.1368–1(g)(2)	1545–1139
1.1374–1A	1545–0130
1.1377–1	1545–1462
1.1378–1	1545–1748
1.1383–1	1545–0074
1.1385–1	1545–0074
	1545–0098
1.1388–1	1545–0118
	1545–0123
1.1397E–1	1545–1908
1.1398–1	1545–1375
1.1398–2	1545–1375
1.1402(a)–2	1545–0074
1.1402(a)–5	1545–0074
1.1402(a)–11	1545–0074
1.1402(a)–15	1545–0074
1.1402(a)–16	1545–0074
1.1402(b)–1	1545–0171
1.1402(c)–2	1545–0074
1.1402(e)(1)–1	1545–0074
1.1402(e)(2)–1	1545–0074
1.1402(e)–1A	1545–0168
1.1402(e)–2A	1545–0168
1.1402(e)–3A	1545–0168
1.1402(e)–4A	1545–0168
1.1402(e)–5A	1545–0168
1.1402(f)–1	1545–0074
1.1402(h)–1	1545–0064
1.1411–10(g)	1545–2227
1.1441–1	1545–1484
1.1441–2	1545–0795
1.1441–3	1545–0165
	1545–0795
1.1441–4	1545–1484
1.1441–5	1545–0096
	1545–0795
	1545–1484
1.1441–6	1545–0055
	1545–0795
	1545–1484
1.1441–7	1545–0795
1.1441–8	1545–1053
	1545–1484
1.1441–9	1545–1484
1.1443–1	1545–0096
1.1445–1	1545–0902
1.1445–2	1545–0902
	1545–1060
	1545–1797
1.1445–3	1545–0902
	1545–1060
	1545–1797
1.1445–4	1545–0902
1.1445–5	1545–0902
1.1445–6	1545–0902
	1545–1060
1.1445–7	1545–0902
1.1445–8	1545–0096
1.1445–9T	1545–0902
1.1445–10T	1545–0902
1.1446–1	1545–1934
1.1446–3	1545–1934
1.1446–4	1545–1934
1.1446–5	1545–1934
1.1446–6	1545–1934
1.1451–1	1545–0054
1.1451–2	1545–0054
1.1461–1	1545–0054
	1545–0055
	1545–0795
	1545–1484
1.1461–2	1545–0054
	1545–0055
	1545–0096
	1545–0795
1.1462–1	1545–0795
1.1492–1	1545–0026
1.1494–1	1545–0026
1.1502–5	1545–0257
1.1502–9	1545–1634
1.1502–9A	1545–0121
1.1502–13	1545–0123
	1545–0885
	1545–1161
	1545–1433
1.1502–16	1545–0123
1.1502–18	1545–0123
1.1502–19	1545–0123
	1545–1774
1.1502–20	1545–1774
1.1502–21	1545–1237
1.1502–21T	1545–2171
1.1502–31	1545–1344
1.1502–32	1545–1344
	1545–1774
1.1502–33	1545–1344
1.1502–35	1545–1828
1.1502–36	1545–2096
1.1502–47	1545–0123
1.1502–75	1545–0025
	1545–0123
	1545–0133
	1545–0152
1.1502–76	1545–1344
1.1502–76T	1545–2019
1.1502–77	1545–1699
1.1502–77A	1545–0123
	1545–1046
1.1502–77B	1545–1699
1.1502–78	1545–0582
1.1502–95	1545–1218
1.1502–95A	1545–1218
1.1502–96	1545–1218
1.1503–2	1545–1583
1.1503–2A	1545–1083
1.1503(d)–1	1545–1946
1.1503(d)–3	1545–1946
1.1503(d)–4	1545–1946
1.1503(d)–5	1545–1946
1.1503(d)–6	1545–1946
1.1552–1	1545–0123
1.1561–3	1545–0123
1.1563–1	1545–0123
	1545–0797
	1545–2019
1.1563–3	1545–0123

CFR part or section where identified and described	Current OMB control No.
1.5000A–3	1545–0074
1.5000A–4	1545–0074
1.6001–1	1545–0058
	1545–0074
	1545–0099
	1545–0123
	1545–0865
1.6011–1	1545–0055
	1545–0074
	1545–0085
	1545–0089
	1545–0090
	1545–0091
	1545–0096
	1545–0121
	1545–0458
	1545–0666
	1545–0675
	1545–0908
1.6011–2	1545–0055
	1545–0938
1.6011–3	1545–0238
	1545–0239
1.6011–4	1545–1685
1.6012–1	1545–0067
	1545–0074
	1545–0085
	1545–0089
	1545–0675
1.6012–2	1545–0047
	1545–0051
	1545–0067
	1545–0123
	1545–0126
	1545–0128
	1545–0130
	1545–0175
	1545–0687
	1545–0890
	1545–1023
	1545–1027
1.6012–3	1545–0047
	1545–0067
	1545–0092
	1545–0196
	1545–0687
1.6012–4	1545–0067
1.6012–5	1545–0067
	1545–0936
	1545–0967
	1545–0970
	1545–0991
	1545–1023
	1545–1033
	1545–1079
1.6012–6	1545–0067
	1545–0089
	1545–0129
1.6013–1	1545–0074
1.6013–2	1545–0091
1.6013–6	1545–0074
1.6013–7	1545–0074
1.6015–5	1545–1719
1.6015(a)–1	1545–0087
1.6015(b)–1	1545–0087
1.6015(d)–1	1545–0087
1.6015(e)–1	1545–0087
1.6015(f)–1	1545–0087
1.6015(g)–1	1545–0087
1.6015(h)–1	1545–0087
1.6015(i)–1	1545–0087
1.6017–1	1545–0074

CFR part or section where identified and described	Current OMB control No.
	1545–0087
	1545–0090
1.6031(a)–1	1545–1583
1.6031(b)–1T	1545–0099
1.6031(c)–1T	1545–0099
1.6032–1	1545–0099
1.6033–2	1545–0047
	1545–0049
	1545–0052
	1545–0092
	1545–0687
	1545–1150
	1545–2117
1.6033–3	1545–0052
1.6034–1	1545–0092
	1545–0094
1.6035–1	1545–0704
1.6035–2	1545–0704
1.6035–3	1545–0704
1.6037–1	1545–0130
	1545–1023
1.6038–2	1545–1617
	1545–2020
1.6038–3	1545–1617
1.6038A–2	1545–1191
1.6038A–3	1545–1191
	1545–1440
1.6038B–1	1545–1617
	1545–2183
1.6038B–1T	1545–0026
	1545–2183
1.6038B–2	1545–1617
1.6039–2	1545–0820
1.6041–1	1545–0008
	1545–0108
	1545–0112
	1545–0115
	1545–0120
	1545–0295
	1545–0350
	1545–0367
	1545–0387
	1545–0441
	1545–0957
	1545–1705
1.6041–2	1545–0008
	1545–0119
	1545–0350
	1545–0441
	1545–1729
1.6041–3	1545–1148
1.6041–4	1545–0115
	1545–0295
	1545–0367
	1545–0387
	1545–0957
1.6041–5	1545–0295
	1545–0367
	1545–0387
	1545–0957
1.6041–6	1545–0008
	1545–0115
1.6041–7	1545–0112
	1545–0295
	1545–0350
	1545–0367
	1545–0387
	1545–0441
	1545–0957
1.6042–1	1545–0110
1.6042–2	1545–0110
	1545–0295

CFR part or section where identified and described	Current OMB control No.
	1545–0367
	1545–0387
	1545–0957
1.6042–3	1545–0295
	1545–0367
	1545–0387
	1545–0957
1.6042–4	1545–0110
1.6043–1	1545–0041
1.6043–2	1545–0041
	1545–0110
	1545–0295
	1545–0387
1.6043–3	1545–0047
1.6044–1	1545–0118
1.6044–2	1545–0118
1.6044–3	1545–0118
1.6044–4	1545–0118
1.6044–5	1545–0118
1.6045–1	1545–0715
	1545–1705
1.6045–1(c)(3)(xi)(C)	1545–2186
1.6045–1(n)(5)	1545–2186
1.6045A–1	1545–2186
1.6045–2	1545–0115
1.6045–4	1545–1085
1.6046–1	1545–0704
	1545–0794
	1545–1317
1.6046–2	1545–0704
1.6046–3	1545–0704
1.6046A	1545–1646
1.6047–1	1545–0119
	1545–0295
	1545–0387
1.6047–2	1545–2234
1.6049–1	1545–0112
	1545–0117
	1545–0295
	1545–0367
	1545–0387
	1545–0597
	1545–0957
1.6049–2	1545–0117
1.6049–3	1545–0117
1.6049–4	1545–0096
	1545–0112
	1545–0117
	1545–1018
	1545–1050
1.6049–5	1545–0096
	1545–0112
	1545–0117
1.6049–6	1545–0096
1.6049–7	1545–1018
1.6049–7T	1545–0112
	1545–0117
	1545–0118
1.6050A–1	1545–0115
1.6050B–1	1545–0120
1.6050D–1	1545–0120
	1545–0232
1.6050E–1	1545–0120
1.6050H–1	1545–0901
	1545–1380
1.6050H–1T	1545–0901
1.6050H–2	1545–0901
	1545–1339
	1545–1380
1.6050I–2	1545–1449
1.6050J–1T	1545–0877
1.6050K–1	1545–0941

CFR part or section where identified and described	Current OMB control No.
1.6050S–1	1545–1678
1.6050S–2	1545–1729
1.6050S–3	1545–1678
1.6050S–4	1545–1729
1.6052–1	1545–0008
1.6052–2	1545–0008
1.6055–1	1545–2252
1.6055–2	1545–2252
1.6060–1	1545–0074
1.6060–1(a)(1)	1545–1231
1.6061–1	1545–0123
1.6062–1	1545–0123
1.6063–1	1545–0123
1.6065–1	1545–0123
1.6071–1	1545–0123
	1545–0810
1.6072–1	1545–0074
1.6072–2	1545–0123
	1545–0807
1.6073–1	1545–0087
1.6073–2	1545–0087
1.6073–3	1545–0087
1.6073–4	1545–0087
1.6074–1	1545–0123
1.6074–2	1545–0123
1.6081–1	1545–0066
	1545–0148
	1545–0233
	1545–1057
	1545–1081
1.6081–2	1545–0148
	1545–1036
	1545–1054
1.6081–3	1545–0233
1.6081–4	1545–0188
	1545–1479
1.6081–6	1545–0148
	1545–1054
1.6081–7	1545–0148
	1545–1054
1.6091–3	1545–0089
1.6107–1	1545–0074
	1545–1231
1.6109–1	1545–0074
1.6109–2	1545–2176
1.6115–1	1545–1464
1.6151–1	1545–0074
1.6153–1	1545–0087
1.6153–4	1545–0087
1.6161–1	1545–0087
1.6162–1	1545–0087
1.6164–1	1545–0135
1.6164–2	1545–0135
1.6164–3	1545–0135
1.6164–5	1545–0135
1.6164–6	1545–0135
1.6164–7	1545–0135
1.6164–8	1545–0135
1.6164–9	1545–0135
1.6302–1	1545–0257
1.6302–2	1545–0098
	1545–0257
1.6411–1	1545–0098
	1545–0135
	1545–0582
1.6411–2	1545–0098
	1545–0582
1.6411–3	1545–0098
	1545–0582
1.6411–4	1545–0582
1.6414–1	1545–0096
1.6425–1	1545–0170

CFR part or section where identified and described	Current OMB control No.
1.6425–2	1545–0170
1.6425–3	1545–0170
1.6654–1	1545–0087
	1545–0140
1.6654–2	1545–0087
1.6654–3	1545–0087
1.6654–4	1545–0087
1.6655(e)–1	1545–1421
1.6662–3(c)	1545–0889
1.6662–4(e) and (f)	1545–0889
1.6662–6	1545–1426
1.6694–1	1545–0074
1.6694–2	1545–0074
1.6694–2(c)	1545–1231
1.6694–2(c)(3)	1545–1231
1.6694–3(e)	1545–1231
1.6695–1	1545–0074
	1545–1385
1.6695–2	1545–1570
1.6696–1	1545–0074
	1545–0240
1.6851–1	1545–0086
	1545–0138
1.6851–2	1545–0086
	1545–0138
1.7476–1	1545–0197
1.7476–2	1545–0197
1.7519–2T	1545–1036
1.7520–1	1545–1343
1.7520–2	1545–1343
1.7520–3	1545–1343
1.7520–4	1545–1343
1.7701(l)–3	1545–1642
1.7872–15	1545–1792
1.9100–1	1545–0074
1.9101–1	1545–0008
2.1–4	1545–0123
2.1–5	1545–0123
2.1–6	1545–0123
2.1–10	1545–0123
2.1–11	1545–0123
2.1–12	1545–0123
2.1–13	1545–0123
2.1–20	1545–0123
2.1–22	1545–0123
2.1–26	1545–0123
3.2	1545–0123
4.954–1	1545–1068
4.954–2	1545–1068
5.6411–1	1545–0042
	1545–0074
	1545–0098
	1545–0129
	1545–0172
	1545–0582
	1545–0619
5c.44F–1	1545–0619
5c.128–1	1545–0123
5c.168(f)(8)–1	1545–0123
5c.168(f)(8)–2	1545–0123
5c.168(f)(8)–6	1545–0123
5c.168(f)(8)–8	1545–0123
5c.305–1	1545–0110
5c.442–1	1545–0152
5f.103–1	1545–0720
5f.103–3	1545–0720
5f.6045–1	1545–0715
6a.103A–2	1545–0123
	1545–0720
6a.103A–3	1545–0720
7.465–1	1545–0712
7.465–2	1545–0712
7.465–3	1545–0712
7.465–4	1545–0712
7.465–5	1545–0712
7.936–1	1545–0217
7.999–1	1545–0216
7.6039A–1	1545–0015
7.6041–1	1545–0115
11.410–1	1545–0710
11.412(c)–7	1545–0710
11.412(c)–11	1545–0710
12.7	1545–0190
12.8	1545–0191
12.9	1545–0195
14a.422A–1	1545–0123
15A.453–1	1545–0228
16.3–1	1545–0159
16A.126–2	1545–0074
16A.1255–1	1545–0184
16A.1255–2	1545–0184
18.1371–1	1545–0130
18.1378–1	1545–0130
18.1379–1	1545–0130
18.1379–2	1545–0130
20.2010–2	1545–0015
20.2011–1	1545–0015
20.2014–5	1545–0015
	1545–0260
20.2014–6	1545–0015
20.2016–1	1545–0015
20.2031–2	1545–0015
20.2031–3	1545–0015
20.2031–4	1545–0015
20.2031–6	1545–0015
20.2031–7	1545–0020
20.2031–10	1545–0015
20.2032–1	1545–0015
20.2032A–3	1545–0015
20.2032A–4	1545–0015
20.2032A–8	1545–0015
20.2039–4	1545–0015
20.2051–1	1545–0015
20.2053–3	1545–0015
20.2053–9	1545–0015
20.2053–10	1545–0015
20.2055–1	1545–0015
20.2055–2	1545–0015
	1545–0092
20.2055–3	1545–0015
20.2056(b)–4	1545–0015
20.2056(b)–7	1545–0015
	1545–1612
20.2056A–2	1545–1443
20.2056A–3	1545–1360
20.2056A–4	1545–1360
20.2056A–10	1545–1360
20.2106–1	1545–0015
20.2106–2	1545–0015
20.2204–1	1545–0015
20.2204–2	1545–0015
20.6001–1	1545–0015
20.6011–1	1545–0015
20.6018–1	1545–0015
	1545–0531
20.6018–2	1545–0015
20.6018–3	1545–0015
20.6018–4	1545–0015
	1545–0022
20.6036–2	1545–0015
20.6060–1(a)(1)	1545–1231
20.6061–1	1545–0015
20.6065–1	1545–0015
20.6075–1	1545–0015

CFR part or section where identified and described	Current OMB control No.
20.6081–1	1545–0015
	1545–0181
	1545–1707
20.6091–1	1545–0015
20.6107–1	1545–1231
20.6161–1	1545–0015
	1545–0181
20.6161–2	1545–0015
	1545–0181
20.6163–1	1545–0015
20.6166–1	1545–0181
20.6166A–1	1545–0015
20.6166A–3	1545–0015
20.6324A–1	1545–0754
20.7520–1	1545–1343
20.7520–2	1545–1343
20.7520–3	1545–1343
20.7520–4	1545–1343
22.0	1545–0015
25.2511–2	1545–0020
25.2512–2	1545–0020
25.2512–3	1545–0020
25.2512–5	1545–0020
25.2512–9	1545–0020
25.2513–1	1545–0020
25.2513–2	1545–0020
	1545–0021
25.2513–3	1545–0020
25.2518–2	1545–0959
25.2522(a)–1	1545–0196
25.2522(c)–3	1545–0020
	1545–0196
25.2523(a)–1	1545–0020
	1545–0196
25.2523(f)–1	1545–0015
25.2701–2	1545–1241
25.2701–4	1545–1241
25.2701–5	1545–1273
25.2702–5	1545–1485
25.2702–6	1545–1273
25.6001–1	1545–0020
	1545–0022
25.6011–1	1545–0020
25.6019–1	1545–0020
25.6019–2	1545–0020
25.6019–3	1545–0020
25.6019–4	1545–0020
25.6060–1(a)(1)	1545–1231
25.6061–1	1545–0020
25.6065–1	1545–0020
25.6075–1	1545–0020
25.6081–1	1545–0020
25.6091–1	1545–0020
25.6091–2	1545–0020
25.6107–1	1545–1231
25.6151–1	1545–0020
25.6161–1	1545–0020
25.7520–1	1545–1343
25.7520–2	1545–1343
25.7520–3	1545–1343
25.7520–4	1545–1343
26.2601–1	1545–0985
26.2632–1	1545–0985
	1545–1892
26.2642–1	1545–0985
26.2642–2	1545–0985
26.2642–3	1545–0985
26.2642–4	1545–0985
26.2642–6	1545–1902
26.2652–2	1545–0985
26.2654–1	1545–1902
26.2662–1	1545–0015
	1545–0985
26.2662–2	1545–0985
26.6060–1(a)(1)	1545–1231
26.6107–1	1545–1231
31.3102–3	1545–0029
	1545–0059
	1545–0065
31.3121(b)(19)–1	1545–0029
31.3121(d)–1	1545–0004
31.3121(i)–1	1545–0034
31.3121(k)–4	1545–0137
31.3121(r)–1	1545–0029
31.3121(s)–1	1545–0029
31.3121(v)(2)–1	1545–1643
31.3302(a)–2	1545–0028
31.3302(a)–3	1545–0028
31.3302(b)–2	1545–0028
31.3302(e)–1	1545–0028
31.3306(c)(18)–1	1545–0029
31.3401(a)–1	1545–0029
31.3401(a)(6)	1545–1484
31.3401(a)(6)–1	1545–0029
	1545–0096
	1545–0795
31.3401(a)(7)–1	1545–0029
31.3401(a)(8)(A)–1	1545–0029
	1545–0666
31.3401(a)(8)(C)–1	1545–0029
31.3401(a)(15)–1	1545–0182
31.3401(c)–1	1545–0004
31.3402(b)–1	1545–0010
31.3402(c)–1	1545–0010
31.3402(f)(1)–1	1545–0010
31.3402(f)(2)–1	1545–0010
	1545–0410
31.3402(f)(3)–1	1545–0010
31.3402(f)(4)–1	1545–0010
31.3402(f)(4)–2	1545–0010
31.3402(f)(5)–1	1545–0010
	1545–1435
31.3402(h)(1)–1	1545–0029
31.3402(h)(3)–1	1545–0010
	1545–0029
31.3402(h)(4)–1	1545–0010
31.3402(i)–(1)	1545–0010
31.3402(i)–(2)	1545–0010
31.3402(k)–1	1545–0065
31.3402(l)–(1)	1545–0010
31.3402(m)–(1)	1545–0010
31.3402(n)–(1)	1545–0010
31.3402(o)–2	1545–0415
31.3402(o)–3	1545–0008
	1545–0010
	1545–0415
	1545–0717
31.3402(p)–1	1545–0415
	1545–0717
31.3402(q)–1	1545–0238
	1545–0239
31.3404–1	1545–0029
31.3405(c)–1	1545–1341
31.3406(a)–1	1545–0112
31.3406(a)–2	1545–0112
31.3406(a)–3	1545–0112
31.3406(a)–4	1545–0112
31.3406(b)(2)–1	1545–0112
31.3406(b)(2)–2	1545–0112
31.3406(b)(2)–3	1545–0112
31.3406(b)(2)–4	1545–0112
31.3406(b)(2)–5	1545–0112
31.3406(b)(3)–1	1545–0112
31.3406(b)(3)–2	1545–0112

CFR part or section where identified and described	Current OMB control No.
31.3406(b)(3)–3	1545–0112
31.3406(b)(3)–4	1545–0112
31.3406(b)(4)–1	1545–0112
31.3406(c)–1	1545–0112
31.3406(d)–1	1545–0112
31.3406(d)–2	1545–0112
31.3406(d)–3	1545–0112
31.3406(d)–4	1545–0112
31.3406(d)–5	1545–0112
31.3406(e)–1	1545–0112
31.3406(f)–1	1545–0112
31.3406(g)–1	1545–0096
	1545–0112
	1545–1819
31.3406(g)–2	1545–0112
31.3406(g)–3	1545–0112
31.3406(h)–1	1545–0112
31.3406(h)–2	1545–0112
31.3406(h)–3	1545–0112
31.3406(i)–1	1545–0112
31.3501(a)–1T	1545–0771
31.3503–1	1545–0024
31.3504–1	1545–0029
31.6001–1	1545–0798
31.6001–2	1545–0034
	1545–0798
31.6001–3	1545–0798
31.6001–4	1545–0028
31.6001–5	1545–0798
31.6001–6	1545–0029
	1459–0798
31.6011(a)–1	1545–0029
	1545–0034
	1545–0035
	1545–0059
	1545–0074
	1545–0256
	1545–0718
	1545–2097
31.6011(a)–2	1545–0001
	1545–0002
31.6011(a)–3	1545–0028
31.6011(a)–3A	1545–0955
31.6011(a)–4	1545–0034
	1545–0035
	1545–0718
	1545–1413
	1545–2097
31.6011(a)–5	1545–0028
	1545–0718
	1545–2097
31.6011(a)–6	1545–0028
31.6011(a)–7	1545–0074
31.6011(a)–8	1545–0028
31.6011(a)–9	1545–0028
31.6011(a)–10	1545–0112
31.6011(b)–1	1545–0003
31.6011(b)–2	1545–0029
31.6051–1	1545–0008
	1545–0182
	1545–0458
	1545–1729
31.6051–2	1545–0008
31.6051–3	1545–0008
31.6053–1	1545–0029
	1545–0062
	1545–0064
	1545–0065
	1545–1603
31.6053–2	1545–0008
31.6053–3	1545–0065
	1545–0714

CFR part or section where identified and described	Current OMB control No.
31.6053–4	1545–0065
	1545–1603
31.6060–1(a)(1)	1545–1231
31.6065(a)–1	1545–0029
31.6071(a)–1	1545–0001
	1545–0028
	1545–0029
31.6071(a)–1A	1545–0955
31.6081(a)–1	1545–0008
	1545–0028
31.6091–1	1545–0028
	1545–0029
31.6107–1	1545–1231
31.6157–1	1545–0955
31.6205–1	1545–0029
	1545–2097
31.6301(c)–1AT	1545–0035
	1545–0112
	1545–0257
31.6302–1	1545–1413
31.6302–2	1545–1413
31.6302–3	1545–1413
31.6302–4	1545–1413
31.6302(c)–2	1545–0001
	1545–0257
31.6302(c)–2A	1545–0955
31.6302(c)–3	1545–0257
31.6402(a)–2	1545–0256
	1545–2097
31.6413(a)–1	1545–0029
	1545–2097
31.6413(a)–2	1545–0029
	1545–0256
	1545–2097
31.6413(c)–1	1545–0029
	1545–0171
31.6414–1	1545–0029
	1545–2097
32.1	1545–0029
	1545–0415
32.2	1545–0029
35a.3406–2	1545–0112
35a.9999–5	1545–0029
36.3121(l)(1)–1	1545–0137
36.3121(l)(1)–2	1545–0137
36.3121(l)(3)–1	1545–0123
36.3121(1)(7)–1	1545–0123
36.3121(1)(10)–1	1545–0029
36.3121(1)(10)–3	1545–0029
36.3121(1)(10)–4	1545–0257
40.6060–1(a)(1)	1545–1231
40.6107–1	1545–1231
40.6302(c)–3(b)(2)(ii)	1545–1296
40.6302(c)–3(b)(2)(iii)	1545–1296
40.6302(c)–3(e)	1545–1296
40.6302(c)–3(f)(2)(ii)	1545–1296
41.4481–1	1545–0143
41.4481–2	1545–0143
41.4483–3	1545–0143
41.6001–1	1545–0143
41.6001–2	1545–0143
41.6001–3	1545–0143
41.6060–1(a)(1)	1545–1231
41.6071(a)–1	1545–0143
41.6081(a)–1	1545–0143
41.6091–1	1545–0143
41.6107–1	1545–1231
41.6109–1	1545–0143
41.6151(a)–1	1545–0143
41.6156–1	1545–0143
41.6161(a)(1)–1	1545–0143
44.4401–1	1545–0235

CFR part or section where identified and described	Current OMB control No.
44.4403–1	1545–0235
44.4412–1	1545–0236
44.4901–1	1545–0236
44.4905–1	1545–0236
44.4905–2	1545–0236
44.6001–1	1545–0235
44.6011(a)–1	1545–0235
	1545–0236
44.6060–1(a)(1)	1545–1231
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[T.D. 8011, 50 FR 10222, Mar. 14, 1985]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 602.101, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at *www.fdsys.gov*.

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