CHAPTER 8B--ISSUES RELATED TO THE REPEAL OF IRC SECTION 415(e)

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INTRODUCTION

Section 415 (including subsection 415(e)) was added to the Code by the Employee Retirement Income Security Act of 1974 (ERISA), generally effective for years beginning after 1975. Section 415(e) proved to be an unpopular section, and was considered difficult to administer by many practitioners. As a result, efforts were made to repeal this section for some years. These efforts finally proved successful upon the enactment of the Small Business Job Protection Act of 1996 ('SBJPA', Public Law 104-188, August 20, 1996) which repealed section 415(e), effective for limitation years beginning after December 31, 1999.

As the effective date of the repeal of section 415(e) approached, questions arose about the implementation of the repeal, including questions about benefit increases for participants (active employees, as well as retired and terminated vested employees) whose benefits were limited by section 415(e), under both plans that incorporate section 415 by reference, and plans that do not incorporate section 415 by reference. In response to questions about the implementation of the repeal of section 415(e) and related issues, the Service issued Notice 99-44, 1999-35 I.R.B. 326, and a field memorandum with the subject "Technical Guidance on IRC Section 401(a)(26) Testing". This lesson provides guidance on the implementation of the repeal of section 415(e) and on issues arising under other Code sections that are affected by the repeal of section 415(e).

OBJECTIVES

At the end of this lesson you will be able to:

1. Determine which participants are affected by the repeal of section 415(e), and the maximum benefit increase that can be provided under a plan upon the repeal of section 415(e);
2. Determine whether nondiscrimination tests are properly taking benefit increases due to the repeal of section 415(e) into account; and
3. Determine whether benefit increases due to the repeal of section 415(e) are funded properly under section 412.

I. IRC 415(E) LIMITATION FOR LIMITATION YEARS BEGINNING BEFORE 2000(PRE-SBJPA 415(E) LIMIT)

For limitation years beginning before 2000, section 415(e) of the Code provides an overall limitation on the total amount of benefits and contributions which can be received or accrued by an employee that is a participant in both a defined benefit plan (or plans) and a defined contribution plan (or plans) sponsored by the same employer. After all similar plans of the employer (in which an employee is or has been a participant) are aggregated as required under section 415(f), a defined benefit plan fraction (DBF) is calculated (according to the rules in Code section 415(e)(2) and the regulations thereunder), and a defined contribution plan fraction (DCF) is calculated (according to the rules in section 415(e)(3) and the regulations thereunder), and the sum of these two fractions must, generally, not exceed 1.0.

Thus, not only must a participant's benefits or contributions under each plan satisfy the limitations of section 415 (on a stand-alone basis as well as on an aggregated basis for plans that are treated as a single plan for section 415 purposes), but the participant's benefits and contributions under all plans of the employer must satisfy the additional limitation of section 415(e).

In general, the DBF for a participant in a non-top heavy defined benefit plan is calculated as shown below.

$$\text{DBF} = \frac{\text{participant's projected annual benefit (as of close of year)}}{\textbf{lesser of } 1.25 \times \text{DB dollar limit for year (applicable to participant)} \quad \textbf{or} \quad 1.4 \times \text{DB compensation limit (applicable to participant)}}$$

In general, the DCF for a participant in a non-top heavy defined contribution plan is calculated as shown below.

$$\text{DCF} = \frac{\text{Sum of annual additions to participant's account (as of close of year)}}{\textbf{sum of lesser of } 1.25 \times \text{DC dollar limit} \quad \textbf{or} \quad 1.4 \times \text{DC compensation}}$$

(for current year and for year limit applicable to participant each prior year of service with employer)

Where the sum of the DBF and DCF for a participant exceed 1.0, the participant's benefit under one plan (or more if necessary) must generally be limited (reduced) until the sum does not exceed 1.0. The terms of the plans must specify which of the plans (and in what order) will reduce benefits in order to satisfy section 415(e).

II. IRC 415(E) LIMITATION FOR LIMITATION YEARS BEGINNING AFTER DECEMBER 31, 1999

Section 1452(a) of SBJPA repealed section 415(e) of the Code, effective for limitation years beginning after December 31, 1999. The most obvious effect of the repeal of section 415(e) is that after testing a participant's aggregated benefits under all defined benefit plans of the employer for satisfaction of section 415(b), and testing a participant's aggregated contributions under all defined contribution plans of the employer for satisfaction of section 415(c), no further testing for satisfaction of section 415(e) is required by the Code. As a result, for limitation years beginning after December 31, 1999, a plan will not fail to satisfy section 415 of the Code solely because the plan provides for benefits or contributions, which exceed the pre-SBJPA 415(e) limitation applicable to the participant. However, a plan must be operated in accordance with its terms, and additional testing may be required under the terms of the plan.

Therefore, for participants with benefits in both a defined benefit plan (or plans) and a defined contribution plan (or plans) of the same employer, whether or not further testing is actually required will depend on the terms of the plans and whether or not (and how) the plans have been amended to take into account the repeal of section 415(e). For example, if a plan is not amended to remove the limitation provisions relating to section 415(e), those limitations may continue to apply after 1999 (depending on the terms of the plan).

III. NOTICE 99-44

Notice 99-44 provides guidance in question and answer format on issues related to the repeal of IRC 415(e), including:

- benefit increases that may be provided upon the repeal of section 415(e),
- plan amendments that may be adopted to take the repeal into account, and
- the treatment of the repeal for purposes of applying the IRC 412 minimum funding standards.

The notice also provides guidance on the effect of the repeal of section 415(e) on other qualification requirements.

A. PLAN NOT AMENDED TO TAKE REPEAL OF IRC 415(E) INTO ACCOUNT.

Under the Tax Reform Act of 1986, except as provided in regulations, a plan is permitted to incorporate by reference the limitations under section 415 of the Code. Regulation 1.415-1(d) provides that the terms of a qualified plan must preclude the possibility that the limitations imposed by section 415 will be exceeded. Regulation 1.401-1(b) provides that a participant's benefit in a defined benefit plan must be definitely determinable. Therefore, even for plans that incorporate section 415 by reference, if there is more than one method available for determining or testing a participant's benefit or annual additions under section 415, the method to be used must be specified by the plan.

Examples of methods that must be specified include:

1. the method of determining compensation to be used for section 415 purposes; and
2. the method under 1.415-6(b)(6) that will be used for the treatment of excess annual additions).

Where a defined plan that incorporates the section 415 limitations by reference has not been amended otherwise to take the section 415(e) repeal into account, accrued benefits previously limited by pre-SBJPA section 415(e) limits generally will automatically increase upon the effective date of the repeal of section 415(e).

Where a defined contribution plan that incorporates the section 415 limitations by reference has not been amended otherwise to take the section 415(e) repeal into account, annual additions that would be limited by the pre-SBJPA section 415(e) limits are no longer limited by section 415(e) and, in some cases, could automatically increase on the effective date of the repeal of section 415(e).

Example 1—Plans Incorporate Section 415 by Reference:

Participant A is an active participant in a defined benefit plan (Plan 1), and in a defined contribution plan (Plan 2) of the same employer.

Neither plan is top heavy, and both plans have a calendar year plan year and limitation year.

For the last three years, Participant A's projected benefit under Plan 1 has been equal to the defined benefit dollar limit, and A's high three average compensation is $200,000.

Plans 1 and 2 incorporate section 415 by reference. Plans 1 and 2 both provide

that contributions under Plan 2 will be limited when a participant's benefits under Plans 1 and 2 exceed the section 415(e) limitation.

Thus, Participant A's annual addition under Plan 2 has been limited for the last 3 years such that the defined contribution plan fraction applicable to Participant A is no greater than 0.2.

Shown below is the calculation of A's DBF, and then A's maximum DCF.

$$\text{DBF} = \frac{\text{(A's projected benefit = DB dollar limit)}}{\text{(1.25 x DB dollar limit)}}$$
$$= 1/(5/4) = 0.8$$

Maximum DCF = 1.0 - 0.8 = 0.2

Upon the effective date of the repeal of section 415(e) (January 1, 2000, for Plans 1 and 2), and without any action taken by the employer, Participant A's annual addition under Plan 2 would increase to whatever it would be without the section 415(e) limitation.

Thus, it would be possible, if the terms of Plan 2 so provided, for Participant A to receive the maximum annual addition under section 415(c) under Plan 2 for the first limitation year beginning after December 31, 1999.

Example 2—Plans do Not Incorporate Section 415 by Reference

Same facts as in Example 1, except that both Plan 1 and Plan 2 have complete section 415 language, including language for determining the defined benefit plan fraction (DBF) and the defined contribution plan fraction (DCF). Again, the plan has not been amended for the repeal of section 415(e). Although following the repeal of section 415(e), it is no longer required under the Code to calculate and test the DBF and DCF, the terms of the plan must be followed. The particular terms of the plans will determine whether Participant A's benefit under the DC plan will continue to be limited. For example, under a plan with terms that define a DBF and DCF and provide that the sum of the DBF and DCF must not exceed 1.0, benefits would continue to be limited after 1999. On the other hand, a plan that provides that the sum of the DBF and DCF must not exceed the limit of section 415(e) would not have a section 415(e) limit to use after section 415(e) is repealed.

1. BENEFIT INCREASES TO REFLECT THE REPEAL OF IRC 415(E)

Two of the questions and answers in Notice 99-44 addressed the question of whether a plan could provide benefit increases to reflect the repeal of section 415(e) for current or former employees who had commenced benefits under the plan prior to the effective date of the repeal and, if the plan could provide such increases, how the maximum permissible increase would be calculated for such employees.

Notice 99-44 provided in Q&A-3 that, for employees or former employees that commenced benefits prior to the effective date of the section 415(e) repeal, a defined benefit plan could provide benefit increases to reflect the repeal of section 415(e), but only if such employee is a participant in the plan on or after that effective date.

> For these purposes, an employee or former employee is a participant in the plan on a date if the employee or former employee has an accrued benefit on that date (other than an accrued benefit resulting from a benefit increase arising solely as a result of the repeal of section 415(e)).

Thus, if a current or former employee accrues additional benefits under the plan that could have been accrued without regard to the repeal of section 415(e) (including benefits that accrue as a result of a plan amendment) on or after the effective date of the repeal for the plan, then the current or former employee may receive a benefit arising from the repeal of section 415(e). Employers who want to give such benefit increases to employees or former employees who commenced benefits prior to the repeal of section 415(e) may have to provide additional benefits not related to the section 415(e) repeal first. Current or former employees who do not have accrued benefits under the plan on or after the effective date of the section 415(e) repeal for the plan cannot be provided benefit increases that reflect the repeal of section 415(e).

2. MAXIMUM INCREASES FOR EMPLOYEES COMMENCING BENEFITS PRIOR TO REPEAL OF IRC 415(E)

Form of Benefit Not Subject to IRC 417(e)(3). Q&A-4 of Notice 99-44 provides that the benefit payable under a defined benefit plan to any current or former employee whose benefits commenced in a year prior to the repeal of IRC 415(e) in a form not subject to section 417(e)(3) (such as a single life annuity or a qualified joint and survivor annuity (QJSA)) may be increased to a benefit no greater than the benefit that would have been permitted for that year under section 415(b) had section

415(e) not limited the benefit at the time of commencement.

If the plan provided for cost-of-living adjustments to the section 415(b) limitations, the annual benefit for the first limitation year beginning on or after the effective date of the section 415(e) repeal (i.e., beginning after 1999) is limited to the section 415(b) limitation, increased for cost-of-living adjustments to such limitation year, applicable at the age the employee commenced benefits. If the plan did not provide for such cost-of-living adjustments, then the benefit is limited to the section 415(b) limit, adjusted for benefit commencement age, if necessary, that was applicable to the employee when benefits commenced.

Form of Benefit Subject to Section 417(e)(3). Where the form of benefit is subject to section 417(e)(3) (such as a single-sum distribution), Q&A-4 of Notice 99-44 provides that the benefit payable for any limitation year beginning on or after the effective date of the repeal of section 415(e) (i.e., beginning after 1999) may be increased by an amount that is actuarially equivalent to the amount of increase that could have been provided had the benefit been paid in the form of a straight life annuity.

Example 3—Increase in Annuity to Retiree in Pay Status:

Plan M Facts:

- DB plan (non-top heavy) with a calendar plan year and limitation year
- Retirement benefits available in the form of an annuity or a single sum
- Provides that benefits for retirees are increased as the dollar limitation increases
- Provides that benefits are limited to the extent necessary to satisfy section 415(e)

Amended January 1, 1995, effective as of that date, to use the applicable interest rate and applicable mortality table to compute single-sum benefits (to meet section 417(e)(3) requirements under GATT)

Amended July 1, 1998, effective January 1, 1995, to apply the section 415(b)(2)(E) changes under GATT and SBJPA to all benefits under the plan on or after the RPA '94 section 415 effective date

Early retirement benefits and other optional forms are determined as the actuarial equivalents of a straight life annuity at NRA using the applicable interest rate and applicable mortality table

- Mortality is used in the pre-retirement period

The applicable interest rate is assumed to be 6% for all relevant periods; and the applicable mortality table is the unisex 1983 GAM table under Rev. Rul. 95-6, 1995-1 C.B. 80.

Participant P Facts

- Participates in Plan M and in Plan N, a DC plan of same employer
- Commences receiving retirement benefits in the form of single life annuity January 1, 1996, at age 56
- Social Security Retirement Age (SSRA) = 66
- DCF at time of retirement is 0.36
- Compensation limit applicable to P at retirement was $150,000
- P's benefit under Plan M, before limitation for section 415 and payable at normal retirement age, is $145,000

DB DOLLAR LIMIT CALCULATION

The DB limit applicable to P is calculated below.

- 1996 dollar limit = $120,000 at SSRA
- Reduced to age 62 using Notice 87-21 factors
  = 120,000 x [1 - {(5/9)(.01)(36) + (5/12)(.01)(12)}]
  = 120,000 x [1 - {.20 + .05}] = 120,000 x .75
  = 90,000

In general, to reduce the limitation from age 62 to age 56, for a form of benefit not subject to section 417(e)(3), two actuarially equivalent values at age 56 of the value (equivalent to the limit at age 62) are calculated, and the lesser of the two is used as the age-adjusted limitation.

The first is calculated (see step (i) below) using the plan interest rate and plan mortality table (or tabular factor) used for actuarial equivalence for early retirement purposes (which in this case, are specified as the applicable interest rate of 6%, and the applicable mortality table).

The second is calculated (see step (ii) below) using 5% and the applicable mortality table.

(i) Using plan factors for actuarial equivalence for early retirement purposes.

The $90,000 limitation at age 62 is reduced to age 56 using 6% and the applicable mortality table. (The following shows adjustment to the

earlier age using interest and mortality, in which case the use of the "D" commutation functions is required.)

$$90{,}000 \times \frac{\frac{N^{(12)}_{62}}{D_{62}} \times \frac{D_{62}}{D_{56}}}{\frac{N^{(12)}_{56}}{D_{56}}}$$

$$= \frac{90{,}000 \times (11.423) \times (0.6802)}{12.772}$$

$$= 54{,}752$$

Note that the first equation above, when the numerator is multiplied by the reciprocal of the denominator fraction (i.e., "invert and multiply"), is algebraically equivalent to

$$\frac{90{,}000 \times N^{(12)}_{62}}{N^{(12)}_{56}}$$

$$= 90{,}000 \times [(282276.32)/(463990.19)]$$

$$= 90{,}000 \times (0.608367)$$

$$= 54{,}753$$ (with the slight difference due to rounding)

[This is a shorter method for getting an actuarially equivalent annuity at an earlier age, and can only be used when both interest and mortality are used (requiring the use of the "D" commutation functions, which cancel or reduce out).]

(ii) Using 5% and the applicable mortality table.

$$90{,}000 \times \frac{\frac{N^{(12)}_{62}}{D_{62}} \times \frac{D_{62}}{D_{56}}}{\frac{N^{(12)}_{56}}{D_{56}}}$$

$$= \frac{90{,}000 \times (12.456) \times (0.7200)}{14.104}$$

$$= 57{,}228$$

Alternatively, the value could be calculated

$$90{,}000 \quad X \quad \frac{N^{(12)}_{62}}{N^{(12)}_{56}}$$

$$= 90{,}000 \quad X \quad \frac{554000.00}{871191.86}$$

$$= 90{,}000 \times 0.6359$$

= 57,231 (with the slight difference due to rounding)

Therefore, the age 56 dollar limitation to be used is $54,573 (the lesser of 54,753 and 57,228).

Because Participant P's compensation limit under section 415(b)(1)(B) is $150,000, the applicable section 415(b) limitation applicable to Participant P is $54,573 (the lesser of the applicable dollar limitation and applicable compensation limitation).

SECTION 415(E) LIMIT CALCULATION

When Participant P retired, P's benefit also had to satisfy section 415(e). This meant that P's DBF had to satisfy the equation

DBF + 0.36 (P's DCF in the DC plan) = 1.0

or DBF = 1.0 - 0.36 = 0.64

That is, the greatest DBF that Participant P is permitted under section 415(e) is 0.64.

Written in fraction form:

$$0.64 = \frac{\text{P's maximum projected annual benefit}}{\text{lesser of (1.25 x dollar limit applicable to P) or (1.4 x compensation limit applicable to P)}}$$

$$= \frac{\text{P's maximum projected annual benefit}}{\text{lesser of (1.25 x 54,753) or (1.4 x 150,000)}}$$

$$\text{lesser of (1.25 x 54,753) or (1.4 x 150,000)} = \text{lesser of } 68{,}441 \text{ or } 210{,}000$$

= (P's maximum projected annual benefit) / 68,441

or, equivalently,

(0.64) x (68,441) = (P's maximum projected annual benefit)

Therefore, P's maximum projected annual benefit is 43,802 (0.64 x 68,441).

Thus, the maximum annual benefit P could otherwise receive (from Plan P at age 56) in 1996 under section 415(b) ($54,753) is further reduced to $43,802 to satisfy section 415(e).

Because Plan M provides that benefits for retirees are increased in accordance with increases under section 415(d), and the dollar limit increased from $120,000 in 1996 to $125,000 for 1997 and $130,000 for 1998 and 1999, P's benefit will be increased as shown below.

For 1997 $43,802 x (125,000/120,000) = $45,628

For 1998 $45,628 x (130,000/125,000) = $47,453

The dollar limit remained unchanged for 1999, and P's benefit is unchanged in 1999 at $47,453.

Calculation of Benefit Increase Due to Repeal of Section 415(e)

With the repeal of section 415(e) becoming effective for Plan M on January 1, 2000, as of that date P's benefit may be increased to the maximum benefit payable under section 415(b) at age 56 (that is, without further reduction under section 415(e)).

Using the 2000 dollar limit of $135,000, the maximum annual benefit payable at age 56 is calculated as shown below. The dollar limit is calculated as before: first adjusted to age 62 using the Notice 87-21 factors; and then adjusted actuarially to age 56 using the same methodology as previously shown.

from age 66 to age 62 135,000 x (.75) = 101,250

from age 62 to age 56, using interest and mortality, shown in brief detail (for more detail, look at previous calculations)

a. Using the plan factors for early retirement (6% and applicable mortality table)

$$101{,}250 \times \frac{N^{(12)}_{62}}{N^{(12)}_{56}} = 101{,}250 \times 0.608367 = \$61{,}597$$

b. Using the applicable mortality table and 5%

$$101{,}250 \times \frac{N^{(12)}_{62}}{N^{(12)}_{56}} = 101{,}250 \times 0.635910 = \$64{,}386$$

Thus, P's benefit can be increased to $61,597 (the lesser of $61,597 and $64,382), effective for 2000. In this case, the increase in P's benefit is not permitted to reflect the difference between the section 415(b) limit and the further reduction required under section 415(e) in prior limitation years. That is, the increase is made on a prospective basis only, beginning in 2000.

If Plan M had not provided that benefits for retirees (whose benefits had been limited (reduced) under section 415) are increased as adjustments are made under section 415(d), P's maximum annual benefit under Plan M would have remained at $43,802 for the years 1996 through 1999. However, if the plan was amended to provide for such increases effective for limitation years beginning January 1, 2000, P's benefit could be increased from $43,802 (the age 56 benefit limited in 1996 by

sections 415(b) and 415(e), without adjustments for increases in the DB dollar limitation) to $61, 597 (the 2000 dollar limit reduced for commencement of benefits at age 56), plus the annual amount that is actuarially equivalent to the $9,128 that could have been paid in the prior limitation years had the plan provided for benefit increases to reflect the cost-of-living increases under section 415(d). The calculation of $9,128 is shown below.

Year	Max. Benefit With COLA Adjustments	_	Max. benefit Without COLAs	=	Increase Due to COLAs
1997	$45,628	–	$43,802	=	$1,826
1998	$47,453	–	$43,802	=	$3,651
1999	$47,453	–	$43,802	=	$3,651
Sum of COLA adjustment increases for 1997-1999					$9,128

If the plan is not amended to provide for such COLA increases as the dollar limit is increased under section 415(d), P's benefit for the 2000 limitation year would only increase to $54,573.

Of course, if P's benefit had commenced in a year earlier than 1996 and the plan is amended to provide for increases (for employees with benefits limited by section 415) as the section 415(b) dollar limit is increased under section 415(d), then the calculations of permissible benefit increases resulting from the repeal of section 415(e) would reflect the applicable section 415(b) limit effective in such earlier year of retirement, and any section 415(d) increases for succeeding years through 1999.

Example 4 – Benefit in Form of 10 Equal Installments:

Same facts as in Example 3, except that Plan M does not provide that benefits for retirees are increased as the dollar limitation is indexed under section 415(d), and P commenced distributions from Plan M in the form of 10 equal annual installments, commencing on January 1, 1996.

Before limitation for section 415(e), P's maximum benefit in 1996 is $89,635 [calculated as the 1996 dollar limitation of $120,000, adjusted to $54,753 for commencement at age 56, and then adjusted to $89,635 for payment in 10 equal installments]. Because the plan mortality table and the applicable table are the same, the determination of 10 equal annual payments is calculated using the applicable mortality table and an interest rate of 6% [the greater of the plan rate (the applicable rate of 6%) and 5%], satisfying the rules under section 415(b)(2)(E).

The adjustment for payment in 10 equal installments is shown below and involves the use of a symbol to represent the present value of 10 beginning-of-period payments of $1 at 6% interest, read as "a angle 10, double dot, at 6%", and written as $\ddot{a}_{\overline{10}|6\%}$.

$$54{,}753 \times \frac{N_{56}^{(12)}}{D_{56}} = \frac{54{,}753 \times 12.772}{\ddot{a}_{\overline{10}|6\%}} = \frac{54{,}753 \times 12.772}{7.80169} = 89{,}635$$

[This is explained as converting the annuity to a lump sum (by multiplication by an age 56 annuity factor), and then dividing the lump sum by the present value at 6% of 10 annual payments of $1.]

When the maximum benefit ($54,753) under section 415(b) is further reduced for satisfaction of the section 415(e) limitation ($43,802), the maximum annual payment amount is calculated as shown below.

$$43{,}802 \times \frac{N_{56}^{(12)}}{D_{56}} = \frac{43{,}802 \times 12.772}{\ddot{a}_{\overline{10}|6\%}} = \frac{43{,}802 \times 12.772}{7.80169} = 71{,}707$$

Thus, P's installment payments were reduced from $89,635 to $71,707 to satisfy section 415(e).

As of January 1, 2000, P has six installment payments remaining. Because Plan M does not provide for cost-of-living adjustments under section 415(d), P's remaining installment payments may be increased, effective January 1, 2000, by the actuarial equivalent, spread over six years, of the value of the increase in the single life annuity that would have been payable beginning in 2000 (because of the repeal of section 415(e)) if P had elected a single life annuity in 1996 rather than the installment payments. In other words, if P had elected a single life annuity under Plan M, P could have received the equivalent of an annual benefit of $54,753 (1996 dollar limit reduced for commencement at age 56) beginning January 1, 2000, upon the repeal of section 415(e).

The value of an additional annual benefit of $10,951 (54,753 - 43,802), beginning at age 60, would be equal to the following:

$$10{,}951 \times \frac{N^{(12)}_{60}}{D_{60}} = 10{,}951 \times 11.905 = 130{,}372.$$

To spread (amortize) $130,372 over six years at 6% interest, divide by the present value of 6 beginning-of-period payments of $1 ("a angle 6, double dot, at 6%"), which is 5.21236.

$$\frac{130{,}372}{\ddot{a}_{\overline{6}|6\%}} = 130{,}372 / 5.21236 = 25{,}012$$

Thus, the six remaining annual payments could be increased by $25,012 to $96,719 (71,707 + 25,012) and still satisfy section 415(b).

However, if Plan M was also amended to provide for cost-of-living adjustments under section 415(d), effective January 1, 2000, then P's remaining six installment payments could be increased by the actuarial equivalent (spread over six years) of the value of the increases in the single life annuity that would have been payable beginning on January 1, 2000 if P had elected a single life annuity (rather than the installment payments). That is, P's payments, effective January 1, 2000, could be increased by the actuarial equivalent of an annual benefit of $17,795 [which is equal to $61,597 (the 2000 dollar limitation, reduced for commencement at age 56, but not limited by section 415(e)) minus $43,802 (the 1996 dollar limitation, reduced for commencement at age 56 and limited for satisfaction of section 415(e))], spread over six years. The calculation of the single-sum equivalent of an annual benefit of $17,795, beginning at age 60 (age in 2000), spread over 6 years at 6% is shown below.

$$\frac{17{,}795 \times \frac{N^{(12)}_{60}}{D_{60}}}{\ddot{a}_{\overline{6}|6\%}} = \frac{17{,}795 \times 11.905}{5.21236} = 40{,}644$$

Additionally, a second increase could be given. Plan M could provide that each of P's six remaining installment payments under Plan M are increased by the actuarial equivalent (spread over six years) of the value of the increases in the prior installment payments that would have been paid in the prior limitation years had the plan provided for increases in the installment payments to reflect increases under

section 415(d). Earlier, we found that if Plan M had provided for COLA increases under section 415(d), and P's benefit had been paid in the form of single life annuity, P would have received an additional $9,128 for the years 1997 through 1999.

Thus, it is possible for P's remaining six payments to be increased by the sum of the actuarial equivalent, spread over six years, of an annual benefit of $17,795 commencing in the year 2000 (when P is age 60), and the actuarial equivalent of the single sum amount of $9,128 spread equally over six years at 6% interest. The increase ($42,395) to be paid in each of the remaining six annual payments is calculated as shown below. The calculations show the conversion of an annual benefit of $17,795 (beginning at age 60) to a single sum which is then spread as six annual payments, and the single sum of $9,128 spread as six annual payments.

$$\frac{17{,}795 \times \frac{N^{(12)}_{60}}{D_{60}}}{\ddot{a}_{\overline{6}|6\%}} + \frac{9{,}128}{\ddot{a}_{\overline{6}|6\%}} = \frac{17{,}795 \times 11.905}{5.21236} + \frac{9{,}128}{5.21236}$$

$$= 40{,}644 + 1{,}751$$

$$= 42{,}395$$

Thus, the six remaining payments may be increased from $71,707 to $114,102 (71,707 + 42,395).

Example 5 – Single Sum Distribution:

Participant A retired under a defined benefit plan, Plan S, in 1996 at age 56. Participant A also participated in a defined contribution plan, Plan T, of the same employer and had a DC fraction of 0.36. Participant A's annual benefit under Plan S, before limitation for section 415 was $150,000.

The section 415(b)(1)(B) compensation limitation applicable to Participant A ($200,000) exceeds the section 415(b)(1)(A) dollar limitation (adjusted for age at commencement of benefits) applicable to Participant A, so the dollar limitation is the applicable limit. The dollar limitation applicable to A's benefit under Plan S, like the dollar limitation applicable to P's benefit under Plan M, was first reduced to $54,753 under section 415(b), and then further reduced to $43,802 under section 415(e). Thus, A's annual benefit under Plan S was limited (reduced) to $43,802.

A's benefit was paid out in 1996 in the optional form of a single-sum distribution. According to Plan S's terms, single sums are computed using the applicable interest rate and the applicable mortality table. Participant A's 1996 single-sum

distribution ($559,439) is calculated below, using the plan factors or the applicable interest rate of 6% and the applicable mortality table.

$$43{,}802 \times \frac{N^{(12)}_{56}}{D_{56}} = 43{,}802 \times 12.772 = 559{,}439$$

To test the single-sum distribution for satisfaction of section 415, it would be converted to an annual benefit using assumptions which satisfy section 415(b)(2)(E)(ii) (and compared with the annual benefit calculated using the plan interest rate and mortality table for calculating single sums), and the largest annual benefit is used as the annual benefit equivalent to the single sum, which must not exceed the section 415 limit applicable to Participant A. In this case, the annual benefit computed using the plan rate and plan mortality table will be the same as that computed using the assumptions under section 415(b)(2)(E)(ii), because the plan rate and mortality table here are the same applicable interest rate and applicable mortality table used under section 415(b)(2)(E)(ii). Both calculations of the equivalent annual benefit are done as shown below.

$$\frac{559{,}439}{\frac{N^{(12)}_{56}}{D_{56}}}$$

$$= 559{,}439/12.772$$
$$= 43{,}802$$

Thus, the single sum satisfies section 415 because it converts, using assumptions which satisfy section 415(b)(2)(E), to an annual benefit that does not exceed the dollar limitation applicable to Participant A.

Without the limitation for section 415(e), A's annual benefit would have only been reduced to $54,753, and A could have received a single-sum distribution of $699,305 (54,753 x 12.772). [Because this single sum would convert, using assumptions, which satisfy section 415(b)(2)(E), to an equivalent annual benefit of $54,753, it would satisfy section 415(b).] Thus, A's single sum would have been $139,866 (699,305 – 559,439) larger but for section 415(e).

Can Plan S be amended to allow Participant A to "recoup" any part of the single sum that could have been paid had A's benefit not been further limited under section 415(e)?

Case 1: Plan S does not provide for COLA increases under section 415(d), and will not be amended to provide for such increases.

Participant A can only receive additional benefits due to the repeal of section 415(e) if Participant A has an accrued benefit under the plan on or after January 1, 2000, that could have been accrued without regard to the repeal of section 415(e). Therefore, if the sponsor of Plan M wants to provide a benefit increase to Participant A following the repeal of section 415(e), some action (possibly a plan amendment for an ad hoc COLA for all retirees) will have to be taken to provide A with an accrued benefit under Plan M. If Participant A does have an accrued benefit under the plan on or after January 1, 2000, then it is permissible for Participant A to receive a total benefit increase effective January 1, 2000, equal to the single sum equivalent of a $10,951 (54,573 - 43,802) prospective annual benefit that Participant A would have received but for the limitation under section 415(e). Because this is a prospective benefit increase, the single sum amount would be calculated using an annuity factor based on Participant A's age in 2000, which is 60. The maximum additional single sum benefit that could be provided to Participant A following the repeal of section 415(e) is calculated below, using 6% and the applicable mortality table.

$$10{,}951 \times \frac{N^{(12)}_{60}}{D_{60}} = 10{,}951 \times 11.905 = 130{,}372$$

Case 2: In addition to the section 415(e) repeal benefit increase, Plan S is also amended to provide that participant's benefits (for participants whose benefits have been limited by section 415(b)) are increased as the defined benefit dollar limit increases under section 415(d).

In this case, if Participant A has an accrued benefit under the plan on or after January 1, 2000, then it is permissible for Participant A to receive a benefit increase effective January 1, 2000, equal to the single sum equivalent of an annual benefit in the amount of $17,795, which is equal to the difference of the age 56 dollar limit in 2000 ($61,597) minus the section 415 age 56 limit applied to Participant A in 1996 ($43,802), with the additional annual benefit commencing in 2000 when Participant A is age 60. This would be calculated as shown below, using 6% and the applicable mortality table.

$$17{,}795 \times \frac{N^{(12)}_{60}}{D_{60}} = 17{,}795 \times 11.905 = 211{,}849$$

B. PLAN AMENDMENT TO TAKE REPEAL OF IRC 415(E) INTO ACCOUNT.

Where a plan is amended to take the repeal of IRC 415(e) into account, the terms of the plan, as amended, will determine how the repeal is taken into account for that particular plan.

Notice 99-44, in Q&A-7, provided that a plan could be amended to limit the extent to which a participant's benefit would otherwise automatically increase under the terms of the plan as a result of the repeal of section 415(e) (most likely as a result of the plan's incorporation of the section 415 limits by reference). Where a plan sponsor would like time to consider the extent to which a benefit increase relating to the repeal of section 415(e) might be provided at some later date (which would be consistent with all relevant qualification requirements), the plan sponsor may make an amendment that precludes a benefit increase that would otherwise occur as a result of the repeal of section 415(e). However, a plan amendment to limit the extent to which a benefit increase would occur that is not both adopted prior to, and effective as of, the first day of the first limitation year beginning on or after January 1, 2000, may fail to satisfy section 411(d)(6).

> Therefore, a plan sponsor wanting to limit such a benefit increase (even though the plan may be amended later during the plan's remedial amendment period to provide for the benefit increase) should adopt an amendment limiting the benefit increase prior to, and effective as of, the first day of the first limitation year beginning on or after January 1, 2000.

Sample plan language was provided in Q&A-7 that could be used by a plan sponsor to amend a defined benefit plan (on an interim basis or on a permanent basis) that would otherwise provide for a benefit increase due to the repeal of section 415(e), to retain the effect of the pre-SBJPA section 415(e) limitations in determining participants' accrued benefits under the plan, without failing to satisfy section 411(d)(6).

It should be noted that certain qualification requirements may not be satisfied for a plan where the plan continues to limit benefits after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA section 415(e) limitations. Where an exception is provided to otherwise applicable qualification rules solely in order to satisfy the limitations of section 415, such an exception will not apply in the case where a participant's benefits or contributions satisfy Code section 415, but do not satisfy the pre-SBJPA section 415(e) limitations under the plan. (See the examples below.)

Example 6:

Participant T participates in a defined benefit plan (Plan A) and a defined contribution plan (Plan B) of the same employer. Plan A and Plan B both have a calendar year plan year and limitation year. The terms of both plans provide that benefits under the defined benefit plan "take the hit" in order to satisfy section 415 of the Code, and under Plan A, a participant's benefit is determined by subtracting the participants DCF from 1.0.

In 1999, Participant T's accrued benefit under Plan A was reduced in order that a contribution for 1999 could be made on T's behalf under Plan B. Prior to 2000, Q&A G-10 of Notice 83-10, 1983-1 C.B. 536, provided relief for such a reduction with respect to Code section 411(d)(6). Q&A G-10 provided that where the benefit under an employer's defined benefit plan was determined by subtracting the participant's existing DCF from the total allowable combined fraction, if an increase in a participant's DCF resulted in a decrease in the participant's DBF, such a reduction would not be considered to violate section 411 of the Code. Following the repeal of section 415(e), this relief is no longer available, and an annual addition to a participant's account under a defined contribution plan that results in a reduction in the participant's accrued benefit under a defined benefit plan would be a violation of section 411(d)(6).

Example 7:

Participant M participates in both a defined benefit plan (Plan 1) and a defined contribution plan (Plan 2), sponsored by his employer. Neither plan is top heavy. Both plans provide that benefits under the defined contribution plan (Plan 2) are limited to satisfy section 415(e). In 1999, Participant M's benefit at his normal retirement age of 65 (also his social security retirement age) under Plan 1 is "maxed out" at the DB dollar limit of Code section 415(b)(1)(A). Thus, Participant M's DBF in 1999 is 0.8. Because Participant M's DCF in 1998 was 0.2, no contribution was made on M's behalf in 1999. However, when forfeitures for 1999 were allocated, the allocation ($750) to M's account would have resulted in an excess annual addition except for the provisions of regulation 1.415-6(b)(6).

Under this regulation section, certain excess annual additions (including those resulting from the allocation of forfeitures) which would cause the section 415 limitations applicable to an individual to be exceeded are not treated as annual additions, provided they are treated in accordance with one of three methods, all of which involve the possible use of suspense accounts. As provided in the terms of Plan 2, the allocation that would be an excess annual addition to Participant M's account is held in a suspense account under method (ii) of regulation 1.415-6(b)(6).

Following the repeal of section 415(e), these provisions are no longer available in the case where an amount is an excess amount under the pre-SBJPA section 415(e) rules, but not an excess amount under the currently effective provisions of the Code. For example, consider the case of Plan 2 continuing in 2000 to use the pre-SBJPA section 415(e) limit. Given the same set of facts in 2000, where no contribution is made to the DC plan on M's behalf, M's DB benefit is at the DB dollar limit, and the allocation of forfeitures causes the pre-SBJPA section 415 limits to be exceeded, the use of the rules in section 1.415-6(b)(6) would not be available. This is because the currently effective Code section 415 limitations are not exceeded, and the allocation of $750 in forfeitures does not constitute an excess annual addition.

C. SBJPA AMENDMENT OF IRC 415(C)(3).

Section 415(c)(3) and the regulations thereunder define compensation to be used for purposes of applying the limitations of IRC 415. Section 1434 of SBJPA amended section 415(c)(3) (with the amendment effective for limitation years beginning on or after January 1, 1998) to include in the compensation used for a participant for purposes of applying the limitations of section 415:

(i) elective deferrals described in section 402(g)(3);

(ii) elective contributions to a section 125 cafeteria plan; and

(iii) elective contributions to a section 457(b) eligible deferred compensation plan.

Where the rules in regulation section 1.415-6(b)(6) are used with respect to excess annual additions, the definition of compensation in section 415(c)(3), as amended by SBJPA, must generally be used for limitation years beginning on or after January 1, 1998. However, Q&A-9 of Notice 99-44 provides that for limitation years ending on or before November 30, 1999, pursuant to section 7805(b), the Service will not treat a defined contribution plan as failing to satisfy the requirements of section 401(a) merely because the rules in section 1.415-6(b)(6) are applied using a definition of compensation within the meaning of section 415(c)(3) prior to its amendment by SBJPA.

D. REPEAL OF SECTION 415(E) AND THE NONDISCRIMINATION RULES.

1. Nondiscrimination in Amount-- Safe Harbor Used

Section 1.401(a)(4)-2(b) of the regulations provides that the nondiscrimination in amount of employer **contributions** under a defined contribution plan requirement may be satisfied through the use of one of two safe harbors,

- a safe harbor for plans with uniform allocation formulas, and
- a safe harbor for plans with uniform points allocation formulas.

Regulation section 1.401(a)(4)-3 (b) provides safe harbors, subject to certain uniformity requirements, under which the nondiscrimination in amount of employer-provided **benefits** under a defined benefit plan requirement may be satisfied.

Notice 99-44 provides in Q&A-5 that a plan that uses a safe harbor and takes the repeal of section 415(e) into account as of the first day of the first limitation year beginning on or after January 1, 2000, will not fail to satisfy the uniformity requirements of section 1.401(a)(4)-2(b) or section 1.401(a)(4)-3(b)(2) merely because the repeal of section 415(e) is taken into account under the plan.

Q&A-10 of Notice 99-44 provides that where a plan continues to limit benefits after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA section 415(e) limitations, the continued application of the pre-SBJPA section 415(e) limitations for a plan year after the repeal effective date applicable to the plan would cause the plan to fail to satisfy the uniformity requirements for the safe harbor. However, if a plan limits benefits at any time on or after the repeal effective date applicable to the plan, using the pre-SBJPA section 415(e) limitations for HCEs (but not for NHCEs), then the plan will not fail to satisfy the uniformity requirements and will not fail to satisfy a nondiscrimination in amount safe harbor merely because of such limited application of the pre-SBJPA section 415(e) limitations.

2. Nondiscrimination in Amount--General Rule Used

Where a defined contribution plan is using the general rule (i.e., the "general test") to satisfy the nondiscrimination in amount of contributions requirement, Q&A-5 of Notice 99-44 provides that increased contributions allocated under the terms of the plan due to the repeal of section 415(e) must be taken into account in accordance with the rules for determining allocation rates found in regulation section 1.401(a)(4)-2(c)(2)(ii).

Where a defined benefit plan is using the general rule to satisfy the nondiscrimination in amount of employer-provided benefits requirement, Q&A-5 of Notice 99-44 provides that increased benefits provided to an employee under the terms of the plan due to the repeal of section 415(e)

- must be included as increases in the employee's accrued benefit (within the meaning of section 411(a)(7)(a)(i)) and the employee's most valuable optional form of payment of the accrued benefit (within the meaning of section 1.401(a)(4)-3(d)(1)(ii)) in accordance with the rules for determination of accrual rates found in section 1.401(a)(4)-3(d), and

- must be included in the computation of both the normal and most valuable accrual rates for any measurement period that includes the plan year for which the increase occurs.

If the limitations of section 415 are taken into account in testing the plan for limitation years beginning on or after January 1, 2000, those limitations must reflect the repeal of section 415(e).

Q&A-10 of Notice 99-44 provides that where the general test is used to satisfy the nondiscrimination in amount requirement, and the plan terms provide for the continued use of the pre-SBJPA section 415(e) limitations after the section 415(e) repeal is effective for the plan, such plan provisions must be reflected in the annual additions or accrued benefits used in performing the general test.

3. Nondiscrimination in Amount--Plan Amendment and Former Employees

Section 1.401(a)(4)-5 of the regulations provides rules for determining whether the timing of a plan amendment or series of amendments has the effect of discriminating significantly in favor of highly compensated employees (HCEs) or former HCEs. For these purposes a plan amendment includes, for example, the establishment or termination of the plan, any change in the benefits, rights, or features, benefit formulas, or allocation formulas under the plan.

Section 1.401(a)(4)-10 provides rules for determining whether a plan satisfies the nondiscriminatory amount and nondiscriminatory availability requirements of sections 1.401(a)(4)-1(b)(2) and (3), respectively, with respect to former employees. This section is generally relevant only in the case of benefits provided through an amendment to the plan effective in the current plan year.

Notice 99-44 provides in Q&A-6 that if benefit increases resulting from the repeal of section 415(e) are provided, as of the effective date of the repeal of section 415(e) for the plan, to either

(1) all current and former employees who have an accrued benefit under the plan immediately before the effective date of the repeal of section 415(e) for the plan, or

(2) all employees participating in the plan that have one hour of service after the effective date of the repeal of section 415(e) for the plan, through the adoption of a plan amendment,

then the timing of such an amendment satisfies the requirements of sections 1.401(a)(4)-5 and 1.401(a)(4)-10(b) of the regulations.

Additionally, if benefit increases are provided as of the effective date of the repeal of section 415(e) for the plan, to either of the two groups described above through the operation of the plan's existing provisions, then the requirements of sections 1.401(a)(4)-5 and 1.401(a)(4)-10(b) of the regulations are satisfied.

If benefit increases due to the repeal of section 415(e) are provided only to a certain group of current or former employees not described above through the adoption of a plan amendment, or if a plan amendment to reflect the repeal of section 415(e) is effective as of a later date than the effective date of the repeal for the plan, then the timing of such an amendment (considered in conjunction with the effect of the repeal) must satisfy a facts-and-circumstances determination under section 1.401(a)(4)-5(a)(2), and the requirements of section 1.401(a)(4)-10 must be applied.

E. OTHER PROVISIONS OF NOTICE 99-44.

Funding

Q&A-11 of Notice 99-44 provides that for purposes of section 412, any increase in the liabilities of a plan as a result of the repeal of section 415(e) (whether pursuant to a plan amendment, or pursuant to existing plan provisions) must be treated as occurring pursuant to a plan amendment, effective no earlier than the first day of the first limitation year beginning on or after January 1, 2000. Accordingly, any amortization base established under section 412 for such an increase in liabilities must have an amortization period of 30 years. A plan amendment making the repeal of section 415(e) effective for a plan cannot be taken into account for purposes of section 412 prior to the effective date of the repeal of section 415(e) for the plan.

Old-law Benefits

Q&A-12 of Notice 99-44 addresses the effect of the repeal of section 415(e) on a participant's "old-law benefit" defined in Q&A-12 of Rev. Rul. 98-1, 1998-2 I.R.B. 5. In general, the repeal of section 415(e) will have no effect on the amount of a participant's old-law benefit. Under the rules of Rev. Rul. 98-1, a participant's old-law benefit is determined as of a specified freeze date that must precede the plan's final implementation date, which cannot be later than the first day of the first limitation year beginning after December 31, 1999 (also the effective date of the repeal of section 415(e) for the plan). Thus, the latest possible freeze date for determining a participant's old-law benefit occurs the day before the repeal of section 415(e) becomes effective for the plan. However, if the old-law benefit for a participant was reduced (due to limitation under section 415(e)) during the period between the freeze date and the date the repeal becomes effective for the plan because of annual additions to the participant's account in a DC plan (where benefits under the DB plan of the same employer "take the hit"), the old-law benefit may increase to the freeze-date level as of the effective date of the repeal of section 415(e) for the plan.

Other Provisions In Notice 99-44

Q&A-13 of Notice 99-44 states that section 415(b)(4)(B) (which provides that a minimum benefit up to and including $10,000 may be provided where the employer has not at any time maintained a defined contribution plan in which the participant participated) is unaffected by the repeal of section 415(e).

Q&A-14 of Notice 99-44 discusses the intention of the Commissioner to modify the regulations regarding the exclusion allowance under section 403(b) (which was mandated by section 1504(b) of the Taxpayer Relief Act of 1997, Pub. L. 105-34) to provide that the fourth sentence of regulation section 1.403(b)-1(d)(5) does not apply after the effective date of the repeal of section 415(e). Such fourth sentence provides that the rules under section 415(e) apply where an employee makes an election under section 415(c)(4)(D) to have his or her exclusion allowance under section 403(b)(2) equal to the maximum contribution under section 415 that could be contributed on the employee's behalf if the annuity contract for the benefit of the employee was treated as a defined contribution plan of the employer.

IV. MEMO PROVIDES GUIDANCE ON SECTION 401(A)(26) TESTING

A memo, dated December 23, 1999, provided guidance on whether and how a plan would test former employees who benefit because of the repeal of section 415(e) for satisfaction of Code section 401(a)(26) and the regulations thereunder. Section 1.401(a)(26)-4 provides that a defined benefit plan that benefits former employees in a plan year must benefit at least the lesser of (i) 50 former employees of the employer, or (ii) 40 percent of the former employees of the employer.

[Note that this regulation has not yet been updated to correspond with Code section 401(a)(26)(A), as amended by SBJPA, which provides that on each day of the plan year a qualified trust must benefit at least the lesser of

(i) 50 employees of the employer, or

(ii) the greater of 40 percent of all employees of the employer, or two employees (if there is only one employee, such employee).]

If a plan has benefit increases or "pop-ups" for former employees in plan year 2000, then the plan must be tested in 2000 under the former employee testing rules of section 1.401(a)(26)-4.

Section 1.401(a)(26)-5(b) provides that a former employee is treated as benefiting under a plan for purposes of section 401(a)(26) if and only if the former employee would be treated as benefiting under section 1.410(b)-3(b) (which provides that a former employee is treated as benefiting for a plan year if and only if the plan provides for a benefit increase described in 1.410(b)-3(a)(1) to the former employee for the plan year). Thus, we look to regulation 1.410(b)-3(a)(1) for the determination of whether a pop-up benefit satisfies regulation 1.401(a)(26)-4.

Regulation section 1.410(b)-3(a)(1) provides that a benefit increase is an increase in a benefit accrued or treated as an accrued benefit under section 411(d)(6). In determining whether there is an increase in a benefit accrued, the exception in regulation section 1.410(b)-3(a)(2)(ii)(a) must be taken into account, which provides that plan provisions that implement the limits of Code section 415 are disregarded in determining whether an employee has a benefit increase. Specifically, any increases due to adjustments under section 415(d)(1) (automatic COLA adjustments), section 415(b)(5) (additional years of participation), or changes to the defined contribution fraction under section 415(e) are all disregarded, but only if such provision applies uniformly to all employees in the plan. Therefore, a benefit

increase due to the repeal of section 415(e) generally is disregarded if the provision applies uniformly to all employees.

However, section 1.410(b)-3(a)(2)(ii)(B) provides an exception to the general rule providing for the disregard of benefit increases due to changes in the section 415 limits. The exception provides that if the plan uses the optional rule in section 1.401(a)(4)-3(d)(2)(ii)(B) to take the section 415 limits into account when running the general test, then an employee or former employee who has an increase in his or her accrued benefit due to a change in the section 415 limit is treated as benefiting under a defined benefit plan. Note that the optional rule here may only be used by plans that do not provide for benefit increases under section 415(d)(1) to former employees.

The memo states the following conclusions.

1. Safe harbor plans providing for uniformly applicable benefit increases due to the section 415(e) repeal do not fail to satisfy regulation section 1.401(a)(26)-4 solely on account of those benefit increases, because benefit increases due to plan provisions that implement the section 415 limits are ignored for this purpose under section 1.410(b)-3(a)(2)(ii)(a).

2. General test plans that do not take section 415 limits into account for nondiscrimination testing and that provide for uniformly applicable benefit increases due to the section 415(e) repeal do not fail to pass regulation section 1.401(a)(26)-4 solely on account of those benefit increases, because benefit increases due to plan provisions that implement the section 415 limits are ignored for this purpose under section 1.410(b)-3(a)(2)(ii).

3. General test plans that take section 415 limits into account for nondiscrimination testing must be tested under regulation section 1.401(a)(26)-4 by treating benefit increases due to the repeal of section 415(e) as benefit increases for purposes of section 1.401(a)(26)-4. Benefit increases due to the repeal of section 415(e) cannot be ignored for this purpose, as the plan does not fit into the exception in section 1.410(b)-3(a)(2)(ii).

SUMMARY

In this lesson, various issues that arise as the repeal of section 415(e) becomes effective for a plan have been discussed. The maximum benefit increases that may be provided under a plan to employees that commenced benefits prior to the repeal of section 415(e) have been discussed and illustrated through examples. The effect of the repeal of section 415(e) on nondiscrimination testing and on certain other sections of the Code has also been discussed. Notice 99-44 and the specified memo have been reviewed.

PART IV. --- ITEMS OF GENERAL INTEREST

New Alternatives for Defined Benefit Master and Prototype and Volume Submitter Plans

Announcement 2001-63

Rev. Rul. 98-1, 1998-1 C.B. 249, provides guidance concerning changes to § 415 of the Internal Revenue Code that were made by the Uruguay Round Agreements Act, which included the Retirement Protection Act of 1994, and by the Small Business Job Protection Act of 1996. Section 415 limits the contributions and benefits under qualified pension, profit-sharing, etc., plans. Q&A-12 of Rev. Rul. 98-1 provides that a defined benefit plan may provide that changes to § 415(b)(2)(E) do not apply to benefits accrued before a certain date, which is referred to here as the "RPA '94 Freeze Date." In addition, the pre-RPA '94 Freeze Date accrued benefits are referred to as "old-law benefits." Q&A-14 of Rev. Rul. 98-1 contains three methods for applying the limitations in § 415(b) in a defined benefit plan that does not apply the changes to § 415(b)(2)(E) to old-law benefits. (How and when the RPA '94 Freeze Date and a participant's old-law benefit are determined are described in Q&A-13 of Rev. Rul. 98-1.)

Previously, the Master and Prototype program and the volume submitter program have permitted only one of the three methods (Method 2) described in Q&A-14 of Rev. Rul. 98-1. These programs also have required the RPA '94 Freeze Date to be the same date as the plan's § 417(e) effective date (i.e., the plan's date as of which the RPA '94 changes to § 417(e)(3) apply). However, commentators have requested the use of all three methods in these programs. They have also requested the use of different dates for the plan's RPA'94 Freeze Date and the plan's § 417(e) effective date.

The Service is now allowing the use of all three methods and the use of different dates for

the plan's RPA '94 Freeze Date and the plan's § 417(e) effective date. The Service has revised Item #40 (Section 415 Limitation on Benefits) of the February 2000, version of the Defined Benefit Listing of Required Modifications and Information Package (the "DB LRM") to include all three methods described in Q&A-14 of Rev. Rul. 98-1 and the use of different dates for the plan's RPA '94 Freeze Date and the plan's § 417(e) effective date. The Service is accepting these revisions in requests for opinion letters for master and prototype plans and advisory letters for volume submitter specimen plans.

The revisions to DB LRM Item #40 are posted to the Employee Plans Internet address at www.irs.gov/ep. In addition, a paper copy of those revisions to the DB LRM may be obtained by writing to the Internal Revenue Service at EP Rulings and Agreements, Att'n: T:EP:RA:ICU, 1111 Constitution Ave., N.W., Washington, D.C. 20024 or by sending a fax to EP Rulings and Agreements, Taxpayer Request, Att'n: Ms. Nancy Arrington, 202-283-9554.

SECTION 415 LIMITATIONS [5-24-01]

40. Document Provision:

Statement of Requirement: **Limitation on benefits, IRC §415, IRC §419A(d); Regs. §1.415-1; Notice 83-10, 1983-1 C.B. 536; Notice 87-21, 1987-1 C.B. 458; Rev. Rul. 98-1, 1998-2 I.R.B. 5; Notice 99-44, 1999-35 I.R.B. 326; Rev. Proc. 99-23, 1999-16 I.R.B. 5; Rev. Proc. 2000-20, §5.07, §5.196 & §8.0315; Rev. Proc. 2000-27, 2000-26 I.R.B. 1272.**

Sample Plan Language:

Article _____: Limitation on Benefits

Section l. This section applies regardless of whether any participant is or has ever been a participant in another qualified plan maintained by the adopting employer. If any participant is or has ever been a participant in another qualified plan maintained by the employer, or a welfare benefit fund maintained by the employer (as defined in § 419(e) of the Internal Revenue Code) under which amounts attributable to post-retirement medical benefits are allocated to separate accounts of key employees (as defined in § 419(A)(d)(3)), or an individual medical account, as defined in § 415(l)(2) of the Internal Revenue Code, maintained by the employer, or a simplified employee pension, as defined in § 408(k) of the Internal Revenue Code, maintained by the employer, that provides an Annual Addition as defined in section 5.1, section 2 is also applicable to that participant's benefits.

Section 1.1. The Annual Benefit otherwise payable to a participant at any time will not exceed the Maximum Permissible Benefit. If the benefit the participant would otherwise accrue in a Limitation Year would produce an Annual Benefit in excess of the Maximum Permissible Benefit, the benefit must be limited (or the rate of accrual reduced) to a benefit that does not exceed the Maximum Permissible Benefit.

Section 1.2. If a participant has made voluntary employee contributions, or mandatory employee contributions as defined in § 411(c)(2)(C) of the Internal Revenue Code, under the terms of this plan, the amount of such contributions is treated as an Annual Addition to a qualified defined contribution plan, for purposes of sections 1.1 and 2.2 of this article.

Section 2. This section applies if any participant is also a participant, or has ever participated, in another plan maintained by the employer, including a qualified plan, a welfare benefit fund maintained by the employer (as defined in § 419(e) of the Internal Revenue Code) under which amounts attributable to post-retirement medical benefits are allocated to separate accounts of key employees (as defined in § 419(A)(d)(3)), an individual medical account, or a simplified employee pension that provides an Annual Addition as described in section 5.1.

Section 2.1. If a participant is, or has ever been, a participant in more than one defined benefit plan maintained by the employer, the sum of the participant's Annual Benefits from all such plans may not exceed the Maximum Permissible Benefit. Where the participant's employer-provided benefits under all defined benefit plans ever maintained by the employer (determined as of the same age) would exceed the Maximum Permissible Benefit applicable at that age, the employer will choose in section _____ of the adoption agreement the method by which the plans will limit a participant's benefit accrual in such cases.

(Note to reviewer: the above blank should be filled in with the section of the adoption agreement where the employer has stated the order and manner in which benefits will be limited when an employee with benefits under more than one defined benefit plan of the employer has a total benefit under all such defined benefit plans that exceeds the Maximum Permissible Benefit. This language is not provided.)

Section 2.2. For Limitation Years beginning before January 1, 2000, if the employer maintains, or ever maintained, one or more qualified defined contribution plans in which any participant in this plan participated, including a welfare benefit fund maintained by the employer (as defined in § 419(e) of the Internal Revenue Code) under which amounts

attributable to post-retirement medical benefits are allocated to separate accounts of key employees (as defined in § 419(A)(d)(3)), an individual medical account, or a simplified employee pension, the sum of the participant's Defined Contribution Plan Fraction and Defined Benefit Plan Fraction will not exceed 1.0 in any Limitation Year and, where the sum exceeds 1.0 for a participant for a Limitation Year, the Annual Benefit otherwise payable to the participant under this plan will be limited in accordance with section _____ of the adoption agreement.

(Note to reviewer: The blank above should be filled in with the section of the adoption agreement in which the plan under which benefits will be limited in order to satisfy the limitation of this section, and the methodology to be used, are specified. This language is not provided.)

Unless a different group of employees is elected in the adoption agreement, benefit increases resulting from the repeal of § 415(e) will be provided to all current and former participants (with benefits limited by § 415(e)) who have an accrued benefit under the plan immediately before the first day of the first Limitation Year beginning in 2000.

(Note to reviewer: Plans may elect in section I of the adoption agreement to provide benefit increases resulting from the repeal of § 415(e) to a different group of employees. See section I of the adoption agreement.)

(Note to reviewer: A plan may elect under Rev. Proc. 2000-20 to continue to apply the combined plan limitations of section 2.2 of LRM 40 to participants in Limitation Years beginning after December 31, 1999, and prior to the plan's adoption date of its GUST restatement. However, in the case of a standardized form plan, the employer will not have reliance on its opinion letter for this period, without a determination letter. Language is not provided for such continued application of the combined plan limitations of section 2.2 of LRM 40. See Q&A-8 of Notice 99-44, relating to qualification requirements that may not be satisfied if a plan continues to limit benefits after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations.)

Section 3. In the case of an individual who was a participant in one or more defined benefit plans of the employer as of the first day of the first Limitation Year beginning after December 31, 1986, the application of the limitations of this article shall not cause the Maximum Permissible Benefit for such individual under all such defined benefit plans to be less than the individual's Tax Reform Act of 1986 (TRA '86) accrued benefit. The preceding sentence applies only if such defined benefit plans met the

requirements of § 415 of the Internal Revenue Code, for all Limitation Years beginning before January 1, 1987.

Section 4. If elected in section _____ of the adoption agreement, where an individual was a participant in one or more defined benefit plans of the employer as of the first day of the first Limitation Year beginning after December 31, 1994, the application of the limitations of this article shall not cause the Maximum Permissible Benefit for such individual under all such defined benefit plans to be less than the individual's Retirement Protection Act of 1994 (RPA '94) Old-Law Benefit. The preceding sentence applies only if such defined benefit plans met the requirements of § 415 of the Internal Revenue Code on December 7, 1994.

(Note to reviewer: The blank above should be filled in with the section of the adoption agreement where an employer elects whether to provide an RPA '94 Old-Law Benefit. See section E of the adoption agreement.)

Section 5. Definitions.

Section 5.1. Annual Additions: The sum of the following amounts credited to a participant's account for the Limitation Year:

(i) employer contributions;

(ii) employee contributions,

(iii) forfeitures;

(iv) allocations under a simplified employee pension; and

(v) amounts allocated after March 31, 1984, to an individual medical account that is part of a pension or annuity plan maintained by the employer, and amounts derived from contributions paid or accrued after December 31, 1985, in taxable years ending after such date, that are attributable to post-retirement medical benefits allocated to the separate account of a key employee (as defined in § 419A(d)(3) of the Internal Revenue Code) under a welfare benefit fund.

(Note to Reviewer: the amounts in (v) above are treated as Annual Additions to a defined contribution plan.)

Section 5.2. Annual Benefit: A benefit that is payable annually in the form of a straight life annuity. Except as provided below, where a benefit is payable in a form other than a straight life

annuity, the benefit must be adjusted to an actuarially equivalent straight life annuity before applying the limitations of this article. Effective for limitation years beginning on or after January 1, 1995, where a participant's benefit must be adjusted to an actuarially equivalent straight life annuity, the actuarially equivalent straight life annuity is equal to the greater of the annuity benefit computed using the interest rate specified in section _____ of the plan and the mortality table (or other tabular factor) specified in section _____ of the plan, and the annuity benefit computed using a 5 percent interest rate assumption and the applicable mortality table defined in section _____ of the plan. In determining the actuarially equivalent straight life annuity for a benefit form other than (1) a nondecreasing annuity payable for a period of not less than the life of the participant (or, in the case of a qualified pre-retirement survivor annuity, the life of the surviving spouse), or (2) an annuity that decreases during the life of the participant merely because of (a) the death of the survivor annuitant (but only if the reduction is not below 50% of the benefit payable before the death of the survivor annuitant), or (b) the cessation or reduction of Social Security supplements or qualified disability payments (as defined in § 401(a)(11)), "the applicable interest rate", as defined in section _____ of the plan, will be substituted for "a 5 percent interest rate assumption" in the preceding sentence. However, where an employer has elected in the adoption agreement to provide an RPA '94 Old-Law Benefit, such actuarially equivalent straight life annuity is determined in accordance with section 6.

No actuarial adjustment to the benefit is required for (a) the value of a qualified joint and survivor annuity, (b) benefits that are not directly related to retirement benefits (such as a qualified disability benefit, pre-retirement death benefits, and post-retirement medical benefits), and (c) the value of post-retirement cost-of-living increases made in accordance with § 415(d) of the Internal Revenue Code and section 1.415-3(c)(2)(iii) of the Income Tax Regulations. The Annual Benefit does not include any benefits attributable to employee contributions or rollover contributions, or the assets transferred from a qualified plan that was not maintained by the employer.

(Note to reviewer: The 1st and 2nd blanks above should be filled in with the sections of the plan that specify, respectively, the interest rate and mortality table specified for such actuarial equivalence. The 3rd and 4th blanks above should be filled in with the sections of the plan that specify, respectively, the applicable mortality table and applicable interest rate and that correspond, respectively, to sections 3 and 2 of LRM #42.)

Section 5.3. Compensation: As elected by the employer in the adoption agreement, Compensation shall mean one of the following:

(1) Information required to be reported under §§ 6041, 6051, and 6052 of the Internal Revenue Code (wages, tips, and other compensation as reported on Form W-2). Compensation is defined as wages, within the meaning of § 3401(a), and all other payments of compensation to an employee by the 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 §§ 6041(d), 6051(a)(3), and 6052. Compensation must be determined without regard to any rules under § 3401(a) 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 § 3401(a)(2)).

(2) Section 3401(a) wages. Compensation is defined as wages within the meaning of § 3401(a) for the purposes of income tax withholding at the source but determined without regard to 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 § 3401(a)(2)).

(3) 415 safe-harbor compensation. Compensation is defined as wages, salaries, and 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 (including, but not limited to, commissions paid salesmen, 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)), and excluding the following:

(a) Employer contributions to a plan of deferred compensation which are not includible in the employee's gross income for the taxable year in which contributed, or employer contributions under a simplified employee pension to the extent such contributions are deductible by the employee, or any distributions from a plan of deferred compensation;

(b) Amounts realized from the exercise of a non-qualified stock option, or when restricted stock (or property) held by the employee either becomes freely transferable or is no longer subject to a substantial

risk of forfeiture;

(c) Amounts realized from the sale, exchange or other disposition of stock acquired under a qualified stock option; and

(d) Other amounts which received special tax benefits, or contributions made by the employer (whether or not under a salary reduction agreement) towards the purchase of an annuity contract described in § 403(b) of the Internal Revenue Code (whether or not the contributions are actually excludable from the gross income of the employee).

For any self-employed individual, Compensation will mean earned income.

For Limitation Years beginning after December 31, 1991, compensation for a Limitation Year is the compensation actually paid or made available during such Limitation Year.

For Limitation Years beginning after December 31, 1997, compensation paid or made available during such Limitation Year shall include any elective deferral (as defined in Code § 402(g)(3)), and any amount which is contributed or deferred by the employer at the election of the employee and which is not includible in the gross income of the employee by reason of §§ 125 or 457. For Limitation Years beginning after December 31, 2000, or an earlier date specified in the adoption agreement, Compensation shall also include any elective amounts that are not includible in the gross income of the employee by reason of § 132(f)(4).

Section 5.4. Defined Benefit Compensation Limitation: 100 percent of a participant's High Three-Year Average Compensation, payable in the form of a straight life annuity.

In the case of a participant who has separated from service, the Defined Benefit Compensation Limitation applicable to the participant will be automatically adjusted by multiplying such limitation by the cost-of-living adjustment factor prescribed by the Secretary of the Treasury under § 415(d) of the Internal Revenue Code in such manner as the Secretary shall prescribe. The adjusted compensation limit will apply to Limitation Years ending with or within the calendar year of the date of the adjustment.

Section 5.5. Defined Benefit Dollar Limitation: $90,000, automatically adjusted, effective January 1 of each year, under § 415(d) of the Internal Revenue Code in such manner as the Secretary shall prescribe, and payable in the form of a straight

life annuity. The new limitation will apply to Limitation Years ending with or within the calendar year of the date of the adjustment.

Section 5.6. Defined Benefit Plan Fraction: a fraction, the numerator of which is the sum of the participant's projected Annual Benefits under all the defined benefit plans (whether or not terminated) maintained by the employer, and the denominator of which is the lesser of (i) 125 percent of the Defined Benefit Dollar Limitation applicable to the participant, or (ii) 140 percent of the Defined Benefit Compensation Limitation applicable to the participant, both adjusted as necessary in accordance with section 5.11 below.

Notwithstanding the above, if the participant was a participant as of the first day of the first Limitation Year beginning after December 31, 1986, in one or more defined benefit plans maintained by the employer which were in existence on May 6, 1986, the denominator of this fraction will not be less than 125 percent of the sum of the Annual Benefits under such plans which the participant had accrued as of the close of the last Limitation Year beginning before January l, 1987, disregarding any changes in the terms and conditions of the plans after May 5, 1986. The preceding sentence applies only if the defined benefit plans individually and in the aggregate satisfied the requirements of § 415 for all Limitation Years beginning before January 1, 1987.

Section 5.7. Defined Contribution Plan Fraction: A fraction, the numerator of which is the sum of the Annual Additions to the participant's account under all the defined contribution plans (whether or not terminated) maintained by the employer for the current and all prior Limitation Years, (including the Annual Additions attributable to the participant's voluntary employee contributions, or mandatory employee contributions as defined in § 411(c)(2)(C) of the Internal Revenue Code, to this and all other defined benefit plans (whether or not terminated) maintained by the employer, and the Annual Additions attributable to all welfare benefit funds maintained by the employer (as defined in § 419(e) of the Internal Revenue Code) under which amounts attributable to post-retirement medical benefits are allocated to separate accounts of key employees (as defined in § 419(A)(d)(3)), or individual medical accounts and simplified employee pensions maintained by the employer), and the denominator of which is the sum of the maximum aggregate amounts for the current and all prior Limitation Years of the participant’s service with the employer (regardless of whether a defined contribution plan was maintained by the employer).

The maximum aggregate amount for any Limitation Year is the lesser of (1) 125 percent of the Defined Contribution Dollar Limitation ,

or (2) 35 percent (1.4 x 25 percent) of the participant's Compensation for such year.

The Annual Addition for any Limitation Year beginning before January 1, 1987, shall not be recomputed to treat all employee contributions as Annual Additions.

If the employee was a participant as of the first day of the first Limitation Year beginning after December 31, 1986, in one or more defined contribution plans maintained by the employer which were in existence on May 6, 1986, the numerator of this fraction will be adjusted if the sum of this fraction and the Defined Benefit Plan Fraction would otherwise exceed 1.0 under the terms of this plan. Under the adjustment, an amount equal to the product of (l) the excess of the sum of the fractions over 1.0 times (2) the denominator of this fraction, will be permanently subtracted from the numerator of this fraction. The adjustment is calculated using the fractions as they would be computed as of the end of the last Limitation Year beginning before January 1, 1987, and disregarding any changes in the terms and conditions of the plans made after May 5, 1986, but using the § 415 limitation applicable to the first Limitation Year beginning on or after January 1, 1987.

Section 5.8. Employer: For purposes of this article, employer shall mean the employer that adopts this plan, and all members of a controlled group of corporations (as defined in § 414(b) of the Internal Revenue Code, as modified by § 415(h)), all commonly controlled trades or businesses (as defined in § 414(c) as modified by § 415(h)), or affiliated service groups (as defined in § 414(m)) of which the adopting employer is a part, and any other entity required to be aggregated with the employer pursuant to § 414(o) of the Internal Revenue Code.

Section 5.9. High Three-Year Average Compensation: The average compensation for the three consecutive years of service with the employer that produces the highest average. A year of service with the employer is the 12-consecutive month period defined in section _____ of the adoption agreement.

Section 5.10. Limitation Year: A calendar year, or the 12-consecutive month period elected by the employer in section _____ of the adoption agreement. All qualified plans maintained by the employer must use the same Limitation Year. If the Limitation Year is amended to a different 12-consecutive month period, the new Limitation Year must begin on a date within the Limitation Year in which the amendment is made.

Section 5.11. Maximum Permissible Benefit: The lesser of the Defined Benefit Dollar Limitation or the Defined Benefit

Compensation Limitation (both adjusted where required, as provided below).

(a) If the participant has less than 10 years of participation in the plan, the Defined Benefit Dollar Limitation shall be multiplied by a fraction -- (i) the numerator of which is the number of years (or part thereof) of participation in the plan, and (ii) the denominator of which is 10. In the case of a participant who has less than ten years of service with the employer, the Defined Benefit Compensation Limitation shall be multiplied by a fraction -- (i) the numerator of which is the number of years (or part thereof) of service with the employer, and (ii) the denominator of which is 10.

Where a Defined Benefit Plan Fraction is calculated, the adjustments of this section (a) shall be applied in the denominator of the fraction based upon years of service. For purposes of computing the Defined Benefit Plan Fraction only, years of service shall include future years of service (or part thereof) commencing before the participant's normal retirement age. Such future years of service shall include the year that contains the date the participant reaches normal retirement age, only if it can be reasonably anticipated that the participant will receive a year of service for such year, or the year in which the participant terminates employment, if earlier.

(b) If the Annual Benefit of the participant commences before the participant's Social Security Retirement Age, but on or after age 62, the Defined Benefit Dollar Limitation (as reduced in (a) above, if necessary) shall be determined as follows:

(i) If a participant's Social Security Retirement Age is 65, for benefits commencing on or after age 62, the Defined Benefit Dollar Limitation is reduced by 5/9 of one percent for each month by which benefits commence before the month in which the participant attains age 65.

(ii) If a participant's Social Security Retirement Age is greater than 65, for benefits commencing on or after age 62, the Defined Benefit Dollar Limitation is reduced by 5/9 of one percent for each of the first 36 months and 5/12 of one percent for each of the additional months (up to 24 months) by which benefits commence before the month of the participant's Social Security Retirement Age.

(c) If the benefit of a participant commences prior to age 62, the Defined Benefit Dollar Limitation applicable to the participant at such earlier age is an annual benefit payable in the form of a straight life annuity that is the actuarial equivalent of the Defined Benefit Dollar Limitation for age 62, as determined above, reduced for each month by which benefits commence before the month in which the participant attains age 62. Effective for Limitation Years beginning on or after January 1, 1995, the Defined Benefit Dollar Limitation applicable at an age prior to age 62 is determined as the lesser of the actuarial equivalent of the Defined Benefit Dollar Limitation for age 62 computed using the interest rate and mortality table (or other tabular factor) specified in section _____ of the plan, and the actuarial equivalent of the Defined Benefit Dollar Limitation for age 62 computed using a 5 percent interest rate and the applicable mortality table as defined in section _____ of the plan. Any decrease in the Defined Benefit Dollar Limitation determined in accordance with this provision (c) shall not reflect a mortality decrement if benefits are not forfeited upon the death of the participant. If any benefits are forfeited upon death, the full mortality decrement is taken into account.

(Note to reviewer: The 1st blank above should be filled in with the section number of the plan that specifies the actuarial equivalence factors to be used for early retirement purposes. The 2nd blank above should be filled in with the section number of the plan corresponding to section 3 of LRM #42.)

(d) If the benefit of a participant commences after the participant's Social Security Retirement Age, the Defined Benefit Dollar Limitation applicable to the participant at the later age is the annual benefit payable in the form of a straight life annuity commencing at the later age that is actuarially equivalent to the Defined Benefit Dollar Limitation applicable to the participant (adjusted under (a) above, if necessary) at the participant's Social Security Retirement Age. Effective for Limitation Years beginning on or after January 1, 1995, the actuarial equivalent of the Defined Benefit Dollar Limitation at the participant's Social Security Retirement Age is determined as the lesser of the actuarial equivalent of the Defined Benefit Dollar Limitation at the participant's Social Security Retirement Age computed using the interest rate and mortality table (or other tabular factor) specified in section _____ of the plan, and the actuarial equivalent of the Defined Benefit Dollar Limitation at the participant's Social Security Retirement Age computed using a 5 percent interest rate assumption and the applicable mortality table as defined in section _____ of the plan.

For these purposes, mortality between a participant's Social Security Retirement Age and the age at which benefits commence must be ignored.

(Note to reviewer: The 1st blank above should be filled in with the section number of the plan that specifies the actuarial equivalence factors to be used for delayed retirement purposes. The 2nd blank above should be filled in with the section number of the plan corresponding to section 3 of LRM #42.)

(e) Minimum benefit permitted: Notwithstanding anything else in this section to the contrary, the benefit otherwise accrued or payable to a participant under this plan shall be deemed not to exceed the Maximum Permissible Benefit if:

(i) the retirement benefits payable for a plan year under any form of benefit with respect to such participant under this plan and under all other defined benefit plans (regardless of whether terminated) ever maintained by the employer do not exceed $1,000 multiplied by the participant's number of years of service or parts thereof (not to exceed 10) with the employer; and

(ii) the employer has not at any time maintained a defined contribution plan, a welfare benefit fund under which amounts attributable to post-retirement medical benefits are allocated to separate accounts of key employees (as defined in § 419(A)(d)(3)), or an individual medical account in which the participant participated (for these purposes, employee contributions, whether voluntary or involuntary, under a defined benefit plan are not treated as a separate defined contribution plan).

Section 5.12. Projected Annual Benefit: The Annual Benefit as defined in section 5.2 of this article, to which the participant would be entitled under the terms of the plan assuming:

(a) the participant will continue employment until normal retirement age under the plan (or current age, if later), and

(b) the participant's Compensation for the current Limitation Year and all other relevant factors used to determine benefits under the plan will remain constant for all future Limitation Years.

(Note to reviewer on sections 5.13, 5.14, and 5.15 below: Only plans adopted and in effect on December 7, 1994, and which satisfy the requirements of § 415 as in effect on December 7, 1994, may

have an RPA ’94 Final Implementation Date, an RPA ’94 Freeze Date, and participants with an RPA ’94 Old-Law Benefit.)

Section 5.13. RPA ’94 Final Implementation Date: The first day of the first limitation year beginning on or after January 1, 2000, unless an earlier date is specified in section _____ of the adoption agreement.

(Note to reviewer: The blank above should be filled in with the section of the adoption agreement, which specifies the Final Implementation Date for the plan.)

(Note to reviewer: Sponsors who amended their plans for RPA ’94 changes to § 415(b)(2)(E) prior to August 20, 1996, (SBJPA enactment date) were permitted by SBJPA to amend the plan to repeal their amendment within one year of the enactment of SBJPA, and this period was extended by section 3.03 of Rev. Proc. 99-23 to the last day of the first plan year beginning on or after January 1, 2000. The period was further extended to the last day of the first plan year beginning on or after January 1, 2001, by section 4 of Rev. Proc. 2000-27.)

Section 5.14. RPA ’94 Freeze Date: The date as of which a participant’s RPA ‘94 Old-Law Benefit is determined, specified in section _____ of the adoption agreement.

(Note to reviewer: The blank above should be filled in with the section of the adoption agreement which specifies the RPA ‘94 Freeze Date, which must be a date prior to the plan’s Final Implementation Date.

Section 5.15. RPA '94 Old-Law Benefit: The participant's accrued benefit under the terms of the plan as of the RPA '94 Freeze Date, for the annuity starting date and optional form and taking into account the limitations of § 415, as in effect on December 7, 1994, including the participation requirements under § 415(b)(5). In determining the amount of a participant's RPA '94 Old-Law Benefit, the following shall be disregarded:

(i) any plan amendment increasing benefits adopted after the RPA '94 Freeze Date; and

(ii) any cost-of-living adjustments that become effective under § 415(d) after the RPA ’94 Freeze Date.

If, at any date after the RPA '94 Freeze Date, the participant's total plan benefit, before the application of § 415, is less than the participant's RPA '94 Old-Law Benefit, the RPA '94 Old-Law Benefit will be reduced to a benefit equal to the participant's total plan benefit.

Unless a different group of employees is elected in the adoption agreement, for all current and former participants who have an accrued benefit under the plan immediately before the first day of the first Limitation Year beginning in 2000, if the RPA '94 Old-Law Benefit was reduced during the period between the RPA '94 Freeze Date and the first day of the first Limitation Year beginning on or after January 1, 2000, because of Annual Additions credited to a participant's account in a defined contribution plan, the RPA '94 Old-Law Benefit will increase to the RPA '94 Freeze Date level as of the first day of the first Limitation Year beginning on or after January 1, 2000.

(Note to reviewer: Plans may elect in section I of the adoption agreement to provide benefit increases resulting from the repeal of § 415(e) to a different group of employees. If a different group of employees is elected under section I, that group will receive the increase described above. See section I of the adoption agreement.)

The use of a different interest rate and mortality table may not increase a participant's RPA '94 Old-Law Benefit to an amount greater than such benefit as of the RPA '94 Freeze Date.

(Note to reviewer: If the plan is amended for the RPA '94 § 417(e)(3) changes on or before the RPA '94 Freeze Date, such changes must be taken into account in determining the plan benefit used in the calculation of a participant's RPA '94 Old-Law Benefit, and where a variable rate (e.g., PBGC rates, applicable rate) is used under the plan, the rate in effect on the RPA '94 Freeze Date is used to determine the RPA '94 Old-Law Benefit on the RPA '94 Freeze Date.)

Section 5.16. Social Security Retirement Age: Age 65 in the case of a participant born before January 1, 1938; age 66 for a participant born after December 31, 1937, but before January 1, 1955; and age 67 for a participant born after December 31, 1954.

Section 5.17. TRA '86 Accrued Benefit: A participant's accrued benefit under the plan, determined as if the participant had separated from service as of the close of the last Limitation Year beginning before January 1, 1987, when expressed as an Annual Benefit within the meaning of § 415(b)(2) of the Internal Revenue Code. In determining the amount of a participant's TRA '86 Accrued Benefit, the following shall be disregarded:

(i) any change in the terms and conditions of the plan after May 5, 1986; and

(ii) any cost-of-living adjustments occurring after May 5, 1986.

Section 5.18. Year of Participation: The participant shall be credited with a Year of Participation (computed to fractional parts of a year) for each accrual computation period for which the following conditions are met: (1) 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 (2) the participant is included as a 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 shall equal the amount of benefit accrual service credited to the participant for such accrual computation period. A participant who is permanently and totally disabled within the meaning of § 415(c)(3)(C)(i) of the Internal Revenue Code for an accrual computation period shall receive a Year of Participation with respect to that period. In addition, for a participant to receive a Year of Participation (or part thereof) for an accrual computation period, the plan must be established no later that the last day of such accrual computation period. In no event will more than one Year of Participation be credited for any 12-month period.

Section 6. Transition Rule – Applying the limitations of this article when a participant has an RPA '94 Old-Law Benefit: For participants with RPA '94 Old-Law Benefits, for purposes of determining whether a participant's benefit exceeds the limitations of this article after the RPA '94 Freeze Date, the employer will elect in section _____ of the adoption agreement which of the following 3 methods will be used.

(Note to reviewer: The blank above should be filled in with the section number of the adoption agreement where a plan sponsor elects one of the three methods.)

(1) Method one: Equivalent Annual Benefits are determined separately with respect to the participant's RPA '94 Old-Law Benefit, and the portion of the participant's total plan benefit that exceeds the RPA '94 Old-Law Benefit. A participant's total Annual Benefit is the sum of these two Annual Benefits, and cannot exceed the Maximum Permissible Benefit applicable to the participant.

If the determination is being made before the Final Implementation Date, where a participant's benefit must be adjusted to an actuarially equivalent Annual Benefit, the

Annual Benefit equivalent to the RPA '94 Old-Law Benefit is calculated using an interest rate equal to the greater of the plan interest rate or 5 percent and the plan mortality table, as provided under § 415(b)(2)(E) as in effect on December 7, 1994, and under the plan terms as of December 7, 1994. The Annual Benefit equivalent to the portion of the participant's total plan benefit that exceeds the RPA '94 Old-Law Benefit is calculated as described in section 5.2. For a determination made after the Freeze Date and before the Final Implementation Date, where the Defined Benefit Dollar Limitation is adjusted for commencement of benefits prior to age 62, such adjustments are made in accordance with section 5.11(c); adjustments for commencement of benefits after Social Security Retirement Age are made in accordance with section 5.11(d).

If the determination is being made on or after the Final Implementation Date, where a participant's benefit must be adjusted to an actuarially equivalent Annual Benefit, the Annual Benefit equivalent to the participant's RPA '94 Old-Law Benefit is calculated using an interest rate equal to the greater of the interest rate specified in section _____ of the plan or 5 percent, and the mortality table specified in section _____ of the plan. The Annual Benefit equivalent to the portion of the participant's total plan benefit that exceeds the RPA '94 Old-Law Benefit is calculated as described in section 5.2. For a determination on or after the Final Implementation Date, where the Defined Benefit Dollar Limitation is adjusted for commencement of benefits prior to age 62, such adjustments are made in accordance with section 5.11(c); adjustments for commencement of benefits after Social Security Retirement Age are made in accordance with section 5.11(d).

(Note to reviewer: The 1st blank above should be filled in with the section of the plan where the interest rate to be used for such actuarial equivalence is specified. The 2nd blank above should be filled in with the section of the plan where the mortality table to be used for such actuarial equivalence is specified.)

(Note to reviewer: The blank above should be filled in with the section of the adoption agreement where the employer providing RPA '94 Old-Law Benefits chooses which of the three methods will be used.)

(2) Method two: A participant's total Annual Benefit under the plan is determined, and this benefit must not exceed the Maximum Permissible Benefit applicable to the participant. Where a participant's benefit must be adjusted to an

actuarially equivalent Annual Benefit, an Annual Benefit equivalent to the participant's total benefit is calculated as described in section 5.2. In any event, the participant will receive no less than the participant's RPA '94 Old-Law Benefit.

(3) Method three: A participant's benefit is limited only to the extent needed to satisfy either the first or second method described above.

Under all of the methods above, a participant will receive no less than the participant's RPA '94 Old-Law Benefit. For purposes of determining that a participant receives no less than the participant's RPA '94 Old-Law Benefit, the limitation applicable to the participant's RPA '94 Old-Law Benefit (old-law limitation) is determined, and the participant may receive the RPA '94 Old-Law Benefit to the extent it does not exceed such old-law limitation. Before the Final Implementation Date, adjustments to the old-law limitation for commencement of benefits prior to age 62 are calculated using an interest rate equal to the greater of the plan interest rate or 5 percent and the plan mortality table, as provided under § 415(b)(2)(E) as in effect on December 7, 1994, and under the plan terms as of December 7, 1994; adjustments to the old-law limitation for commencement of benefits after Social Security Retirement Age are calculated using an interest rate equal to the lesser of the plan interest rate or 5 percent and the plan mortality table, as provided under § 415(b)(2)(E) as in effect on December 7, 1994, and under the plan terms as of December 7, 1994. On or after the Final Implementation Date, adjustments to the old-law limitation for commencement of benefits prior to age 62 are calculated using an interest rate equal to the greater of the plan interest rate or 5 percent, and the plan mortality table, using the interest rate and mortality table included in the plan as of the date of determination; adjustments to the old-law limitation for commencement of benefits after Social Security Retirement Age are calculated using an interest rate equal to the lesser of the plan interest rate or 5 percent and the plan mortality table, using the interest rate and mortality table included in the plan as of the date of determination. (However, in no event may a participant's Old-Law Benefit exceed the participant's Old-Law Benefit as of the RPA '94 Freeze Date.)

Sample Adoption Agreement Language:

A. If an employer maintains, or ever maintained, another qualified plan other than paired plan # _____ in which any participant in this plan is (or was) a participant or could become a participant, the employer must complete this section. The employer must also complete this section if it maintains a welfare benefit fund, as defined in § 419(e) of the Internal Revenue Code under which amounts attributable to post-retirement medical benefits are allocated to separate accounts of key employees (as defined in § 419(A)(d)(3)), or an individual medical account, as defined in § 415(l)(2) of the Internal Revenue Code, under which amounts are treated as Annual Additions with respect to any participant in this plan.

(Note to reviewer: For Limitation Years beginning before January 1, 2000, the sponsor should leave space for the adopting employer to provide language that will satisfy the 1.0 limitation of § 415(e) of the Code. Such language must preclude employer discretion as required under Regs. § 1.415-1(d).)

(Note to reviewer: If this plan is paired with another plan maintained by the employer, this plan must provide for the appropriate reductions under IRC 415(e) for Limitation Years beginning before January 1, 2000. See LRM #93 for appropriate language.)

(Note to reviewer: If the employer maintains or has ever maintained another defined benefit plan, such employer must provide language that will assure that the Maximum Permissible Benefit is never exceeded. In the alternative, the employer may identify the other plan that will provide suitable language so that the Maximum Permissible Benefit is never exceeded.)

B. The Limitation Year is the following 12-consecutive month period:_____

C. For purposes of calculating the participant's High Three-Year Average Compensation, a year of service is the following 12-consecutive month period:
_____

D. Compensation will mean all of each participant's:

( ) Wages, tips, and other compensation as reported on Form W-2

( ) Section 3401(a) wages

( ) 415 safe-harbor compensation

For Limitation Years beginning after December 31, 1997, for purposes of applying the limitations of this article, Compensation paid or made available during such Limitation Year shall include any elective deferral (as defined in Code § 402(g)(3)), and any amount which is contributed or deferred by the employer at the election of the employee and which is not includible in the gross income of the employee by reason of §§ 125 or 457. Compensation shall also include any elective amounts that are not includible in the gross income of the employee by reason of § 132(f)(4) for Limitation Years beginning after December 31, 2000. If the plan was first operated in accordance with the § 415 changes under the Community Renewal Tax Relief Act of 2000 on a date prior to the first day of the first Limitation Year beginning in 2001, then Compensation shall include such elective amounts for the Limitation Year including such date and successive Limitation Years, but only if such Limitation Year(s) begin after December 31, 1997. The first Limitation Year (beginning after December 31, 1997) in which the plan was operated in accordance with the § 415 changes under the Community Renewal Tax Relief Act of 2000, is the first Limitation Year beginning after _____.

(Note to reviewer: the above blank should be filled in with the last day of the Limitation Year prior to the first Limitation Year beginning after 1997 in which the plan was operated in accordance with the § 415 changes under the Community Renewal Tax Relief Act of 2000.)

E. Election to provide RPA '94 Old-Law Benefit.

( ) The RPA '94 § 415(b)(2)(E) changes will not be applied with respect to benefits accrued as of the date specified in G below. This election is only available for plans adopted and in effect before December 8, 1994.

(Note to reviewer: For plans adopted and in effect before December 8, 1994, the employer may or may not choose to provide an Old-Law Benefit.)

(Note to reviewer: Employers who do not make the election in E above, will not make elections under F, G, and H below.)

F. The RPA '94 Final Implementation Date, for plans adopted and in effect on December 7, 1994, and which satisfied the requirements of § 415 as of such date, is:

( ) The first day of the first Limitation Year beginning on or after January 1, 2000; or

( ) _____ (Insert the later of the date a plan amendment applying the RPA '94 § 415(b)(2)(E) changes is adopted or made effective.)

(Note to reviewer: the blank above is filled in only if (1) the plan was amended to apply the RPA '94 § 415(b)(2)(E) changes prior to the plan's first Limitation Year beginning in 2000, and (2) the amendment was adopted prior to the plan's first Limitation Year beginning in 2000.)

G. The RPA '94 Freeze Date, applicable to all participants, as of which a participant's RPA '94 Old-Law Benefit is determined is _____, which must be a date prior to the plan's RPA '94 Final Implementation Date.

H. Where a participant has an RPA '94 Old-Law Benefit, the method used to determine whether the participant's benefit exceeds the Maximum Permissible Benefit is:

( ) Method one;

( ) Method two; or

( ) Method three.

(Note to reviewer: an employer having participants with RPA '94 Old-Law Benefits must choose one and only one of the three methods above.)

I. Benefit increases resulting from the repeal of § 415(e).

( ) Benefit increases resulting from the repeal of § 415(e) will only be provided to all employees participating in the plan that have one hour of service after the first day of the first Limitation Year beginning in 2000.

DISTRIBUTION PROVISIONS

41. Document Provision:

Statement of Requirement: Defined benefit plans must state the normal form of benefit for the benefits to be definitely determinable, Regs. §1.401-1(b)(1)(i).

Sample Plan Language:

The normal form of benefit shall be as selected in section _____ of the adoption agreement. The normal form of benefit will not be expressed in the form of a joint and survivor annuity.

(Note to reviewer: To assure that a participant whose benefit is at the 415 limitations does not violate those limitations when the participant elects an alternate form of distribution, the normal form of benefit may not be expressed in the form of a joint and survivor annuity.)

42. Document Provision:

Statement of Requirement: Definite benefit, IRC §401(a)(25), §411(a)(11), §417(e)(3); Regs. §1.401-1(b)(l)(i), §1.411(a)-(11)(d), §1.417(e)-1(d); Rev. Rul. 79-90.

Sample Plan Language:

Section 1. Except to the extent a participant's benefits are suspended in accordance with the suspension of benefits rules in section ____ of the plan, the amount of any form of benefit under the terms of this plan will be the actuarial equivalent of the participant's accrued benefit in the normal form commencing at normal retirement age.

(Note to reviewer: The blank in the preceding paragraph should be

filled in with the section number of the plan corresponding to LRM #55.)

Actuarial equivalence will be determined on the basis of the interest rate and mortality table specified in the adoption agreement. In the case of a plan that provides for the disparity permitted under section 401(l), if benefits commence to a participant at an age other than normal retirement age, the participant's benefit will be adjusted in accordance with section _____ of the plan.

(Note to reviewer: The blank should be filled in with the plan section number corresponding to LRM #27B.)

Notwithstanding the preceding paragraph, for purposes of determining the amount of a distribution in a form other than an Annual Benefit that is nondecreasing for the life of the participant or, in the case of a qualified pre-retirement survivor, the life of the participant's spouse; or that decreases during the life of the participant merely because of the death of the surviving annuitant (but only if the reduction is to a level not below 50% of the Annual Benefit payable before the death of the surviving annuitant) or merely because of the cessation or reduction of Social Security supplements or qualified disability payments, actuarial equivalence will be determined on the basis of the applicable mortality table and applicable interest rate under section 417(e), if it produces a benefit greater than that determined under the preceding paragraph.

The preceding two paragraphs will not apply to the extent they would cause the plan to fail to satisfy the requirements of section ____ or ____ of the plan.

(Note to reviewer: The blanks above should be filled in with the plan section numbers corresponding to LRM #40 and LRM #102.)

Section 2. The applicable interest rate is the rate of interest on 30-year Treasury securities as specified by the Commissioner for the lookback month for the stability period specified in the adoption agreement. The lookback month applicable to the stability period is the first, second, third, fourth, or fifth calendar month preceding the first day of the stability period, as specified in section _____ of the adoption agreement. The stability period is the successive period of one calendar month, one plan quarter, one calendar quarter, one plan year, or one calendar year, as specified in section _____ of the adoption agreement, that contains the annuity starting date for the distribution and for which the applicable interest rate remains constant.

Notwithstanding the election by the employer in section _____ of the adoption agreement, a plan amendment that changes the date for determining the applicable interest rate (including an indirect change as a result of a change in plan year), shall not be given effect with respect to any distribution during the period commencing one year after the later of the amendment's effective date or adoption date, if, during such period and as a result of such amendment, the participant's distribution would be reduced.

(Note to reviewer: The blanks above should be filled in with the corresponding adoption agreement section numbers at the end of this LRM #42.)

Section 3. The section 417 applicable mortality table is set forth in Rev. Rul. 95-6, 1995-1 C.B. 80.

(Note to reviewer: The sponsor may include language that provides for a reduction to the post-normal retirement age benefit accrual otherwise required under section 411(b)(1)(H) of the Code to the extent permitted under Proposed Regulations 1.411(b)-2(b)(4). But see LRM #51 for special rules on the interaction of certain actuarial increases with section 411(b)(1)(H).)

Sample Adoption Agreement Language:

A. Except as provided in section ____ of the plan, actuarial equivalence will be determined based on the following interest and mortality assumptions:

(Note to reviewer: The blank above should be filled in with the plan section number corresponding to LRM #42.)

Interest rate: _____% (must be between 7 ½% & 8 ½% if the plan provides for permitted disparity under section 401(l) of the Internal Revenue Code)

Mortality table: _____(must be standard mortality table as described in section 1.401(a)(4)-12 of the Income Tax Regulations if the plan provides for permitted disparity under section 401(l) of the Internal Revenue Code)

B. For purposes of the time for determining the applicable interest rate, the stability period under the plan is:

( ) one calendar month

( ) one plan quarter

( ) one calendar quarter

( ) one plan year

( ) one calendar year

The lookback month, relating to the stability period under the plan, is the:

( ) first

( ) second

( ) third

( ) fourth

( ) fifth

calendar month preceding the first day of the stability period.

C. The provisions of section _____ and section _____ relating to the applicable interest rate and applicable mortality table respectively, shall apply to distributions in plan years beginning after _____ (this date must be earlier than the first day of the first plan year beginning after December 31, 1999).

(Note to reviewer: The first two blanks should be filled in with the section numbers of the plan corresponding to sections 2 and 3, respectively, of LRM #42.)

DEFINED BENEFIT LISTING OF REQUIRED MODIFICATIONS AND INFORMATION PACKAGE (LRMS) ITEM #40 (SECTION 415) 02-2000 VERSION

The Service has issued a revised LRM Item #40 (Section 415) of the 02-2000 version of the Defined Benefit Listing of Required Modifications and Information Package (LRMs). The adoption agreement language in the revised LRM 40 includes specific elections for employers to provide RPA'94 Old-Law Benefits and the associated RPA '94 Freeze Dates and RPA '94 Final Implementation Dates; corresponding plan language has been expanded and clarified. A significant change in the revised LRM 40 (made in response to requests from practitioners) is the expansion of the methodology, used to determine whether benefits of participants with RPA '94 Old-Law Benefits satisfy the limitations of § 415(b), to provide the employer a choice of using any one of three methods described in Q&A-14 of Revenue Ruling 98-1. Additionally, the revised LRM 40 provides that, unless a different group of employees is elected in the adoption agreement, benefit increases resulting from the repeal of § 415(e) are provided to all current and former participants (with benefits limited by § 415(e)) who have an accrued benefit under the plan immediately before the first day of the first Limitation Year beginning in 2000.

Other changes include: a change in terminology from "maximum permissible amount" and "highest average compensation" to, respectively, "Maximum Permissible Benefit" and "High Three-Year Average Compensation"; "Defined Benefit Compensation Limitation" is defined; "welfare benefit fund" language is expanded; and elective reductions under § 132(f)(4) are included in "Compensation" for limitation years beginning after December 31, 2000 (or an earlier date specified in the adoption agreement).

PART III - ADMINISTRATIVE, PROCEDURAL AND MISCELLANEOUS

Inclusion of Elective Reductions for Qualified Transportation Fringes in Compensation Under Qualified Plans and 403(b) Plans

Notice 2001-37

I. PURPOSE

The purpose of this notice is to provide guidance relating to the amendments made by § 314(e) of the Community Renewal Tax Relief Act of 2000 ("CRA") to §§ 403(b)(3), 414(s)(2), and 415(c)(3) of the Internal Revenue Code. These Code sections provide definitions of compensation that apply to plans described in §§ 401(a) and 403(a) ("qualified plans") and § 403(b) ("403(b) plans"). The CRA amendments change these compensation definitions to reflect the amount of the compensation reduction elected for qualified transportation fringes that is not includible in the employee's gross income by reason of § 132(f)(4) of the Code ("§ 132(f) elective reductions"). The CRA amendments to §§ 403(b)(3), 414(s), and 415(c)(3) are retroactively effective for years beginning after December 31, 1997.

Specifically, this notice provides that –

- Qualified plans must be operated in accordance with the CRA amendments for plan and limitation years beginning on or after January 1, 2001. Plan amendments that are needed as a result of the CRA amendments must be adopted within the GUST remedial amendment period. The plan amendments must be effective no later than the first day of the first plan and limitation years beginning on or after January 1, 2001.

- Sponsors of qualified plans may satisfy the preceding requirements by adopting the model amendments included in the appendix to this notice.

- Qualified plans will not be disqualified solely on account of a failure to reflect in form or operation the CRA amendments to §§ 414(s) and 415(c)(3) for plan and limitation years beginning before January 1, 2001. Retroactive plan amendments that take the CRA amendments into account for those years are required only for plans that operated in those years in accordance with §§ 414(s) and 415(c)(3) as amended.

- Exclusion allowances for employees who participate in 403(b) plans need not be recalculated under § 403(b)(2) on account of the CRA amendments for years before January 1, 2001.

II. BACKGROUND

Section 132(a)(5) of the Code provides that a qualified transportation fringe is excluded from an employee's gross income. Section 132(f)(1) defines a qualified transportation fringe to include employer-provided transportation in a commuter highway vehicle between the employee's home and office, transit passes, and qualified parking. Section 132(f)(4) provides that no amount is included in an employee's gross income solely because the employer offers the employee a choice between any qualified transportation fringe and compensation that would otherwise be included in gross income.

The definition of compensation under § 415(c)(3) is used to determine whether annual additions to a participant's account exceed the percentage limitation described in § 415(c)(1)(B). The definition is also used for other purposes under the Code relating to qualified plans, including the percentage limitation described in § 415(b)(1)(B), the determination of who is a highly compensated employee under § 414(q), and the determination of who is a key employee and the amount of required minimum contributions or benefits for top-heavy plans under § 416. Further, this definition is frequently used by qualified plans to determine employees' benefits. Section 415(c)(3)(D) was added by the Small Business Job Protection Act of 1996 ("SBJPA"), effective for years beginning after December 31, 1997. Prior to amendment by CRA, § 415(c)(3)(D) provided that a participant's compensation includes elective deferrals as defined in § 402(g)(3) and amounts contributed or deferred by the employer at the election of the employee that are not includible in gross income by reason of § 125 or 457. CRA amended § 415(c)(3)(D)(ii), effective for years beginning after December 31, 1997, to provide that a participant's compensation for any year after 1997 also includes § 132(f) elective reductions. It should be noted that, for some of the purposes for which the definition of § 415(c)(3) is used, e.g., the definition of highly compensated employee (which is required to be based on prior year compensation data), the change to the § 415(c)(3) compensation would not affect the plan until the year after the first year for which it is effective.

Section 414(s) provides a definition of compensation that applies for any Code provision that specifically refers to § 414(s). The definition of compensation under § 414(s) is used for nondiscrimination testing under qualified plans and 403(b) plans, including the actual deferral percentage ("ADP") test under § 401(k)(3) and the actual contribution percentage ("ACP") test under § 401(m)(2). Section 414(s)(1) provides that compensation has the meaning given in § 415(c)(3). Prior

to amendment by CRA, § 414(s)(2) provided that an employer may elect not to include as compensation amounts contributed by the employer pursuant to a salary reduction agreement that are not includible in the employee's gross income under § 125, 402(e)(3), 402(h), or 403(b). CRA amended § 414(s)(2), effective for years beginning after December 31, 1997, to add § 132(f) elective reductions to this list. Section 414(s)(3) requires the Secretary of the Treasury to provide for alternative definitions of compensation that satisfy § 414(s) and that do not discriminate in favor of highly compensated employees.

Section 1.414(s)-1(c)(1) prescribes general rules regarding the definition of compensation under § 414(s). Section 1.414(s)-1(c)(2) provides that a definition of compensation that includes all compensation under § 415(c)(3), as described in § 1.415-2(d), and excludes all other compensation, is a safe harbor definition of compensation for purposes of § 414(s). Prior to the amendment of § 415(c)(3) by SBJPA, total compensation under § 415(c)(3) did not include elective amounts. Section 1.414(s)-1(c)(4) provides that a definition of compensation that includes all compensation under § 415(c)(3) and also includes elective amounts that are not includible in gross income under §§ 125, 402(e)(3), 401(h), and 403(b), compensation deferred under an eligible deferred compensation plan described in § 457(b), and employee contributions described in § 414(h)(2) that are picked up by the employer, is a safe harbor definition of compensation for purposes of § 414(s). Section 1.414(s)-1(c)(1) and (4) does not reflect the amendments to § 415(c)(3) by SBJPA and CRA. A definition of compensation that does not satisfy one of the safe harbors can nonetheless satisfy § 414(s) if it satisfies the nondiscrimination requirement of § 1.414(s)-1(d).

Section 403(b)(3) provides a definition of "includible compensation" that is used for purposes of determining an employee's exclusion allowance under § 403(b)(2). The Taxpayer Relief Act of 1997 ("TRA '97") amended the definition of includible compensation under § 403(b)(3) to include elective deferrals as defined in § 402(g)(3) and amounts contributed or deferred by the employer at the election of the employee that are not currently includible in gross income by reason of § 125 or 457, effective for years beginning after December 31, 1997. CRA amended § 403(b)(3)(B), effective for years beginning after December 31, 1997, to provide that includible compensation for any year after 1997 also includes § 132(f) elective reductions. For employees who make the election under § 415(c)(4)(D) to have the provisions of § 415(c)(4)(C) apply, the exclusion allowance under § 403(b)(2) is determined with reference to the limitations under § 415. In this case, the definition of compensation under § 415(c)(3) applies.

Section 1.401(b)-1(b)(3) authorizes the Commissioner to designate a plan provision as a disqualifying provision if the provision either (1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those

requirements or (2) is integral to a qualification requirement that has been changed. The remedial amendment period for a disqualifying provision that is integral to a qualification requirement that has been changed begins on the first day on which the plan was operated in accordance with such provision, as amended (unless another time is specified by the Commissioner). Section 1.401(b)-1(c)(3) authorizes the Commissioner, in the case of disqualifying provisions designated as described in the preceding sentence, to impose limits and provide additional rules regarding the amendments that may be made with respect to that disqualifying provision.

Revenue Procedure 2000-27, 2000-26 I.R.B. 1272, provides that the GUST remedial amendment period for nongovernmental plans ends on the last day of the first plan year beginning on or after January 1, 2001. The remedial amendment period for governmental plans, as defined in § 414(d), ends on the later of (i) the last day of the first plan year beginning on or after January 1, 2001 or (ii) the last day of the first plan year beginning on or after the "2000 legislative date" (that is, the 90th day after the opening of the first legislative session beginning after December 31, 1999 of the governing body with authority to amend the plan, if that body does not meet continuously). An extended GUST remedial amendment period may be available under the provisions of Rev. Proc. 2000-20, 2000-6 I.R.B. 553. The GUST remedial amendment period is available for certain plan amendments, including amendments to comply with the Uruguay Round Agreements Act, the Uniformed Services Employment and Reemployment Rights Act of 1994, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, and the Internal Revenue Service Restructuring and Reform Act of 1998.

III. APPLICATION OF THE CRA AMENDMENTS TO §§ 414(s) AND 415(c)(3) TO QUALIFIED PLANS

The CRA amendments not only change the definitions of compensation under §§ 414(s) and 415(c) but also, as described above, affect other qualification requirements that depend in part on those Code sections. Pursuant to § 1.401(b)-1(b)(3), plan provisions that must be amended as a result of the CRA amendments and plan provisions that are integrally related to qualification requirements changed by the CRA amendments are hereby designated disqualifying provisions, as further described below. Pursuant to the authority under § 1.401(b)-1(c)(3), the remedial amendment period with respect to such disqualifying provisions ends on the last day of a plan's GUST remedial amendment period.

A. Prospective application

For plan and limitation years beginning on or after January 1, 2001, a plan provision is a disqualifying provision if it causes the plan to fail to satisfy the qualification requirements as a result of the CRA amendments for such years. Accordingly, a plan must be amended within the plan's GUST remedial amendment period to the extent necessary to comply in form with the CRA amendments for plan and limitation years beginning on or after January 1, 2001. The plan must also be operated in accordance with the CRA amendments for those years.

B. Retroactive application

Pursuant to § 7805(b), the Service will not treat a qualified plan as having failed to satisfy the requirements of § 401(a) merely because the plan did not take the CRA amendments into account for plan or limitation years beginning before January 1, 2001.

For plan and limitation years beginning on or after January 1, 1998, a plan provision is a disqualifying provision if the plan provision is integral to a qualification requirement changed by the CRA amendments. Thus, plans that took the CRA amendments into account in operation for plan or limitation years beginning before January 1, 2001 must be retroactively amended within the GUST remedial amendment period to the extent necessary to comply in form with the CRA amendments. The plan amendments must be effective retroactively to the first day of the plan and limitation years for which the plan was first operated in accordance with the CRA amendments. Under this notice, retroactive plan amendments that take into account the CRA amendments for plan and limitation years beginning before January 1, 2001 are required only for those plans that took the CRA amendments into account in operation for those years. A plan that has not been operated in accordance with the CRA amendments for plan or limitation years beginning before January 1, 2001 may not be amended retroactively for CRA, but must be amended for years beginning on or after January 1, 2001, as described in § IIIA above.

C. Examples

The following examples illustrate the application of the CRA amendment to § 415(c)(3) to qualified plans. The examples assume, in each case, that the employers provide for § 132(f) elective reductions.

Example 1. Employer A sponsors a calendar year defined benefit plan that specifically includes amounts deferred under §§ 125, 402(g)(3), and 457, but not § 132(f) elective reductions, in the definition of compensation for purposes of

applying the § 415(b) limitations, the definition of key employee under § 416, and calculating the § 416 top-heavy minimums. Because the plan's definition of compensation is used for purposes of the plan's provisions relating to §§ 415 and 416, the plan must be operated and amended, effective January 1, 2001, by the end of its GUST remedial amendment period, to reflect § 415(c)(3) as amended by CRA.

Example 2. Employer B sponsors a money purchase pension plan that includes a definition of compensation for making contributions that specifically includes amounts deferred under §§ 125, 402(g)(3), and 457, but not § 132(f) elective reductions, in the definition of compensation for purposes of applying the § 415(c) limitations, the definition of key employee under § 416, and calculating the § 416 top-heavy minimums. The plan year and limitation year both begin on October 1. However, for plan and limitation years beginning on October 1, 1999, the plan administrator operated the plan to include § 132(f) elective reductions. Employer B must amend the plan's definition of compensation to include § 132(f) elective reductions. The amendment must be made effective retroactively for plan and limitation years beginning on October 1, 1999 and must be adopted by the end of the plan's GUST remedial amendment period.

IV. 403(b) PLANS

CRA amended § 403(b)(3) to provide that, for purposes of determining the exclusion allowance under § 403(b)(2), § 132(f) elective reductions are to be included in an employee's compensation for years beginning after December 31, 1997. For the 2001 and later taxable years, employees' exclusion allowances are calculated taking into account the CRA amendment of § 403(b)(3). For purposes of determining the exclusion allowance for employees for 1998 and years thereafter to the extent the determination uses compensation with respect to 1998, 1999, and 2000, compensation may be calculated in accordance with § 403(b) as it read after amendment by TRA '97 but before amendment by CRA, i.e., by not including § 132(f) elective reductions in the definition of compensation.

A 403(b) plan that is required to satisfy the nondiscrimination requirements of § 403(b)(12) must be operated in accordance with the CRA amendments to §§ 403(b), 414(s), and 415(c) in years beginning on or after January 1, 2001.

V. PROCEDURES RELATING TO ADOPTION OF MODEL AMENDMENTS

The model amendments that appear in the Appendix to this revenue procedure may be adopted by sponsors of individually designed plans (including adopters of volume submitter plans) and by practitioners that sponsor volume submitter specimen plans. The model amendments may also be used by sponsors and adopters of master and prototype (M&P) plans.

The model amendments in the appendix to this revenue procedure, if adopted on a word-for-word identical basis within a plan's GUST remedial amendment period, will be deemed to satisfy the requirements of §§ 415(c)(3) and 414(s)(2) as amended by CRA, respectively. Practitioners that sponsor volume submitter specimen plans may include the model amendments in a specimen plan without adversely affecting the plan's advisory letter. An employer that has adopted a volume submitter specimen plan prior to this amendment of the specimen plan may individually adopt the model amendments without adversely affecting the plan's determination letter. Sponsors of M&P plans that have not yet been approved for GUST may incorporate the model provisions in adoption agreements. Sponsors of M&P plans that have been approved for GUST may provide the model amendments to adopting employers as supplements to the approved adoption agreement. The Service will not issue new opinion, advisory or determination letters for plans that are amended solely to add the model amendments.

M&P and volume submitter plan sponsors that use the model language must file Form 8837, Notice of Adoption of Revenue Procedure Model Amendments. At line 2 of Form 8837 enter "Notice 2001-37" instead of "Revenue Procedure."

DRAFTING INFORMATION

The principal drafter of this revenue procedure is Diane S. Bloom of the Employee Plans Division. For further information regarding this revenue procedure, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 283-9516 or (202) 283-9517, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday. Ms. Bloom may be reached at (202) 283-9888. These telephone numbers are not toll-free.

APPENDIX -- MODEL AMENDMENTS

The following are model amendments that sponsors of qualified plans may adopt to comply with §§ 415(c) and 414(s), as amended by CRA. Plan sponsors should first review their plan documents and operation to determine whether the plan already complies with §§ 415(c) and 414(s), as amended.

A. Model language for § 415(c)(3) compensation definition

For limitation years beginning on and after [enter the earlier of January 1, 2001 or the first day of the first limitation year for which the plan was operated in accordance with the CRA amendment of § 415(c)(3), but in no case earlier than the first day of the first limitation year beginning on or after January 1, 1998], for purposes of applying the limitations described in section ____ of the plan, compensation paid or made available during such limitation years shall include elective amounts that are not includible in the gross income of the employee by reason of § 132(f)(4).

(Note: The following language may be adopted for plans that also use § 415(c)(3) compensation for other purposes under the plan.)

This amendment shall also apply to the definition of compensation for purposes of section(s) ____ of the plan for plan years beginning on and after [enter the earlier of January 1, 2001, or the first day of the first plan year for which these sections of the plan were operated in accordance with the CRA amendment of § 415(c)(3), but in no case earlier than the first day of the first plan year beginning on or after January 1, 1998].

B. Model language for § 414(s) compensation definition that excludes amounts of compensation reduction elected for qualified transportation fringes

(Note: The following language should be adopted only for a plan that either 1) has been operated since the first day of the first plan year beginning on or after January 1, 1998 (or any subsequent plan year beginning before January 1, 2001), or 2) has been operated since the first day of the first plan year beginning on or after January 1, 2001, by excluding from its definition of compensation under § 414(s) any amount that is contributed by the employer pursuant to a salary reduction agreement and that is not includible in the employee's gross income under § 125, 132(f), 402(e)(3), 402(h), or 403(b).

For plan years beginning on and after [enter the earlier of January 1, 2001 or the first day of the first plan year for which the plan was operated in accordance with the CRA amendment of § 414(s), but in no case earlier than the first day of the first plan year beginning on or after January 1, 1998], compensation shall not include elective amounts that are not includible in the gross income of the employee under § 125, 132(f)(4), 402(e)(3), 402(h), or 403(b). This amendment shall apply for purposes of section(s) _____ of the plan.