Internal Revenue
bulletin

Bulletin No. 2005-27
July 5, 2005

# HIGHLIGHTS OF THIS ISSUE

**These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.**

## INCOME TAX

### Rev. Rul. 2005–38, page 6.

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for July 2005.

### Rev. Rul. 2005–39, page 1.

**Golden parachute payments; treatment of section 83(b) elections.** This ruling discusses whether restricted stock for which a section 83(b) election has been made is treated as outstanding stock for purposes of determining whether there has been a change in ownership or control under section 280G of the Code and for determining the amount of stock held by shareholders in testing whether the shareholder is a disqualified individual under section 280G.

### Rev. Rul. 2005–40, page 4.

**Insurance, federal income tax purposes.** This ruling considers four circumstances in which arrangements between unrelated entities do, and do not, constitute insurance for federal income tax purposes and whether the issuer qualifies as an insurance company for federal income tax purposes.

### Notice 2005–48, page 9.

This notice solicits applications for designation of a project as a qualified green building and sustainable design project under section 142(l) of the Code. The notice also provides guidance on the requirements a project must meet in order to be eligible for designation as a qualified green building and sustainable design project.

### Notice 2005–49, page 14.

This notice requests comments on the qualification of additional arrangements as insurance, including cell captive arrangements, loan-backs of amounts paid as premiums, the relevance of homogeneity in determining whether risk has been adequately distributed, and arrangements involving finite risk.

### Notice 2005–50, page 14.

This notice provides guidance on miscellaneous issues that have arisen in the administration of the health coverage tax credit (HCTC) under section 35 of the Code.

## EMPLOYEE PLANS

### REG–130241–04, page 18.

Proposed regulations under section 415 of the Code contain proposed amendments to regulations regarding limitation on benefits and contributions under qualified plans. The proposed amendments provide comprehensive guidance regarding the limitations of section 415, including updates to the regulations for numerous statutory changes since regulations were last published. The proposed regulations also make conforming changes to regulations under sections 401(A)(9), 401(k), 403(b), and 457, and make other minor corrective changes to regulations under section 457. A public hearing is scheduled for August 17, 2005.

**(Continued on the next page)**

**Finding Lists begin on page ii.**

Department of the Treasury
Internal Revenue Service

## EXEMPT ORGANIZATIONS

**Notice 2005–49, page 14.**
This notice requests comments on the qualification of additional arrangements as insurance, including cell captive arrangements, loan-backs of amounts paid as premiums, the relevance of homogeneity in determining whether risk has been adequately distributed, and arrangements involving finite risk.

**Announcement 2005–46, page 63.**
A list is provided of organizations now classified as private foundations.

## EXCISE TAX

**Notice 2005–49, page 14.**
This notice requests comments on the qualification of additional arrangements as insurance, including cell captive arrangements, loan-backs of amounts paid as premiums, the relevance of homogeneity in determining whether risk has been adequately distributed, and arrangements involving finite risk.

## ADMINISTRATIVE

**Notice 2005–48, page 9.**
This notice solicits applications for designation of a project as a qualified green building and sustainable design project under section 142(l) of the Code. The notice also provides guidance on the requirements a project must meet in order to be eligible for designation as a qualified green building and sustainable design project.

# The IRS Mission

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# Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

**Part I.—1986 Code.**
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

**Part II.—Treaties and Tax Legislation.**
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

**Part III.—Administrative, Procedural, and Miscellaneous.**
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

**Part IV.—Items of General Interest.**
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.



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# Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 83.—Property Transferred in Connection With Performance of Services

How are section 83(b) elections treated for purposes of measuring a change in ownership or control under section 280G and in testing whether an individual is a disqualified individual under section 280G? See Rev. Rul. 2005-39, page 1.

## Section 142.—Exempt Facility Bond

How may State and local governments apply for designation by the Secretary as qualified green building and sustainable design projects? What are the requirements for designating projects as qualified green building and sustainable design projects? See Notice 2005-48, page 9.

## Section 162.—Trade or Business Expenses

*26 CFR 1.162–1: Business expenses.*

A revenue ruling that sets forth circumstances in which arrangements between unrelated entities do not constitute, and a circumstance in which such arrangements do constitute, insurance for federal income tax purposes. See Rev. Rul. 2005-40, page 4.

## Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

*26 CFR 1.280G–1: Golden parachute payments. (Also § 83.)*

**Golden parachute payments; treatment of section 83(b) elections.** This ruling discusses whether restricted stock for which a section 83(b) election has been made is treated as outstanding stock for purposes of determining whether there has been a change in ownership or control under section 280G of the Code and for determining the amount of stock held by shareholders in testing whether the shareholder is a disqualified individual under section 280G.

## Rev. Rul. 2005–39

ISSUES

1) In determining whether a corporation has experienced a change in ownership or control under § 280G(b)(2)(A)(i) of the Internal Revenue Code, are unvested shares of restricted stock for which an election under § 83(b) has been made treated as outstanding stock?

2) In determining the amount of stock held by a shareholder for purposes of testing whether the shareholder is a disqualified individual under §1.280G–1, Q/A–17 of the Income Tax Regulations, are unvested shares of restricted stock for which an election under § 83(b) has been made treated as outstanding stock?

FACTS

Corporation X and Corporation Y are unrelated publicly-held companies. Both Corporation X and Corporation Y maintain restricted stock plans and option plans for their respective employees. Immediately prior to the merger described below, without considering any outstanding options or restricted stock, the shareholders of Corporation X own stock with a total fair market value of $105*x* and the shareholders of Corporation Y own stock with a total fair market value of $105*x*.

Employees of Corporation X hold restricted Corporation X stock that is not substantially vested but with respect to which elections under § 83(b) have been made. They also hold vested options to purchase vested stock of Corporation X. The fair market value of this Corporation X restricted stock and the Corporation X stock subject to these options is $3*x*.

Employees of Corporation Y hold restricted Corporation Y stock that is not substantially vested but with respect to which elections under § 83(b) have been made. They also hold vested options to purchase vested stock of Corporation Y. The fair market value of this Corporation Y restricted stock and the Corporation Y stock subject to these options is $2*x*.

Certain employees of Corporation X and Corporation Y also hold restricted stock that is not substantially vested with respect to which no election under § 83(b) has been made and vested options to purchase substantially nonvested stock.

On February 20, 2005, Corporation X merges into Corporation Y, with Corporation Y as the surviving corporation. In the merger, the shareholders of Corporation X receive Corporation Y stock in exchange for their Corporation X stock. The holders of nonvested restricted Corporation X stock receive nonvested restricted Corporation Y stock in exchange for their nonvested restricted Corporation X stock. The holders of options to acquire Corporation X stock receive options to acquire Corporation Y stock in exchange for their options to acquire Corporation X stock. After the merger, Corporation Y stock (vested or nonvested, as applicable) will be issued on the exercise of all outstanding options.

LAW

Section 83(a) provides that the excess of the fair market value of property transferred in connection with the performance of services over the amount (if any) paid for the property is included in the gross income of the person performing the services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier.

Section 83(b) permits any person performing services in connection with which property is transferred to elect to include in gross income for the taxable year in which the property is transferred the excess of its fair market value at the time of transfer (determined without regard to lapse restrictions) over the amount (if any) paid for the property.

Section 1.83–1(a) provides that property transferred to an employee in connection with the performance of services by such employee is not taxable until the

employee acquires a beneficial ownership interest in such property and it has become substantially vested (as defined in § 1.83–3(b)) in such employee. Until such property becomes substantially vested, the transferor is regarded as the owner of such property, and any income from such property received by the employee is included in the gross income of such employee as additional compensation for the taxable year in which such income is received.

Section 1.83–3(b) provides that property is substantially nonvested if it is subject to a substantial risk of forfeiture and is nontransferable.

Section 1.83–2(a) provides that the employee providing the services may elect to include in gross income under § 83(b), as compensation for services, the excess (if any) of the fair market value of the property at the time of transfer (determined without regard to any lapse restrictions) over the amount (if any) paid for such property. If this election is made, the substantial vesting rules of § 83(a) and the regulations thereunder do not apply with respect to such property. Thus, property with respect to which this election is made is includible in gross income as of the time of transfer, and no compensation will be includible in gross income when such property becomes substantially vested.

In Rev. Rul. 83–22, 1983–1 C.B. 17, an employee who received restricted stock made an election under § 83(b) and later earned dividends on the restricted stock. The ruling provides that the regulations under § 83(b) treat stock transferred to an employee in connection with the performance of services as substantially vested when the employee makes an election under § 83(b), and the employee is considered the owner of the stock. Accordingly, the ruling holds that a dividend paid to the employee who has made a § 83(b) election is not additional compensation to the employee, but retains its character as a dividend in the hands of the employee.

Section 280G denies a deduction for any excess parachute payment. Section 4999 imposes a nondeductible 20-percent excise tax on the recipient of any excess parachute payment, within the meaning of § 280G(b).

An excess parachute payment is defined in § 280G(b)(1) as an amount equal to the excess of any parachute payment over the portion of the disqualified individual's base amount that is allocated to such payment.

Section 280G(b)(2)(A) defines a parachute payment as any payment in the nature of compensation to (or for the benefit of) a disqualified individual if (i) such payment is contingent on a change in the ownership of a corporation, the effective control of a corporation, or the ownership of a substantial portion of the assets of a corporation (a change in ownership or control), and (ii) the aggregate present value of the payments in the nature of compensation which are contingent on such change equals or exceeds an amount equal to 3 times the base amount.

Section 1.280G–1, Q/As–27 and 29, provides guidance concerning whether a corporation is considered to have undergone a change in ownership or control in a merger.

Section 1.280G–1, Q/A–27(a), provides that a change in the ownership of a corporation occurs on the date that any one person, or more than one person acting as a group (as defined in Q/A–27(b)), acquires ownership of stock of the corporation that, together with stock held by such person or group, possesses more than 50 percent of the total fair market value or total voting power of the stock of such corporation. Section 1.280G–1, Q/A–27(b), provides that persons will not be considered to be acting as a group merely because they happen to purchase or own stock of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the corporation.

Section 1.280G–1, Q/A–27(c), provides that § 318(a) applies to determine stock ownership. Section 1.280G–1, Q/A–27(c), also provides that stock underlying a vested option is considered owned by an individual who holds the vested option (and the stock underlying an unvested option is not considered owned by an individual who holds the unvested option). For purposes of the preceding sentence, however, if the option is exercisable for stock that is not substantially vested (as defined in § 1.83–3(b) and (j)), the stock underlying the option is not treated as owned by the individual who holds the option.

Section 1.280G–1, Q/A–29, provides that a change in the ownership of a substantial portion of a corporation's assets occurs on the date that any one person, or more than one person acting as a group (as defined in Q/A–29(c)), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from the corporation that have a total gross fair market value equal to or more than one-third of the total gross fair market value of all of the assets of the corporation immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the corporation, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

Section 1.280G–1, Q/A–29(b)(1), provides that there is no change in ownership or control under Q/A–29(a) when there is a transfer to an entity that is controlled by the shareholders of the transferring corporation immediately after the transfer, as provided in Q/A–29(b).

Section 1.280G–1, Q/A–29(c), contains the same language as § 1.280G–1, Q/A–27(b), concerning when persons will be considered to be acting as a group. Section 1.280G–1, Q/A–29(d), refers to Q/A–27(c) for purposes of determining stock ownership.

For purposes of determining when a payment in the nature of compensation under § 280G(b)(2)(A) has been made, § 1.280G–1, Q/A–12(b), provides that an election made by a disqualified individual under § 83(b) with respect to the transferred property does not apply. A payment in the nature of compensation for purposes of that determination is generally considered made (or to be made) when the property is transferred to, and becomes substantially vested in, such individual. The § 280G regulations, however, are silent for purposes of determining whether restricted stock subject to an election under § 83(b) is outstanding when determining whether there has been a change in ownership or control.

The position in § 1.280G–1, Q&A–12(b) was adopted, in part, because the legislative history provides that all transfers of property are to be valued for purposes of the golden parachute rules. See H.R. Conf. Rep. No. 98–861, 98th Cong. 2d Sess. at 851 (1984), 1984–3

C.B. (Vol. 2) 851; Joint Committee on Taxation Staff, *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, 98th Cong. 2d Sess. (1984) at 203. The vesting of payments contingent on a change in control frequently provides substantial benefits to an individual without regard to whether an election under § 83(b) has been made. This concern, however, is not present when determining whether a change in ownership or control has occurred.

ANALYSIS

The regulations under § 280G have generally adopted objective rules to determine whether a change in ownership or control has occurred. Pursuant to § 1.280G–1, Q/A–27(c), vested stock underlying a vested option is considered owned by the individual who holds the vested option. Thus, the vested shares subject to vested options held by the former Corporation X employees and the Corporation Y employees are considered outstanding for purposes of determining whether a change in ownership or control occurred. However, the substantially nonvested shares underlying vested options held by the former Corporation X employees and the Corporation Y employees are not considered outstanding for purposes of determining whether a change in ownership or control occurred.

In determining whether a change in ownership or control has occurred, § 1.280G–1, Q/A–27(c) generally implements an expansive rule for determining the shares treated as owned by an individual, treating, for example, shares subject to a vested option as owned by the holder of the option. Accordingly, an employee should be considered the owner of unvested shares of restricted stock for which an election under § 83(b) has been made for purposes of § 1.280G–1, Q/A–27 because the regulations under § 83(b) treat stock transferred to an employee in connection with the performance of services as substantially vested when the employee makes an election under § 83(b), and the employee is considered the owner of the stock for that purpose. However, restricted stock with respect to which an election under § 83(b) has not been made is not considered outstanding for purposes of determining whether a change in ownership or control occurred.

Consequently, the shareholders of Corporation X and Corporation Y, along with the employees holding vested options to receive vested stock and holding restricted stock that has been subject to an election under § 83(b), will be treated as acting as a group with respect to their acquisition of stock or assets. Applying the above-described rules, the Corporation X shareholders acquired ownership of Corporation Y stock ($108*x*) that has more than 50 percent of the total fair market value of the Corporation Y stock ($215*x*) outstanding immediately after the merger. Thus, there is a change in control of Corporation Y under § 1.280G–1, Q/A–27.

Turning to Corporation X, all of the assets of Corporation X were transferred to Corporation Y in exchange for Corporation Y stock. Because more than 50 percent of the fair market value of the outstanding stock of Corporation Y is owned by the former shareholders of Corporation X (immediately after the exchange), the transfer of assets to Corporation Y is not treated as a change in ownership of a substantial portion of the assets of Corporation X under § 1.280G–1, Q/A–29(b)(1).

Additionally, for purposes of determining the amount of stock owned by an individual under §1.280G–1, Q/A–17, the same rule as described above applies. Thus, an individual who holds restricted stock with respect to which an election under § 83(b) has been made is considered to hold the outstanding stock under § 1.280G–1, Q/A–17.

HOLDINGS

1) In determining whether a corporation has experienced a change in ownership or control under § 280G(b)(2)(A)(i) of the Internal Revenue Code, unvested shares of restricted stock for which an election under § 83(b) has been made are treated as outstanding stock.

2) In determining the amount of stock held by a shareholder for purposes of testing whether the shareholder is a disqualified individual under §1.280G–1, Q/A–17 of the Income Tax Regulations, unvested shares of restricted stock for which an election under § 83(b) has been made are treated as outstanding stock.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Erinn Madden and Jean Casey of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this revenue ruling, contact Ms. Casey or Ms. Madden at (202) 622–6030 (not a toll-free call).

## Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

*26 CFR 1.401(a)(9)–6: Required minimum distributions for defined benefit plans and annuity contracts.*
*26 CFR 1.401(k)–1: Certain cash or deferred arrangements.*

To conform to the proposed amendments to the section 415 Income Tax Regulations, Q&A–13(c)(3) of section 1.401(a)(9)–6 is revised. Also, to conform to the proposed amendments to the section 415 Income Tax Regulations, section 1.401(k)–1 is amended by adding paragraph (e)(8). See REG-130241-04, page 18.

## Section 403.—Taxation of Employee Annuities

*26 CFR 1.403(b)–3: Exclusion for contributions to purchase section 403(b) contracts.*

To conform to the proposed amendments to the section 415 Income Tax Regulations, section 1.403(b)–3(b)(4)(ii) is proposed to be revised. See REG-130241-04, page 18.

## Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 457.—Deferred Compensation Plans of State and Local Governments and Tax-Exempt Organizations

*26 CFR 1.457–4: Annual deferrals, deferral limitations, and deferral agreements under eligible plans.*

To conform to the proposed amendments to the section 415 Income Tax Regulations, section 1.457–4 is proposed to be amended by revising paragraph (d). Also, proposed minor corrective changes are made to section 1.457–5(d). Example 2, section 1.457–6(a) and (c) and section 1.457–10(b)(8). See REG-130241-04, page 18.

## Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 831.—Tax on Insurance Companies Other Than Life Insurance Companies

*(Also § 162; 1.162–1.)*

**Insurance, federal income tax purposes.** This ruling considers four circumstances in which arrangements between unrelated entities do, and do not, constitute insurance for federal income tax purposes and whether the issuer qualifies as an insurance company for federal income tax purposes.

### Rev. Rul. 2005–40

ISSUE

Do the arrangements described below constitute insurance for federal income tax purposes? If so, are amounts paid to the issuer deductible as insurance premiums and does the issuer qualify as an insurance company?

FACTS

*Situation 1*. *X*, a domestic corporation, operates a courier transport business covering a large portion of the United States. *X* owns and operates a large fleet of automotive vehicles representing a significant volume of independent, homogeneous risks. For valid, non-tax business purposes, *X* entered into an arrangement with *Y*, an unrelated domestic corporation, whereby in exchange for an agreed amount of "premiums," *Y* "insures" *X* against the risk of loss arising out of the operation of its fleet in the conduct of its courier business.

The amount of "premiums" under the arrangement is determined at arm's length according to customary insurance industry rating formulas. *Y* possesses adequate capital to fulfill its obligations to *X* under the agreement, and in all respects operates in accordance with the applicable requirements of state law. There are no guarantees of any kind in favor of *Y* with respect to the agreement, nor are any of the "premiums" paid by *X* to *Y* in turn loaned back to *X*. *X* has no obligation to pay *Y* additional premiums if *X*'s actual losses during any period of coverage exceed the "premiums" paid by *X*. *X* will not be entitled to any refund of "premiums" paid if *X*'s actual losses are lower than the "premiums" paid during any period. In all respects, the parties conduct themselves consistent with the standards applicable to an insurance arrangement between unrelated parties, except that *Y* does not "insure" any entity other than *X*.

*Situation 2*. The facts are the same as in Situation 1 except that, in addition to its arrangement with *X*, *Y* enters into an arrangement with *Z*, a domestic corporation unrelated to *X* or *Y*, whereby in exchange for an agreed amount of "premiums," *Y* also "insures" *Z* against the risk of loss arising out of the operation of its own fleet in connection with the conduct of a courier business substantially similar to that of *X*. The amounts *Y* earns from its arrangements with *Z* constitute 10% of *Y*'s total amounts earned during the taxable year on both a gross and net basis. The arrangement with *Z* accounts for 10% of the total risks borne by *Y*.

*Situation 3*. *X*, a domestic corporation, operates a courier transport business covering a large portion of the United States. *X* conducts the courier transport business through 12 limited liability companies (LLCs) of which it is the single member. The LLCs are disregarded as entities separate from *X* under the provisions of § 301.7701–3 of the Procedure and Administration Regulations. The LLCs own and operate a large fleet of automotive vehicles, collectively representing a significant volume of independent, homogeneous risks. For valid, non-tax business purposes, the LLCs entered into arrangements with *Y*, an unrelated domestic corporation, whereby in exchange for an agreed amount of "premiums," *Y* "insures" the LLCs against the risk of loss arising out of the operation of the fleet in the conduct of their courier business. None of the LLCs account for less than 5%, or more than 15%, of the total risk assumed by *Y* under the agreements.

The amount of "premiums" under the arrangement is determined at arm's length according to customary insurance industry rating formulas. *Y* possesses adequate capital to fulfill its obligations to the LLCs under the agreement, and in all respects

operates in accordance with the licensing and other requirements of state law. There are no guarantees of any kind in favor of *Y* with respect to the agreements, nor are any of the "premiums" paid by the LLCs to *Y* in turn loaned back to *X* or to the LLCs. No LLC has any obligation to pay *Y* additional premiums if that LLC's actual losses during the arrangement exceed the "premiums" paid by that LLC. No LLC will be entitled to a refund of "premiums" paid if that LLC's actual losses are lower than the "premiums" paid during any period. *Y* retains the risks that it assumes under the agreement. In all respects, the parties conduct themselves consistent with the standards applicable to an insurance arrangement between unrelated parties, except that *Y* does not "insure" any entity other than the LLCs.

*Situation 4*. The facts are the same as in Situation 3, except that each of the 12 LLCs elects pursuant to § 301.7701–3(a) to be classified as an association.

LAW

Section 831(a) of the Internal Revenue Code provides that taxes, computed as provided in § 11, are imposed for each taxable year on the taxable income of each insurance company other than a life insurance company. Section 831(c) provides that, for purposes of § 831, the term "insurance company" has the meaning given to such term by § 816(a). Under § 816(a), the term "insurance company" means any company more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

Section 162(a) provides, in part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 1.162–1(a) of the Income Tax Regulations provides, in part, that among the items included in business expenses are insurance premiums against fire, storms, theft, accident, or other similar losses in the case of a business.

Neither the Code nor the regulations define the terms "insurance" or "insurance contract." The United States Supreme Court, however, has explained that in order for an arrangement to constitute insurance for federal income tax purposes, both risk shifting and risk distribution must be present. *Helvering v. Le Gierse*, 312 U.S. 531 (1941).

The risk transferred must be risk of economic loss. *Allied Fidelity Corp. v. Commissioner*, 572 F.2d 1190, 1193 (7th Cir.), *cert. denied*, 439 U.S. 835 (1978). The risk must contemplate the fortuitous occurrence of a stated contingency, *Commissioner v. Treganowan*, 183 F.2d 288, 290–91 (2d Cir.), *cert. denied*, 340 U.S. 853 (1950), and must not be merely an investment or business risk. *Le Gierse*, at 542; Rev. Rul. 89–96, 1989–2 C.B. 114.

Risk shifting occurs if a person facing the possibility of an economic loss transfers some or all of the financial consequences of the potential loss to the insurer, such that a loss by the insured does not affect the insured because the loss is offset by a payment from the insurer. Risk distribution incorporates the statistical phenomenon known as the law of large numbers. Distributing risk allows the insurer to reduce the possibility that a single costly claim will exceed the amount taken in as premiums and set aside for the payment of such a claim. By assuming numerous relatively small, independent risks that occur randomly over time, the insurer smooths out losses to match more closely its receipt of premiums. *Clougherty Packing Co. v. Commissioner*, 811 F.2d 1297, 1300 (9th Cir. 1987).

Courts have recognized that risk distribution necessarily entails a pooling of premiums, so that a potential insured is not in significant part paying for its own risks. *Humana, Inc. v. Commissioner*, 881 F.2d 247, 257 (6th Cir. 1989). *See also Ocean Drilling & Exploration Co. v. United States*, 988 F.2d 1135, 1153 (Fed. Cir. 1993) ("Risk distribution involves spreading the risk of loss among policyholders."); *Beech Aircraft Corp. v. United States*, 797 F.2d 920, 922 (10th Cir. 1986) ("'[R]isk distributing' means that the party assuming the risk distributes his potential liability, in part, among others."); *Treganowan*, at 291 (quoting Note, *The New York Stock Exchange Gratuity Fund: Insurance that Isn't Insurance*, 59 Yale L. J. 780, 784 (1950)) ("'By diffusing the risks through a mass of separate risk shifting contracts, the insurer casts his lot with the law of averages. The process of risk distribution, therefore, is the very essence of insurance.'"); *Crawford Fitting Co. v. United States*, 606 F. Supp. 136, 147 (N.D. Ohio 1985) ("[T]he court finds . . . that various nonaffiliated persons or entities facing risks similar but independent of those faced by plaintiff were named insureds under the policy, enabling the distribution of the risk thereunder."); *AMERCO and Subsidiaries v. Commissioner*, 96 T.C. 18, 41 (1991), *aff'd*, 979 F.2d 162 (9th Cir. 1992) ("The concept of risk-distributing emphasizes the pooling aspect of insurance: that it is the nature of an insurance contract to be part of a larger collection of coverages, combined to distribute risk between insureds.").

ANALYSIS

In order to determine the nature of an arrangement for federal income tax purposes, it is necessary to consider all the facts and circumstances in a particular case, including not only the terms of the arrangement, but also the entire course of conduct of the parties. Thus, an arrangement that purports to be an insurance contract but lacks the requisite risk distribution may instead be characterized as a deposit arrangement, a loan, a contribution to capital (to the extent of net value, if any), an indemnity arrangement that is not an insurance contract, or otherwise, based on the substance of the arrangement between the parties. The proper characterization of the arrangement may determine whether the issuer qualifies as an insurance company and whether amounts paid under the arrangement may be deductible.

In Situation 1, *Y* enters into an "insurance" arrangement with *X*. The arrangement with *X* represents *Y*'s only such agreement. Although the arrangement may shift the risks of *X* to *Y*, those risks are not, in turn, distributed among other insureds or policyholders. Therefore, the arrangement between *X* and *Y* does not constitute insurance for federal income tax purposes.

In Situation 2, the fact that *Y* also enters into an arrangement with *Z* does not change the conclusion that the arrangement between *X* and *Y* lacks the requisite risk distribution to constitute insurance. *Y*'s contract with *Z* represents only 10% of the total amounts earned by *Y*, and 10% of total risks assumed, under all its arrangements. This creates an insufficient pool

of other premiums to distribute *X*'s risk. *See* Rev. Rul. 2002–89, 2002–2 C.B. 984 (concluding that risks from unrelated parties representing 10% of total risks borne by subsidiary are insufficient to qualify arrangement between parent and subsidiary as insurance).

In Situation 3, *Y* contracts only with 12 single member LLCs through which *X* conducts a courier transport business. The LLCs are disregarded as entities separate from *X* pursuant to § 301.7701–3. Section 301.7701–2(a) provides that if an entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch or division of the owner. Applying this rule in Situation 3, *Y* has entered into an "insurance" arrangement only with *X*. Therefore, for the reasons set forth in Situation 1 above, the arrangement between *X* and *Y* does not constitute insurance for federal income tax purposes.

In Situation 4, the 12 LLCs are not disregarded as entities separate from *X*, but instead are classified as associations for federal income tax purposes. The arrangements between *Y* and each LLC thus shift a risk of loss from each LLC to *Y*. The risks of the LLCs are distributed among the various other LLCs that are insured under similar arrangements. Therefore the arrangements between the 12 LLCs and *Y* constitute insurance for federal income tax purposes. *See* Rev. Rul. 2002–90, 2002–2 C.B. 985 (similar arrangements between affiliated entities constituted insurance). Because the arrangements with the 12 LLCs represent *Y*'s only business, and those arrangements are insurance contracts for federal income tax purposes, *Y* is an insurance company within the meaning of §§ 831(c) and 816(a). In addition, the 12 LLCs may be entitled to deduct amounts paid under those arrangements as insurance premiums under § 162 if the requirements for deduction are otherwise satisfied.

HOLDINGS

In Situations 1, 2 and 3, the arrangements do not constitute insurance for federal income tax purposes.

In Situation 4, the arrangements constitute insurance for federal income tax purposes and the issuer qualifies as an insurance company. The amounts paid to the issuer may be deductible as insurance premiums under § 162 if the requirements for deduction are otherwise satisfied.

DRAFTING INFORMATION

The principal author of this revenue ruling is John E. Glover of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact Mr. Glover at (202) 622–3970 (not a toll-free call).

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## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

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## Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

*(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)*

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for July 2005.

## Rev. Rul. 2005–38

This revenue ruling provides various prescribed rates for federal income tax purposes for July 2005 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the blended annual rate for 2005 for purposes of section 7872.

REV. RUL. 2005–38 TABLE 1

Applicable Federal Rates (AFR) for July 2005

| | *Period for Compounding* | | | |
|---|---|---|---|---|
| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
| *Short-Term* | | | | |
| AFR | 3.45% | 3.42% | 3.41% | 3.40% |
| 110% AFR | 3.80% | 3.76% | 3.74% | 3.73% |
| 120% AFR | 4.14% | 4.10% | 4.08% | 4.07% |
| 130% AFR | 4.50% | 4.45% | 4.43% | 4.41% |
| *Mid-Term* | | | | |
| AFR | 3.86% | 3.82% | 3.80% | 3.79% |
| 110% AFR | 4.24% | 4.20% | 4.18% | 4.16% |
| 120% AFR | 4.63% | 4.58% | 4.55% | 4.54% |
| 130% AFR | 5.03% | 4.97% | 4.94% | 4.92% |
| 150% AFR | 5.81% | 5.73% | 5.69% | 5.66% |
| 175% AFR | 6.80% | 6.69% | 6.63% | 6.60% |
| *Long-Term* | | | | |
| AFR | 4.35% | 4.30% | 4.28% | 4.26% |
| 110% AFR | 4.79% | 4.73% | 4.70% | 4.68% |
| 120% AFR | 5.23% | 5.16% | 5.13% | 5.11% |
| 130% AFR | 5.67% | 5.59% | 5.55% | 5.53% |

REV. RUL. 2005–38 TABLE 2

Adjusted AFR for July 2005

| | *Period for Compounding* | | | |
|---|---|---|---|---|
| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
| Short-term adjusted AFR | 2.82% | 2.80% | 2.79% | 2.78% |
| Mid-term adjusted AFR | 3.06% | 3.04% | 3.03% | 3.02% |
| Long-term adjusted AFR | 4.09% | 4.05% | 4.03% | 4.02% |

REV. RUL. 2005–38 TABLE 3

Rates Under Section 382 for July 2005

| | |
|---|---|
| Adjusted federal long-term rate for the current month | 4.09% |
| Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.) | 4.37% |

REV. RUL. 2005–38 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for July 2005

| | |
|---|---|
| Appropriate percentage for the 70% present value low-income housing credit | 7.95% |
| Appropriate percentage for the 30% present value low-income housing credit | 3.41% |

| REV. RUL. 2005–38 TABLE 5 | |
|---|---|
| Rate Under Section 7520 for July 2005 | |
| Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest | 4.6% |

| REV. RUL. 2005–38 TABLE 6 | |
|---|---|
| Rate Under Section 7520 for July 2005 | |
| Blended Annual Rate for 2005 | |
| Section 7872(e)(2) blended annual rate for 2005 | 3.11% |

## Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

## Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2005. See Rev. Rul. 2005-38, page 6.

# Part III. Administrative, Procedural, and Miscellaneous

## Brownfields Demonstration Program for Qualified Green Building and Sustainable Design Projects

## Notice 2005–48

### PURPOSE

This notice solicits applications for designation of a project as a qualified green building and sustainable design project under section 142(l) of the Internal Revenue Code (the Code). This notice also provides guidance on the requirements a project must meet in order to be eligible for designation as a qualified green building and sustainable design project. Applications must be submitted in accordance with this notice.

### INTRODUCTION

Section 701 of the American Jobs Creation Act of 2004, Pub. L. No. 108–357 (the Act) added sections 142(a)(14) and 142(l) to the Code. In general, sections 142(a)(14) and 142(l) authorize up to $2,000,000,000 of tax-exempt private activity bonds to be issued by State or local governments for qualified green building and sustainable design projects. Section 142(l)(1) defines "qualified green building and sustainable design project" as any project meeting certain requirements, as described below, that is designated by the Secretary of the Treasury Department (the Treasury Secretary), after consultation with the Administrator of the Environmental Protection Agency (the EPA Administrator), as a qualified green building and sustainable design project. With certain exceptions, sections 142(a)(14) and 142(l) apply to bonds issued after December 31, 2004, and before October 1, 2009.

### BACKGROUND

Section 103(a) provides that, except as provided in section 103(b), gross income does not include interest on any State or local bond.

Section 103(b)(1) provides that the exclusion under section 103(a) does not apply to any private activity bond that is not a qualified bond (within the meaning of section 141).

Section 141(e) provides that the term "qualified bond" includes an exempt facility bond that meets certain requirements.

Section 142(a)(14) provides that the term "exempt facility bond" includes any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide qualified green building and sustainable design projects.

Section 142(l)(1) defines "qualified green building and sustainable design project," in general, as any project that is designated by the Treasury Secretary, after consultation with the EPA Administrator, as a qualified green building and sustainable design project and that meets the following requirements: (1) at least 75 percent of the square footage of commercial buildings that are part of the project is registered for United States Green Building Council's Leadership in Energy and Environmental Design (LEED) certification and is reasonably expected (at the time of the designation) to receive such certification; (2) the project includes a brownfield site as defined by section 101(39) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601) (CERCLA), including a site described in subparagraph (D)(ii)(II)(aa) thereof; (3) the project receives specific State or local government resources of at least $5,000,000; and (4) the project includes at least (a) 1,000,000 square feet of building or (b) 20 acres.

Under sections 142(l)(3) and (4), a project may not be designated as a qualified green building and sustainable design project unless the project is nominated by a State or local government within 180 days of the enactment of the Act. The application for designation must describe the energy efficiency, renewable energy, and sustainable design features of the project. The application also must demonstrate, and provide written assurances, that: (1) the project will satisfy the requirements described above relating to LEED certification, brownfield sites, State or local government resources, and square feet (or acres) of building (or land); (2) the net benefit of the tax-exempt financing will be allocated to (a) the purchase, construction, integration, or other use of energy efficiency, renewable energy, and sustainable design features of the project, (b) compliance with LEED certification standards cited under section 142(l)(4)(A)(i), or (c) the purchase, remediation, and foundation construction and preparation of the brownfields site; (3) no proceeds of the issue will be used to provide a facility the principal business of which is the sale of food or alcoholic beverages for consumption on the premises; and (4) the project is projected to provide permanent employment of at least 1,500 full time equivalents (150 full time equivalents in rural States) when completed and construction employment of at least 1,000 full time equivalents (100 full time equivalents in rural States).

Furthermore, under section 142(l)(4)(B), each application must contain for each project a description of (1) the amount of electric consumption reduced as compared to conventional construction, (2) the amount of sulfur dioxide daily emissions reduced compared to coal generation, (3) the amount of the gross installed capacity of the project's solar photovoltaic capacity measured in megawatts, and (4) the amount, in megawatts, of the project's fuel cell energy generation.

Section 142(l)(2)(A) provides that the Treasury Secretary, after consultation with the EPA Administrator, shall designate qualified green building and sustainable design projects within 60 days after the end of the application period under section 142(l)(3)(A). Section 142(l)(2)(A) also provides that: (1) at least one of the designated projects must be located in, or within a ten-mile radius of, an empowerment zone under section 1391; (2) at least one of the designated projects must be located in a rural State (as defined in section 142(l)(6)(A)); (3) no more than one project may be designated in any State; and (4) a project may not be designated if the project includes a stadium or arena for professional sports exhibitions or games.

Section 142(l)(6)(A) defines "rural State" as any State that has (1) a population of less than 4,500,000 according to the 2000 census, (2) a population density of less than 150 people per square mile according to the 2000 census, and (3) in-

creased in population by less than half the rate of the national increase between the 1990 and 2000 censuses.

Section 142(l)(2)(B) provides that the Treasury Secretary, after consultation with the EPA Administrator, shall ensure that, in the aggregate, the projects designated shall (1) reduce electric consumption by more than 150 megawatts annually as compared to conventional generation, (2) reduce daily sulfur dioxide emissions by at least 10 tons compared to coal generation power, (3) expand by 75 percent the domestic solar photovoltaic market in the United States (measured in megawatts) as compared to the expansion of that market from 2001 to 2002, and (4) use at least 25 megawatts of fuel cell energy generation.

Under section 142(l)(7)(B), the Treasury Secretary may allocate authority to issue qualified green building and sustainable design project bonds in an aggregate face amount not exceeding $2,000,000,000.

Section 142(l)(7)(B) provides that an issue shall not be treated as an issue described in section 142(a)(14) if the aggregate face amount of bonds issued by the State or local government pursuant thereto for a project (when added to the aggregate face amount of bonds previously so issued for such project) exceeds an amount designated by the Secretary as part of the designation.

Section 142(l)(5) provides that no later than 30 days after the completion of each designated project, the project must certify to the Treasury Secretary that the net benefit of the tax-exempt financing was used for the purposes described in section 142(l)(4).

Section 142(l)(6)(C) defines "net benefit of tax-exempt financing" as the present value of the interest savings (determined by a calculation established by the Secretary) which result from the tax-exempt status of the bonds.

The Act requires each issuer to maintain, on behalf of each project, an interest bearing reserve account equal to one percent of the net proceeds of any bond issued under sections 142(a)(14) and 142(l) for such project. Not later than five years after the date of issuance, the Treasury Secretary, after consultation with the EPA Administrator, will determine whether the project financed with such bonds has substantially complied with the basic eligibility requirements described in section 142(l)(4)(A). If the Treasury Secretary, after such consultation, certifies that the project has substantially complied with the basic eligibility requirements described in section 142(l)(4)(A), amounts in the reserve account, including all interest, will be released to the project. If the Treasury Secretary determines that the project has not substantially complied with the basic eligibility requirements, amounts in the reserve account, including all interest, will be paid to the United States Treasury.

## APPLICATION REQUIREMENTS

Each application for designation of a project as a qualified green building and sustainable design project must be prepared and submitted in accordance with this section. By submitting an application for designation pursuant to section 142(l) and this notice, the applicant agrees to comply with the requirements of this notice.

1. *State or local government*. A project must be nominated by a State or local government or a combination of State or local governments. A "local government" is any county, city, town, township, parish, village, or other general purpose political subdivision of a State. The application must identify the nominating State or local government(s).

2. *Signatures*. An application must be signed by an authorized employee of each nominating State or local government.

3. *Addresses*. Applications must be submitted in duplicate to the Internal Revenue Service (IRS), Attention CC:TEGE:EOEG:TEB, 1111 Constitution Avenue, NW, Room 4306, Washington, D.C. 20224. Applications may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, attention CC:TEGE:EOEG:TEB.

A copy of each application also must be submitted to the Environmental Protection Agency (EPA) at Environmental Protection Agency, Office of Congressional and Intergovernmental Relations, Mail Code 1305A, 1200 Pennsylvania Avenue, N.W., Washington, D. C. 20460.

4. *Due date*. Applications must be filed with the IRS on or before November 2, 2005. For purposes of section 142(l)(3)(A), if an application for a project is filed with the IRS in accordance with this notice on or before November 2, 2005, the project will be deemed nominated within 180 days of the enactment of the Act.

5. *Project description*. Each application must contain a detailed description of the project, including the information required by this subsection 5.

a. *Energy efficiency, renewable energy, and sustainable design features*. The application must describe the energy efficiency, renewable energy, and sustainable design features of the project.

b. *Basic eligibility requirements*. The application must demonstrate and provide written assurances that the project will satisfy each of the following eligibility requirements:

i. *Green building and sustainable design*.

A. *LEED certification*. At least 75 percent of the square footage of commercial buildings that are part of the project is registered for United States Green Building Council's LEED certification and is reasonably expected by the applicant (at the time of the designation) to receive such certification, based on all the facts and circumstances, including statements of the United States Green Building Council, opinions of independent experts in green building and sustainable design, and relevant experience of the project developer. The application must include: (1) LEED Letter Templates indicating which LEED credits the applicant plans to pursue and the applicant's planned approach to pursuing such credits; (2) documentation demonstrating the applicant's plans to design and construct LEED-certified, sustainably-designed buildings, including, where applicable, architectural plans, drawings and specifications, policy statements, contracts, leases and other applicable documents, and other related applicable information; (3) information on how plans to build LEED-certified, sustainably-designed buildings will be implemented through the management structure, for example, by placing LEED-accredited professional(s) and other experienced green building professionals in positions of authority over the project to ensure that the applicant's green building plans are realized; (4) information on any plans to attract broader expertise and perspectives

to the project that could support the effort to achieve LEED certification through such means as green building design charettes or consultation with additional green building experts; and (5) information on financial incentives and penalties that will be included in the design, construction, engineering and other building contracts and subcontracts to tie a part of the contractors' and subcontractors' compensation to their level of success in designing and constructing LEED-certified, sustainably-designed buildings.

B. *Certain practices relating to the use of wood for the project.* In connection with demonstrating that the project will satisfy the requirement for LEED certification, the application should indicate the extent to which any wood products will be used in the project. In addition, the application should indicate whether such wood products will receive certification under the Sustainable Forestry Initiative Program or the American Tree Farm System, or, in the case of composite wood products, under standards established by the American National Standards Institute, or such other voluntary standards as are published in the **Federal Register** by the EPA Administrator.

ii. *Brownfield redevelopment.* The project includes a brownfield site as defined by section 101(39) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601), including a site described in subparagraph (D)(ii)(II)(aa) thereof. For purposes of meeting this definition, applicants may use guidance provided in Appendices 3 and 4 of the EPA Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund and Cleanup Grants. Appendices 3 and 4, which provide guidance on the definition of a brownfields site under section 101(39) of CERCLA, are published by the EPA on its internet site: *http://www.epa.gov/brownfields/pg/appendix3_fy05.htm* and *http://www.epa.gov/brownfields/pg/appendix 4_fy05.htm*.

iii. *State and local support.*

A. *In general.* The project will receive specific State or local government resources that will support the project in an amount equal to at least $5,000,000. For this purpose, "resources" includes tax abatement benefits and contributions in kind. The State or local government resources may be provided at any time during the period beginning on October 22, 2001 (three years prior to the enactment of the Act), and ending on the last day that any bond issued for the project as part of an issue under section 142(l) remains outstanding.

B. *Determination of amount of State or local government resources.*

I. *Resources provided prior to issuance of bonds.* The amount of State or local government resources that are provided for a project prior to the date of issuance of any bonds subject to section 142(l) for the project and on or after October 22, 2001, is the amount of such resources as of the date the resources were or are provided.

II. *Resources provided on or after issuance of bonds.* The amount of State or local government resources that will be provided for a project on or after the date of issuance of the first issue of bonds subject to section 142(l) for the project is the present value of such resources, as of the date of issuance of such bonds, using as a discount rate the long-term adjusted Applicable Federal Rate (AFR), compounded semi-annually, for the month in which the bonds are sold.

iv. *Size.* The project includes at least one of the following: (1) at least 1,000,000 square feet of building; or (2) at least 20 acres. A project shall not fail to qualify as a green building and sustainable design project solely because it does not lie on contiguous parcels, or is interrupted by streets, highways, or vacant land.

v. *Net benefit of the tax-exempt financing.* For each issue of bonds subject to section 142(l) that finances the project, the net benefit of the tax-exempt financing will not exceed the present value, as of the date of issuance, of the reasonably expected amount of proceeds of the issue to be expended on the project for the following purposes: (1) the purchase, construction, integration, or other use of energy efficiency, renewable energy, and sustainable design features of the project; (2) compliance with LEED certification standards cited under section 142(l)(4)(A)(i); or (3) the purchase, remediation, and foundation construction and preparation of the brownfields site. The net benefit of the tax-exempt financing for an issue is the present value, as of the date of issuance, of the interest savings that result from the tax-exempt status of the bonds. The interest savings that result from the tax-exempt status of the bonds equal the sum of the annual interest savings for each year the issue is expected, as of the date of issuance, to be outstanding. The annual interest savings for a year are determined by multiplying: (1) the difference between (a) 110 percent of the long-term AFR (semiannual compounding) and (b) the long-term adjusted AFR (semiannual compounding), in each case for the month in which the issue is sold; by (2) the total principal amount of the issue that is expected, as of the date of issuance, to be outstanding in that year. For purposes of this paragraph, present values shall be determined using the long-term adjusted AFR (semiannual compounding), for the month in which the issue is sold, as the discount rate.

vi. *Certain prohibited facilities.*

A. *Certain stadiums or arenas.* The project will not include a stadium or arena for professional sports exhibitions or games. For purposes of this notice and section 142(l), a stadium or arena is a stadium or arena for professional sports exhibitions or games if: (1) it is designed differently, sized larger, built sooner, or constructed in a more costly manner than is reasonably required for amateur exhibitions or games; (2) it is designed or constructed for any professional team or organization; or (3) in any calendar year in which bonds subject to section 142(l) for the project are outstanding, it is used more than five days during such calendar year for professional sports exhibitions or games.

B. *Certain facilities for the sale of food or alcoholic beverages.* If the project is designated, any issue financing the project will not be treated as described in section 142(a)(14) if proceeds of the issue will be used to provide any facility the principal business of which is the sale of food or alcoholic beverages for consumption on the premises.

vii. *Employment.* Based on projections, the project will provide permanent employment of at least 1,500 full time equivalents (150 full time equivalents in rural States) when completed and construction employment of at least 1,000 full time equivalents (100 full time equivalents in rural States). For purposes of this notice, a full time equivalent with respect to construction employment is determined based on the average daily full time employ-

ment during the construction period. For example, if a project employs an average of 1,200 full-time workers each business day of the construction period, then the project provides construction employment of 1,200 full time equivalents. In addition, for purposes of section 142(l)(6)(A) and this notice, a "rural State" means any State that has (1) a population of less than 4,500,000 according to the 2000 census, (2) a population density of less than 150 people per square mile according to the 2000 census, and (3) increased in population by less than half the rate of the national increase between the 1990 and 2000 censuses. The following States (as that term is defined in section 103(c)(2)) meet the definition of "rural State" under section 142(l)(6)(A): Iowa, Louisiana, Maine, North Dakota, and West Virginia. In connection with demonstrating how the project will meet this requirement, the application must include an independent analysis that describes the project's economic impact, including the amount of projected employment.

c. *Goals for conservation and technology innovation*. The application must describe:

i. The amount of electric consumption (in megawatt hours) reduced by the project as compared to conventional construction and conventional generation. For this purpose, a project will be considered to reduce electric consumption as a result of (1) conservation and energy efficiency in the building system designs; (2) non-conventional generation capacity installed as part of the project (including, but not limited to, photovoltaic, wind, biomass, geothermal and fuel cell generation); (3) the use of thermal output by the project from a cogeneration system that is part of the project in such a way as to reduce electrical consumption (such as waste heat-fired absorption cooling or displaced electric space heating); or (4) avoidance of transmission and distribution losses of the electrical grid due to the reduction of electric consumption resulting from items (1), (2), and (3) of this paragraph 5.c.i. The application must describe with specificity how the non-conventional design of the building will reduce electric consumption, the sources of energy for the project, the extent to which these sources of energy will reduce the project's need for energy from conventional generation, and the methodology used to determine the amount of transmission and distribution losses avoided. Applicants are encouraged to use the U.S. Department of Energy's Energy Plus software (available on-line at <*www.energyplus.gov*>) to assist in determining the amount of electric consumption reduced as a result of conservation and energy efficiency in the building system designs.

ii. The amount of sulfur dioxide daily emissions reduced by the project as compared to coal generation. Applicants must determine the amount of sulfur dioxide daily emissions reduced by the project as compared to coal generation by multiplying (1) the sulfur dioxide emission rate set forth in the following table for the North American Electric Reliability Council (NERC) region (or State, in the case of Alaska or Hawaii) where the project is located, by (2) the daily amount of electric consumption reduced by the project as compared to conventional construction and conventional generation (as determined in accordance with paragraph 5.c.i. of this section). A description of NERC regions may be found on-line at <*www.nerc.com/regional*>.

**Sulfur Dioxide (SO2) Emission Rate (lb/MWh) for Coal-fired Power Plants**

| NERC region (as in effect on April 8, 2005) or State | 2000 SO2 Emission Rate for Coal-fired Power Plants (lbs/MWh) |
|---|---|
| Alaska | 6.12 |
| ECAR | 14.28 |
| ERCOT | 8.26 |
| FRCC | 8.44 |
| Hawaii | 2.25 |
| MAAC | 16.50 |
| MAIN | 9.96 |
| MRO (formerly MAPP) | 7.81 |
| NPCC | 16.25 |
| SERC | 12.88 |
| SPP | 6.72 |
| WECC | 4.54 |

iii. The amount of the gross installed capacity of the project's solar photovoltaic capacity measured in megawatts. The application must describe in detail the technology and the means and methods of its application that are reasonably expected to produce such capacity. The application also should specify the percentage by which the project will expand the domestic solar photovoltaic market in the United States (measured in megawatts) as compared to the expansion of that market from 2001 to 2002. This percentage must be determined by dividing the project's solar photovoltaic capacity measured in megawatts by 14.424 megawatts, which represents the expansion of the domestic solar photovoltaic market from 2001 to 2002. This figure has been obtained from information contained in Table 26 of the Energy Information Administration's report titled, "Solar Thermal and Photovoltaic Collector Manufacturing Activities 2003", which is available at *www.eia.doe.gov/cneaf/solar.renewables/page/solarreport/soltable26.html*.

iv. The amount, in megawatts, of the project's fuel cell energy generation capacity, which includes the fuel cells' genera-

tion of thermal and electrical energy used by the project. The application must describe in detail the fuel cell installed electrical generating capacity, as well as any reduced electrical consumption that will result from the use by the project of the fuel cells' thermal energy output. The application must also describe how the fuel cell electrical and thermal energy will be used by the project.

d. *Location of project*. The application must indicate the location of the project, including: (i) the State in which the project will be located; (ii) whether the project will be located in, or within a ten-mile radius of, an empowerment zone under section 1391; and (iii) whether the project will be located in a rural State.

6. *Plan of financing*. The application must contain a detailed description of the plan of financing for the project, including the expected issuer of the bonds, the anticipated date of issuance, the sources of security and repayment for the bonds, and the aggregate face amount of bonds expected to be issued for the project.

**DESIGNATIONS**

Subject to the availability of eligible projects, the IRS, after consultation with the EPA, will designate qualified green building and sustainable design projects. In order to evaluate an application submitted, the IRS may disclose selected information from the application, pursuant to section 6103(k)(6), in order to verify the application's contents and the project's eligibility as a qualified green building and sustainable design project. As part of the designation process, the IRS may impose requirements or conditions on a designee that are in addition to those described in this notice or other published guidance.

**CERTIFICATION OF USE OF TAX BENEFIT**

No later than 30 days after the completion of a project, each issuer of qualified green building and sustainable design project bonds for the project must submit to the Internal Revenue Service, Attn: SE:T:GE:TEB:O, 1111 Constitution Ave., NW, PE — 5T2, Washington, DC 20224, the following certification: "The [insert name of issuer] hereby certifies that the net benefit of the tax-exempt financing received pursuant to section 701 of the American Jobs Creation Act of 2004 for [insert name of project] was used for the purposes described in section 142(l)(4)(A)(v) of the Internal Revenue Code." Each issuer must submit documentation supporting the certification, including documentation describing the calculation and allocation of the net benefit of the tax-exempt financing for the project in accordance with paragraph 5.b.v. of the "APPLICATION REQUIREMENTS" section of this notice.

**REPORT OF COMPLIANCE**

Twenty-four months after the completion of a project, but not later than 48 months after the date of issuance of bonds subject to section 142(l) that financed the project, the issuer of the bonds must submit to the Internal Revenue Service, Attn: SE:T:GE:TEB:O, 1111 Constitution Ave., NW, PE — 5T2, Washington, DC 20224, and to the Environmental Protection Agency, Office of Congressional and Intergovernmental Relations, Mail Code 1305A, 1200 Pennsylvania Avenue, N.W., Washington, D. C. 20460 a written report together with attachments listed below that: (1) describes with specificity whether the project has complied (and is expected to comply in the future) with the basic eligibility requirements of section 142(l)(4)(A) and currently meets (and is expected to meet in the future) the commitments with respect to conservation and technology innovation set forth in the application for the project; (2) provides the identity of, and contact information for, a person duly authorized to represent the issuer before the IRS relating to the issue; and (3) includes Form 8821 (*Tax Information Authorization*) authorizing the IRS to disclose any information relating to the project to the officers and employees of the Environmental Protection Agency and the United States Department of Energy for the purpose of determining whether the project is accomplishing the goals for conservation and technology innovation set forth in the application for the designation of the project . The issuer shall attach to this report a copy of the Form 8038 filed with respect to the issue, as well as a copy of the application for designation by the IRS that was submitted in accordance with the requirements described above.

**ACCOUNTABILITY**

Each issuer must maintain, on behalf of each project, an interest bearing reserve account in an amount equal to one percent of the net proceeds (as defined in section 150(b)(3)) of any bond issued under sections 142(a)(14) and 142(l) for such project. Not later than five years after the date of issuance of the bonds, the IRS, after consultation with the EPA, shall determine whether the project has substantially complied with the basic eligibility requirements described in section 142(l)(4)(A). The IRS may extend the five-year period by up to two years if the project is not placed in service, as determined under § 1.150–2(c), within 48 months after the date of issuance of any bonds issued under section 142(l) to finance any part of the project. If the IRS, after receipt of the compliance report and consultation with the EPA, certifies that the project has substantially complied with the basic eligibility requirements of section 142(l)(4)(A), amounts in the reserve account, including all interest, shall be released to the project. If the IRS determines that the project has not substantially complied with the basic eligibility requirements, amounts in the reserve account, including all interest, shall be paid to the United States Treasury.

**COORDINATION WITH OTHER RULES GOVERNING QUALIFIED PRIVATE ACTIVITY BONDS.**

Except as otherwise provided in this notice, nothing in this notice shall be construed as overriding any requirements or limitations applicable to exempt facility bonds found in sections 103, and 141 through 150 of the Code and the applicable regulations thereunder, or affecting the ability of the IRS to examine the bond issue for compliance with those requirements or limitations.

**REQUIRED DECLARATIONS**

Each application, certification, report or other document submitted under this notice must include the following declaration signed by an individual who has personal knowledge of the relevant facts and circumstances: "Under penalties of perjury, I declare that I have examined this document and, to the best of my knowledge and

belief, the document contains all the relevant facts relating to the document, and such facts are true, correct, and complete."

**INFORMATION REPORTING**

An issuer of qualified green building and sustainable design project bonds must complete Form 8038, *Information Return for Tax-Exempt Private Activity Bond Issues*, in accordance with the instructions and complete Part II by checking the box on Line 11m (Other), writing "qualified green building and sustainable design project bonds" in the space provided for the bond description, and entering the amount of the bonds in the Issue Price column.

**DRAFTING INFORMATION**

The principal author of this notice is Timothy L. Jones of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). However, other personnel from the IRS, the Treasury Department, the Environmental Protection Agency, and the Energy Department participated in its development. For further information regarding this notice, contact Timothy L. Jones at (202) 622–3980 (not a toll-free call).

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## Qualification of Certain Arrangements as Insurance

## Notice 2005–49

This notice requests comments on additional guidance concerning the standards for determining whether an arrangement constitutes insurance for federal income tax purposes.

In Rev. Rul. 2001–31, 2001–1 C.B. 1348, the Internal Revenue Service announced that it would no longer raise the "economic family theory" set forth in Rev. Rul. 77–316, 1977–2 C.B. 53, in addressing whether captive insurance transactions constitute insurance for federal income tax purposes. Since 2001, the Service and the Treasury Department have published four revenue rulings providing guidance on the standards to be used to determine whether a particular arrangement constitutes insurance. Most recently, Rev. Rul. 2005–40, page 4, this Bulletin, explains that (1) in order for an arrangement to qualify as insurance, both risk shifting and risk distribution must be present, and (2) the risk distribution requirement is not satisfied if the issuer of an "insurance" contract enters into such a contract with only one policyholder. *See also* Rev. Rul. 2002–89, 2002–2 C.B. 984 (setting forth circumstances under which arrangements between a domestic parent corporation and its wholly owned subsidiary constitute insurance); Rev. Rul. 2002–90, 2002–2 C.B. 985 (setting forth circumstances under which payments for professional liability coverage by a number of operating subsidiaries to an insurance subsidiary of a common parent constitute insurance); Rev. Rul. 2002–91, 2002–2 C.B. 991 (setting forth circumstances under which amounts paid to a group captive of unrelated insureds are deductible as insurance premiums and in which the group captive qualifies as an insurance company).

The Service and the Treasury Department are aware that further guidance is needed in this area and request comments on issues that should be addressed. In particular, comments are requested regarding (1) the factors to be taken into account in determining whether a cell captive arrangement constitutes insurance and, if so, the mechanics of any applicable federal tax elections; (2) circumstances under which the qualification of an arrangement between related parties as insurance may be affected by a loan back of amounts paid as "premiums;" (3) the relevance of homogeneity in determining whether risks are adequately distributed for an arrangement to qualify as insurance, and (4) federal income tax issues raised by transactions involving finite risk.

Comments should be submitted in writing on or before October 3, 2005, and should include a reference to Notice 2005–49. Comments may be submitted to CC:PA:LPD:PR (Notice 2005–49), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, comments may be submitted electronically via the following e-mail address: *Notice.Comments@irscounsel.treas.gov*. Please include "Notice 2005–49" in the subject line of any electronic communications.

Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2005–49), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

For further information regarding this notice, contact William Sullivan or Thomas Preston of the Office of Associate Chief Counsel (Financial Institutions & Products) at (202) 622–3970 (not a toll-free call).

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## Miscellaneous Issues Arising in Connection With the Health Coverage Tax Credit

## Notice 2005–50

This notice provides guidance on miscellaneous issues that have arisen under section 35 of the Internal Revenue Code (added by the Trade Act of 2002, Public Law 107–210). Section 35 provides a 65% tax credit for amounts certain individuals spend on certain kinds of health coverage for themselves and certain family members. This credit is referred to as the Health Coverage Tax Credit (HCTC).

INTRODUCTION

The HCTC may be claimed for eligible coverage months by eligible individuals. There are three categories of eligible individuals: (1) eligible TAA recipients (individuals eligible for trade adjustment assistance under a program administered by the Employment and Training Administration of the U.S. Department of Labor); (2) eligible ATAA recipients (individuals eligible for alternative trade adjustment assistance under a program administered by the Employment and Training Administration of the U.S. Department of Labor); and (3) eligible PBGC pension recipients (individuals who are at least age 55 and who are receiving a benefit any portion of which is paid by the Pension Benefit Guaranty Corporation). An eligible individual is entitled to claim the HCTC with respect to qualifying family members. Qualifying family

members include the eligible individual's spouse and any person the eligible individual can claim as a dependent on the eligible individual's federal income tax return.

An eligible individual can claim the HCTC only for qualified health coverage. There are ten categories of qualified health coverage. Seven of the categories are qualified coverage only if a state government elects them to be qualified. These are referred to as state-based coverage. The other three categories are COBRA coverage, coverage under a group health plan that is available through the employment of an eligible individual's spouse (spousal coverage), and certain individual insurance coverage.

An eligible individual who pays for qualified health coverage for a month is nevertheless not entitled to the HCTC for that month if the eligible individual has other specified coverage on the first day of the month. Other specified coverage generally includes health coverage 50 percent or more of the cost of which is paid or incurred by an employer or former employer of the eligible individual or of the eligible individual's spouse. For this purpose, the cost of coverage is treated as paid or incurred by an employer to the extent the coverage is in lieu of a right to receive cash or other qualified benefits under a cafeteria plan (as defined in section 125(d) of the Code). (For ATAA recipients, other specified coverage includes health coverage if the employer pays or incurs any portion of the cost of coverage.) Coverage under the following programs is also other specified coverage: Medicare, Medicaid, State Children's Health Insurance Program (S-CHIP), TRICARE coverage (for members of the military and their families), and FEHBP coverage (for federal civil employees).

Eligible individuals and their qualifying family members have certain rights with respect to state-based coverage if the eligible individual has at least three months of creditable coverage, does not have other specified coverage, and is not imprisoned under federal, state, or local authority. Such an eligible individual and the eligible individual's qualifying family members are referred to as qualifying individuals. They have guaranteed issue rights to state-based coverage, their state-based coverage cannot be subject to a preexisting condition exclusion, they cannot be charged more for state-based coverage than similarly situated individuals, and they must be entitled to the same benefits under state-based coverage as similarly situated individuals.

The HCTC can be claimed on the eligible individual's federal tax return. However, individuals can also claim the HCTC under an advance payment program authorized by section 7527 of the Code. Eligible individuals registering with the advance payment program can send the IRS 35% of the cost of qualified health coverage on a monthly basis and the IRS will pay the health coverage provider 100% of the cost of qualified health coverage. Amounts paid through the advance payment program cannot be claimed for the HCTC on the eligible individual's tax return.

QUESTIONS AND ANSWERS

Q–1. Is an individual who receives a lump sum payment from the Pension Benefit Guaranty Corporation (PBGC) on or after August 6, 2002, considered to be receiving monthly benefits from the PBGC?

A–1. Yes. An individual who receives a lump sum payment from the PBGC on or after August 6, 2002 (the date of enactment of the Trade Act of 2002), is considered to be receiving monthly benefits from the PBGC for as long as the individual would have received a PBGC annuity had the PBGC not paid the individual a lump sum of their PBGC benefit. Consequently, if such an individual is at least age 55 as of the first day of a month, the individual is an eligible individual for purposes of the Health Coverage Tax Credit (HCTC).

Q–2. Can an eligible individual claim the HCTC with respect to amounts paid for qualified health coverage of a qualifying family member if that qualified health coverage does not cover the eligible individual?

A–2. Yes, but only if the eligible individual has qualified health coverage for the month. However, that qualified health coverage need not be the same as that covering a qualifying family member in order for the eligible individual to be entitled to claim the HCTC with respect to amounts paid for the qualifying family member's qualified health coverage for that month. For example, if an eligible individual is enrolled in qualified state-based health coverage in a month and a qualifying family member of the eligible individual is enrolled in COBRA coverage in that month, the eligible individual is entitled to claim the HCTC for that month with respect to amounts paid both for the eligible individual's enrollment in the state-based coverage and for the qualifying family member's enrollment in the COBRA coverage.

Q–3. If qualified health coverage of an eligible individual or a qualifying family member also covers someone who is neither an eligible individual nor a qualifying family member (a nonqualifying beneficiary), how is the amount paid by the eligible individual for qualified coverage allocated between, on the one hand, the eligible individual and any qualifying family members, and, on the other hand, nonqualifying beneficiaries?

A–3. Amounts paid by an eligible individual for qualified health coverage covering one or more nonqualifying beneficiaries are allocated on an incremental basis, attributing those amounts first to the cost of covering the eligible individual and any qualifying family members and then to the cost of covering nonqualifying beneficiaries. Thus, if the cost of covering a nonqualifying beneficiary does not add to the cost of covering the eligible individual or any qualifying family members, then the cost of covering the nonqualifying beneficiary is zero. If the cost of covering a nonqualifying beneficiary adds to the cost of covering an eligible individual or any qualifying family member, it is the incremental cost that is ineligible for the HCTC. This incremental allocation rule for nonqualifying beneficiaries is illustrated by the following examples:

*Example 1. Facts.* Qualified health coverage of an eligible individual covers an eligible individual and the eligible individual's spouse and two children. The two children satisfy the conditions for being qualifying family members (that is, they do not have other specified coverage and the eligible individual is entitled to claim them as dependents on the eligible individual's federal income tax return). The spouse, however, is not a qualifying family member (because the spouse has other specified coverage). The eligible individual pays $800 per month for self-plus-two-or-more-dependents under the qualified coverage.

*Conclusion.* The amount the eligible individual pays for covering the eligible individual and the two children (the qualifying family members) under the qualified health coverage is $800 per month. The amount the eligible individual pays for the spouse (the nonqualifying beneficiary) is $0 per month. The

eligible individual is entitled to claim the HCTC with respect to $800 per month.

*Example 2*. *Facts*. The facts are the same as in *Example 1* of this Q&A–3 except that the eligible individual has only one child. Although the eligible individual pays $800 per month for self-plus-two-or-more-dependents under the qualified coverage, the eligible individual would be required to pay $600 per month for self-plus-one-dependent under the coverage.

*Conclusion*. The amount the eligible individual pays for covering the eligible individual and the child (the one qualifying family member) under the qualified health coverage is $600 per month. The amount the eligible individual pays for the spouse (the nonqualifying beneficiary) is $200 per month. The eligible individual is entitled to claim the HCTC with respect to $600 per month.

Q–4. Is entitlement to or receipt of benefits from the Veterans Administration other specified coverage?

A–4. No. The statute lists various forms of health coverage — including the entitlement to receive benefits under chapter 55 of title 10 of the United States Code (TRICARE) — as other specified coverage. Entitlement to or receipt of benefits from the Veterans Administration, however, comes under title 38 of the United States Code and does not fit any of the categories of other specified coverage.

Q–5. How is a determination made whether an employer pays or incurs at least 50% of the cost of coverage or any portion of the cost of coverage?

A–5. (a) The rules of this Q&A–5 are used to determine whether an employer pays or incurs at least 50% of the cost of coverage or any portion of the cost of coverage. The factors for making such a determination consist of (1) the basis for determining the dollar amount of the cost (described in paragraph (b) of this Q&A–5); (2) the effect of cafeteria plan contributions under section 125 of the Code (described in paragraph (c) of this Q&A–5); and (3) the category of coverage (described in paragraph (d) of this Q&A–5).

(b) The dollar amount of cost is determined in accordance with the rules in section 4980B(f)(4) of the Code (used in determining the applicable premium for COBRA continuation coverage).

(c) Any portion of the cost of coverage of an individual paid or incurred in lieu of a right to receive cash or other qualified benefits under a cafeteria plan under section 125 is considered to be paid or incurred by an employer.

(d) If the proportion of the cost of coverage paid or incurred by an employer varies with the category of coverage, the amount paid or incurred by the employer for each category is determined on an aggregate basis. Thus, for example, in a plan that makes coverage available in self-only and family categories, the portion of the cost of family coverage paid or incurred by the employer is determined by dividing the total cost of such coverage by the total amount the employer pays or incurs for such coverage. This rule is further illustrated in the following example:

*Example*. *Facts*. Employees participating in a group health plan maintained by an employer may choose among three categories of coverage: (1) self-only, (2) self-plus-one-dependent, and (3) self-plus-two-or-more-dependents. The total cost of the coverage, as determined under the rules of section 4980B(f)(4), is (1) $300 per month for self-only coverage, (2) $600 per month for self-plus-one-dependent coverage, and (3) $800 per month for self-plus-two-or-more-dependents coverage. No portion of the cost of coverage is paid or incurred under a cafeteria plan under section 125. The employer pays or incurs (1) $225 per month for self-only coverage, (2) $325 per month for self-plus-one-dependent coverage, and (3) $350 per month for self-plus-two-or-more-dependents coverage.

*Conclusion*. The portion of the cost of coverage that the employer pays for each category is (1) 75% for self-only coverage ($225/$300), (2) 54% for self-plus-one-dependent coverage ($325/$600, rounded to the nearest whole percentage), and (3) 44% for self-plus-two-or-more-dependents coverage ($350/$800, rounded to nearest whole percentage). Thus, for any eligible individual or qualifying family member receiving coverage under the plan, the categories self-only and self-plus-one-dependent are other specified coverage (and thus the eligible individual cannot claim the HCTC); the category self-plus-two-or-more-dependents is not other specified coverage (except in connection with the special rules that apply for ATAA recipients).

Q–6. May a plan providing COBRA coverage to an eligible individual or a qualifying family member reject payment from the HCTC advance payment program because it does not come directly from a COBRA qualified beneficiary?

A–6. No. Under the COBRA continuation coverage requirements of section 4980B of the Code, payment is merely required to be made; there is no requirement that it be made by the qualified beneficiary. If full payment by a third party (such as the HCTC advance payment program) is tendered timely to a plan for the COBRA coverage of a qualified beneficiary and the plan terminates the coverage of the qualified beneficiary for failure to make timely payment, the plan is not in compliance with the COBRA continuation coverage requirements and is subject to the excise tax of section 4980B (generally, $100 per day per beneficiary for each day that the plan is not in compliance with respect to that beneficiary).

Q–7. To be qualified health coverage, must a state-based plan allow qualifying individuals to pay for their coverage through the HCTC advance payment program?

A–7. Yes. Part of the guaranteed issue requirement for any state-based plan is that the plan allow qualifying individuals to pay for their coverage through the HCTC advance payment program.

Q–8. How is it determined if a qualifying family member of an eligible individual is a qualifying individual?

A–8. If the family member has met the requirements for being a qualifying family member (relationship to eligible individual and no other specified coverage) and the eligible individual is a qualifying individual, then the family member is a qualifying individual. There are no additional requirements for the family member to satisfy (such as having a certain amount of creditable coverage).

Q–9. How is it determined whether an eligible individual has three months or more of creditable coverage?

A–9. The rules of section 9801 of the Code and the regulations thereunder (including those rules describing what constitutes a significant break in coverage and tolling rules for significant breaks in coverage) apply in determining if an eligible individual has three months or more of creditable coverage as of any date. Those rules prescribe that creditable coverage is determined on the basis of days rather than months. In applying those rules under section 35, an individual who has at least 89 days of creditable coverage as of a certain date is considered to have three months or more of creditable coverage as of that date.

Q–10. Must a state-based plan restrict eligibility for enrollment among eligible individuals and qualifying family members to those who are also qualifying individuals in order for the state-based plan to be qualified health coverage?

A–10. No. A state-based plan does not fail to satisfy the requirements for qualified health coverage merely because it allows eligible individuals and qualifying

family members who are not qualifying individuals to enroll in the plan.

Q–11. Does a state-based plan fail to satisfy the guaranteed issue requirement merely because it restricts eligibility under the plan to residents of the state?

A–11. No. Moreover, if a state has a system of plans covering distinct geographic regions in the state, each plan may restrict eligibility to residents of that region as long as any qualifying individual in the state is eligible for at least one plan in the system.

Q–12. Are there other restrictions that a state-based plan can impose on the enrollment of qualifying individuals?

A–12. Yes. State-based plans can require qualifying individuals to enroll within a reasonable period after becoming qualifying individuals or during limited regular enrollment periods thereafter (such as annual enrollment periods), can deny enrollment to qualifying individuals for fraud or misrepresentation of material facts, and can deny enrollment for failure to make timely payment.

Q–13. Can state-based coverage (including a high risk pool) condition enrollment of a qualifying individual on being rejected for coverage in the individual or group health insurance market?

A–13. No. Any coverage elected by a state to be qualified health coverage must be made available to a qualifying individual if the qualifying individual pays for enrollment (or enrolls in the advance payment program and the IRS pays for enrollment on behalf of the qualifying individual) and cannot be subject to any condition other than those described in Q&A–11 and Q&A–12 of this notice.

DRAFTING INFORMATION

The principal author of this notice is Russ Weinheimer of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information about this notice, contact Mr. Weinheimer at (202) 622–6080 (not a toll-free call).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking and Notice of Public Hearing

## Limitations on Benefits and Contributions Under Qualified Plans

## REG–130241–04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed amendments to the regulations under section 415 of the Internal Revenue Code regarding limitations on benefits and contributions under qualified plans. The proposed amendments would provide comprehensive guidance regarding the limitations of section 415, including updates to the regulations for numerous statutory changes since regulations were last published under section 415. The proposed amendments would also make conforming changes to regulations under sections 401(a)(9), 401(k), 403(b), and 457, and would make other minor corrective changes to regulations under section 457. These regulations will affect administrators of, participants in, and beneficiaries of qualified employer plans and certain other retirement plans. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by July 25, 2005. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for August 17, 2005, at 10 a.m., must be received by July 27, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–130241–04), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–130241–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington D.C. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, D.C.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Vernon S. Carter at (202) 622–6060 or Linda S. F. Marshall at (202) 622–6090; concerning submissions and the hearing and/or to be placed on the building access list to attend the hearing, Richard A. Hurst at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains proposed amendments to the Income Tax Regulations (26 CFR Parts 1 and 11) under section 415 of the Internal Revenue Code (Code) relating to limitations on benefits and contributions under qualified plans. In addition, this document contains conforming amendments to the Income Tax Regulations under sections 401(a)(9), 401(k), 403(b), and 457 of the Code, as well as minor corrective changes to the regulations under section 457.

Section 415 was added to the Internal Revenue Code by the Employee Retirement Income Security Act of 1974 (ERISA), and has been amended many times since. Section 415 provides a series of limits on benefits under qualified defined benefit plans and contributions and other additions under qualified defined contribution plans. See also section 401(a)(16). Pursuant to section 415(a)(2), the limitations of section 415 also apply to section 403(b) annuity contracts and to simplified employee pensions described in section 408(k) (SEPs). In addition, the limitations of section 415 for defined contribution plans apply to contributions allocated to any individual medical account that is part of a pension or annuity plan established pursuant to section 401(h) and to amounts attributable to medical benefits allocated to an account established for a key employee pursuant to section 419A(d)(1).

Section 404(j) provides generally that, in computing the amount of any deduction for contributions under a qualified plan, benefits and annual additions in excess of the applicable limitations under section 415 are not taken into account. In addition, in computing the applicable limits on deductions for contributions to a defined benefit plan, and in computing the full funding limitation, an adjustment under section 415(d)(1) is not taken into account for any year before the year for which that adjustment first takes effect.

The definition of compensation that is used for purposes of section 415 is also used for a number of other purposes under the Internal Revenue Code. Under section 219(b)(3), contributions on behalf of an employee to a plan described in section 501(c)(18) are limited to 25% of compensation as defined in section 415(c)(3). Section 404(a)(12) provides that, for various specified purposes in determining deductible limits under section 404, the term *compensation* includes amounts treated as *participant's compensation* under section 415(c)(3)(C) or (D). Pursuant to section 409(b)(2), for purposes of determining whether employer securities are allocated proportionately to compensation in accordance with the rules of section 409(b)(1), the amount of compensation paid to a participant for any period is the amount of such participant's compensation (within the meaning of section 415(c)(3)) for such period. Under section 414(q)(3), for purposes of determining whether an employee is a highly compensated employee within the meaning of section 414(q), the term *compensation* has the meaning given such term by section 415(c)(3). Section 414(s), which defines the term *compensation* for purposes of certain qualification requirements, generally provides that the term *compensation* has the meaning given such term by section 415(c)(3). Under section 416(c)(2), allocations to participants who are non-key employees under a top-heavy plan that is a defined contribution plan are required to be at least 3% of the participant's compensation (within the meaning of section 415(c)(3)). Pursuant to section 457(e)(5), the term *includible compensa-*

*tion*, which is used in limiting the amount that can be deferred for a participant under an eligible deferred compensation plan as defined in section 457(b), has the same meaning as the term *participant's compensation* under section 415(c)(3).

Comprehensive regulations regarding section 415 were last issued in 1981. See T.D. 7748, 1981–1 C.B. 259, published in the **Federal Register** on January 7, 1981 (46 FR 1687). Since then, changes to section 415 have been made in the Economic Recovery Tax Act of 1981, Public Law 97–34 (95 Stat. 320) (ERTA), the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97–248 (96 Stat. 623) (TEFRA), the Deficit Reduction Act of 1984, Public Law 98–369 (98 Stat. 494) (DEFRA), the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2481) (TRA '86), the Technical and Miscellaneous Revenue Act of 1988, Public Law 100–647 (102 Stat. 3342) (TAMRA), the Uruguay Round Agreements Act of 1994, Public Law 103–465 (108 Stat. 4809) (GATT), the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755) (SBJPA), the Community Renewal Tax Relief Act of 2000, Public Law 106–554 (114 Stat. 2763), the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107–16 (115 Stat. 38) (EGTRRA), the Job Creation and Worker Assistance Act of 2002, Public Law 107–147 (116 Stat. 21) (JCWAA), the Pension Funding Equity Act of 2004, Public Law 108–218 (118 Stat. 596) (PFEA), and the Working Families Tax Relief Act of 2004, Public Law 108–311 (118 Stat. 1166).

Although two minor changes to the regulations were made after 1981, most of the statutory changes made since that time are not reflected in the regulations, but in IRS notices, revenue rulings, and other guidance of general applicability, as follows:

- Notice 82–13, 1982–1 C.B. 360, provides guidance on deductible employee contributions (including guidance under section 415) to reflect the addition of provisions relating to deductible employee contributions in ERTA.

- Notice 83–10, 1983–1 C.B. 536, provides guidance on the changes to section 415 made by TEFRA. The TEFRA changes were extensive, and included reductions of the dollar limits on annual benefits under a defined benefit plan and annual additions under a defined contribution plan, changes to the age and form adjustments made in the application of the limits under a defined benefit plan, and rules regarding the deductibility of contributions with respect to benefits that exceed the applicable limitations of section 415.

- Notice 87–21, 1987–1 C.B. 458, provides guidance on the changes to section 415 made by TRA '86. The TRA '86 changes modified the rules for the indexing of the dollar limit on annual additions under a defined contribution plan, the treatment of employee contributions as annual additions, and the rules for age adjustments under defined benefit plans, and added a phase-in of the section 415(b)(1)(A) dollar limitation over 10 years of participation, as well as rules permitting the limitations of section 415 to be incorporated by reference under the terms of a plan.

- Rev. Rul. 95–6, 1995–1 C.B. 80, and Rev. Rul. 2001–62, 2001–2 C.B. 632, (superseding Rev. Rul. 95–6) provide mortality tables to be used to make certain form adjustments to benefits under a defined benefit plan for purposes of applying the limitations of section 415, pursuant to the requirement to use a specified mortality table added by GATT.

- Rev. Rul. 95–29, 1995–1 C.B. 81, and Rev. Rul. 98–1, 1998–1 C.B. 249, (modifying and superseding Rev. Rul. 95–29) provide guidance regarding certain form and age adjustments under a defined benefit plan pursuant to changes made by GATT (as modified under SBJPA), including transition rules relating to those adjustments.

- Notice 99–44, 1999–2 C.B. 326, provides guidance regarding the repeal under SBJPA of the limitation on the combination of a defined benefit plan and a defined contribution plan under former section 415(e).

- Notice 2001–37, 2001–1 C.B. 1340, provides guidance regarding the inclusion of salary reduction amounts for qualified transportation fringe benefits in the definition of compensation for purposes of section 415, as provided under the Community Renewal Tax Relief Act of 2000.

- Rev. Rul. 2001–51, 2001–2 C.B. 427, provides guidance relating to the increases in the limitations of section 415 for both defined benefit and defined contribution plans, which were enacted as part of EGTRRA.

- Notice 2002–2, 2002–1 C.B. 285, provides guidance regarding the treatment of reinvested ESOP dividends under section 415(c), to reflect changes made by SBJPA.

- Rev. Rul. 2002–27, 2002–1 C.B. 925, provides guidance pursuant to which a definition of compensation can be used for purposes of applying the limitations of section 415 even if that definition treats certain specified amounts that may not be available to an employee in cash as subject to section 125 (and therefore included in compensation).

- Rev. Rul. 2002–45, 2002–2 C.B. 116, provides guidance regarding the treatment of certain payments to defined contribution plans to restore losses resulting from actions by a fiduciary for which there is a reasonable risk of liability for breach of a fiduciary duty (including the treatment of those payments under section 415).

- Notice 2004–78, 2004–48 I.R.B. 879, provides guidance regarding the actuarial assumptions that must be used for distributions with annuity starting dates occurring during plan years beginning in 2004 and 2005, to determine whether an amount payable under a defined benefit plan in a form that is subject to the minimum present value requirements of section 417(e)(3) satisfies the requirements of section 415. This guidance reflects changes made in PFEA.

These guidance items are reflected in the proposed regulations with some modifications. In addition, the proposed regulations reflect other statutory changes

not previously addressed by guidance, and include some other changes and clarifications to the existing final regulations. Treasury and the IRS believe that a single restatement of the section 415 rules serves the interests of plan sponsors, third-party administrators, plan participants, and plan beneficiaries. To the extent practicable, this preamble identifies and explains substantive changes from the existing final regulations or existing guidance.

**Explanation of Provisions**

*Overview*

A. *Reflection of statutory changes*

These proposed regulations reflect the numerous statutory changes to section 415 and related provisions that have been made since 1981. Some of the statutory changes reflected in the proposed regulations are as follows:

- The current statutory limitations under section 415(b)(1)(A) and 415(c)(1) applicable for defined benefit and defined contribution plans, respectively, as most recently amended by EGTRRA.

- Changes to the rules for age adjustments to the applicable limitations under defined benefit plans, under which the dollar limitation is adjusted for commencement before age 62 or after age 65.

- Changes to the rules for benefit adjustments under defined benefit plans. The proposed regulations also specify the parameters under which a benefit payable in a form other than a straight life annuity is adjusted in order to determine the actuarially equivalent annual benefit that is subject to the limitations of section 415(b).

- The phase-in of the dollar limitation under section 415(b)(1)(A) over 10 years of participation, as added by TRA '86.

- The addition of the section 401(a)(17) limitation on compensation that is permitted to be taken into account in determining plan benefits, as added by TRA '86, and the interaction of this requirement with the limitations under section 415.

- Exceptions to the compensation-based limitation under section 415(b)(1)(B) for governmental plans, multiemployer plans, and certain other collectively bargained plans.

- Changes to the aggregation rules under section 415(f) under which multiemployer plans are not aggregated with single-employer plans for purposes of applying the compensation-based limitation of section 415(b)(1)(B) to a single-employer plan.

- The repeal under SBJPA of the section 415(e) limitation on the combination of a defined benefit plan and a defined contribution plan.

- The changes to section 415(c) that were made in conjunction with the repeal under EGTRRA of the exclusion allowance under section 403(b)(2).

- The current rounding and base period rules for annual cost-of-living adjustments pursuant to section 415(d), as most recently amended in EGTRRA and the Working Families Tax Relief Act of 2004.

- Changes to section 415(c) under which certain types of arrangements are no longer subject to the limitations of section 415(c) (*e.g.*, individual retirement accounts other than SEPs) and other types of arrangements have become subject to the limitations of section 415(c) (*e.g.*, certain individual medical accounts).

- The inclusion in compensation (for purposes of section 415) of certain salary reduction amounts not included in gross income.

B. *Other significant changes*

The proposed regulations contain new rules for determining the annual benefit under a defined benefit plan where there has been more than one annuity starting date (*e.g.*, where benefits under a plan are aggregated with benefits under another plan under which distributions previously commenced). These rules would resolve the numerous issues that have arisen in determining the annual benefit under a plan where the application of the section 415(b) limitations must take into account prior distributions as well as currently commencing distributions.

The proposed regulations also provide specific rules regarding when amounts received following severance from employment are considered compensation for purposes of section 415, and when such amounts are permitted to be deferred pursuant to section 401(k), section 403(b), or section 457(b). These rules would resolve issues that have arisen with respect to payments made after the end of employment. The proposed regulations generally provide that amounts received following severance from employment are not considered to be compensation for purposes of section 415, but provide exceptions for certain payments made within 2½ months following severance from employment. These exceptions apply to payments (such as regular compensation, and payments for overtime, commissions, and bonuses) that would have been payable if employment had not terminated, and to payments with respect to leave that would have been available for use if employment had not terminated. This notice of proposed rulemaking includes corresponding changes to the regulations under sections 401(k), 403(b), and 457 that would provide that amounts receivable following severance from employment can only be deferred if those amounts meet these conditions. The rule pursuant to which compensation received after severance from employment is not considered compensation for purposes of section 415 generally does not apply to payments to an individual in qualified military service.

*§1.415(a)–1: General rules*

Section 1.415(a)–1 of these proposed regulations sets forth general rules relating to limitations under section 415 and provides an overview of the remaining regulations, including cross-references to special rules that apply to section 403(b) annuities, multiemployer plans, and governmental plans. In addition, this section provides rules for a plan's incorporation by reference of the rules of section 415 pursuant to section 1106(h) of TRA '86 (including detailed guidelines regarding

incorporation by reference of the annual cost-of-living adjustments to the statutory limits and the application of default rules), rules for plans maintained by more than one employer, and rules that apply in other special situations.

*§1.415(b)–1: Limitations applicable to defined benefit plans*

Section 1.415(b)–1 of these proposed regulations sets forth rules for applying the limitations on benefits under a defined benefit plan. Under these limitations, the annual benefit must not be greater than the lesser of $160,000 (as adjusted pursuant to section 415(d)) or 100% of the participant's average compensation for the participant's high 3 consecutive years. A retirement benefit payable in a form other than a straight life annuity is adjusted to an actuarially equivalent straight life annuity to determine the annual benefit payable under that form of distribution. In addition, the dollar limitation under section 415(b)(1)(A) is actuarially adjusted for benefit payments that commence before age 62 or after age 65. The proposed regulations clarify that, in addition to applying to benefits payable to participants and beneficiaries, the limitations of section 415(b) apply to accrued benefits and benefits payable from an annuity contract distributed to a participant. Thus, the limitations of section 415(b) apply to a participant's entire accrued benefit, regardless of whether the benefit is vested. Where a participant's accrued benefit is computed pursuant to the fractional rule of section 411(b)(1)(C), the limitations of section 415(b) apply to the accrued benefit as of the end of the limitation year and, for ages prior to normal retirement age, are not required to be applied to the projected annual benefit commencing at normal retirement age from which the accrued benefit is computed. In addition, the proposed regulations provide a number of other updates, clarifications, and other changes to the existing regulations, as described below.

*A. Actuarial assumptions used to convert benefit to a straight life annuity*

The proposed regulations provide rules under which a retirement benefit payable in any form other than a straight life annuity is converted to the straight life annuity that is actuarially equivalent to that other form to determine the annual benefit (which is used to demonstrate compliance with section 415) with respect to that form of distribution. These rules reflect statutory changes that specify the actuarial assumptions that are to be used for these equivalency calculations (including, for plan years beginning in 2004 and 2005, the use of a 5.5% interest rate for benefits that are subject to the present value rules of section 417(e)(3),[1] as set forth in PFEA), as well as published guidance that has been issued since 1981. In addition to setting forth rules for adjusting forms of benefit other than straight life annuities, the proposed regulations would permit the IRS to issue published guidance setting forth simplified methods for making these adjustments.

Under the proposed regulations, the annual benefit is determined as the greater of the actuarially equivalent straight life annuity determined under the plan's actuarial assumptions or the actuarially equivalent straight life annuity determined under actuarial assumptions specified by statute. This methodology implements the policy reflected in section 415(b)(2)(E), under which the plan's determination that a straight life annuity is actuarially equivalent to a particular optional form of benefit is overridden only when the optional form of benefit is more valuable than the corresponding straight life annuity when compared using statutorily specified actuarial assumptions.

The rules in the proposed regulations under which a retirement benefit payable in any form other than a straight life annuity is converted to a straight life annuity to determine the annual benefit with respect to that form of distribution generally follow the rules set forth in Rev. Rul. 98–1. However, the calculation of the actuarially equivalent straight life annuity determined using the plan's assumptions for actuarial equivalence has been simplified for a form of benefit that is not subject to the minimum present value rules of section 417(e)(3). Under the simplified calculation, instead of determining the actuarial assumptions used under the plan and applying those assumptions to convert an optional form of benefit to an actuarially equivalent straight life annuity, the regulations use the straight life annuity, if any, that is payable at the same age under the plan. This straight life annuity is then compared to the straight life annuity that is the actuarial equivalent of the optional form of benefit, determined using the standardized assumptions, and the larger of the two straight life annuities is used for purposes of demonstrating compliance with section 415. This simplification has not been extended to forms of benefit that are subject to the minimum present value rules of section 417(e), however, because under the plan those forms of benefit may be determined as the actuarial equivalent of the deferred annuity, rather than as the actuarial equivalent of the immediate straight life annuity.

*B. Inclusion of social security supplements in annual benefit*

The proposed regulations clarify that a social security supplement is included in determining the annual benefit. Under section 415(b)(2)(B), the annual benefit does not include ancillary benefits that are not directly related to retirement benefits. However, because a social security supplement is payable upon retirement as a form of retirement income, it is a retirement benefit. Thus, a social security supplement is included in determining the annual benefit without regard to whether it is an ancillary benefit or a QSUPP within the meaning of §1.401(a)(4)–12.

*C. Determination of high 3 average compensation*

The proposed regulations would make two changes that would have a significant effect on the determination of a participant's average compensation for the participant's high 3 consecutive years. Consistent with the provisions of section

[1] Section 417(e)(3) provides minimum present value requirements for certain forms of benefit payable from a defined benefit plan under which payments cannot be less than the amount calculated using a specified interest rate and a specified mortality table. For forms of benefit that are subject to the minimum present value rules of section 417(e)(3), the limitations of section 415(b) apply to limit the amount of a distribution even if those limitations result in a lower distribution than would otherwise be required under the rules of section 417(e)(3). See §1.417(e)–1(d)(1).

415(b)(3), the proposed regulations would restrict compensation used for this purpose to compensation earned in periods during which the participant was an active participant in the plan. In addition, the proposed regulations under §1.415(c)–2 would clarify the interaction of the requirements of section 401(a)(17) and the definition of compensation that must be used for purposes of determining a participant's average compensation for the participant's high 3 consecutive years. Because a plan may not base benefit accruals on compensation in excess of the limitation under section 401(a)(17), a plan's definition of compensation used for purposes of applying the limitations of section 415 is not permitted to reflect compensation in excess of the limitation under section 401(a)(17). Thus, for example, where a participant commences receiving benefits in 2005 at age 75 (so that the adjusted dollar limitation could be as high as $379,783), and the participant had compensation in excess of the applicable section 401(a)(17) limit for 2002, 2003, and 2004, the participant's benefit under the plan is limited by the average compensation for his highest three years as limited by section 401(a)(17) (*i.e.*, $201,667, or the average of $200,000, $200,000, and $205,000).

The proposed regulations set forth rules for computing the limitation of section 415(b)(1)(B) of 100% of the participant's compensation for the period of the participant's high 3 years of service for a participant who is employed with the employer while an active participant for less than 3 consecutive calendar years. For such a participant, the period of a participant's high 3 years of service is the actual number of consecutive years of employment (including fractions of years) while an active participant in the plan. In such a case, the limitation of section 415(b)(1)(B) of 100% of the participant's compensation for the period of the participant's high 3 years of service is computed by averaging the participant's compensation during the participant's longest consecutive period of employment while a plan participant over the actual period of service (including fractions of years, but not less than one year).

*D. Treatment of benefits paid partially in the form of a QJSA*

Under section 415(b)(2)(B), the portion of any joint and survivor annuity that constitutes a qualified joint and survivor annuity (QJSA) as defined in section 417(b) is not taken into account in determining the annual benefit for purposes of applying the limitations of section 415(b). The proposed regulations would clarify how this exception from the limitations of section 415 for the survivor annuity portion of a QJSA applies to benefits paid partially in the form of a QJSA and partially in some other form. Under this clarification, the rule excluding the survivor portion of a QJSA from the annual benefit applies to the survivor annuity payments under the portion of a benefit that is paid in the form of a QJSA, even if another portion of the benefit is paid in some other form.

*E. Dollar limitation applicable to early or late commencement*

The determination of the age-adjusted dollar limitation under the proposed regulations reflects the rules enacted in EGTRRA. As provided in Q&A–3 of Rev. Rul. 2001–51, this determination generally follows the same steps and procedures as those used in Rev. Rul. 98–1, except that such determination takes into account the increased defined benefit dollar limitation enacted by EGTRRA and that the adjustments for early or late commencement are no longer based on social security retirement age. Applying rules that are similar to those that are used for determining actuarial equivalence among forms of benefits, the proposed regulations generally use the plan's determinations for actuarial equivalence of early or late retirement benefits, but override those determinations where the use of the specified statutory assumptions results in a lower limit.

The proposed regulations adopt rules for mortality adjustments used in computing the dollar limitation on a participant's annual benefit for distributions commencing before age 62 or after age 65. Under these rules, to the extent that a forfeiture does not occur upon the participant's death, no adjustment is made to reflect the probability of the participant's death during the relevant time period, and to the extent a forfeiture occurs upon the participant's death, an adjustment must be applied to reflect the probability of the participant's death during the relevant time period. These rules generally are consistent with the guidance provided in Notice 83–10.

The proposed regulations would also provide a simplified method for applying this rule. Under this simplified method, a plan is permitted to treat no forfeiture as occurring upon a participant's death if the plan does not charge participants for providing a qualified preretirement survivor annuity, but only if the plan applies this treatment for adjustments that apply both before age 62 and after age 65.

*F. Nonapplication of adjustment to dollar limitation for early commencement with respect to police department and fire department employees*

Consistent with section 415(b)(2)(G) and (H), the proposed regulations would provide that the early retirement reduction does not apply to certain participants in plans of state and local government units who are employees of a police department or fire department, or former members of the Armed Forces of the United States. This rule applies to any participant in a plan maintained by a state or political subdivision of a state who is credited, for benefit accrual purposes, with at least 15 years of service as either (1) a full-time employee of any police department or fire department of the state or political subdivision that provides police protection, firefighting services, or emergency medical services, or (2) a member of the Armed Forces of the United States. The proposed regulations would clarify that the application of this rule depends on whether the employer is a police department or fire department of the state or political subdivision, rather than on the job classification of the individual participant.

*G. Application of $10,000 exception*

Pursuant to section 415(b)(4), the benefits payable with respect to a participant satisfy the limitations of section 415(b) if the retirement benefits payable with respect to such a participant under the plan and all other defined benefit plans of the employer do not exceed $10,000 for the

plan year or for any prior plan year, and the employer has not at any time maintained a defined contribution plan in which the participant participated. The proposed regulations would clarify that the section 415(b)(4) alternative $10,000 limitation is applied to actual distributions made during each year. Thus, a distribution for a limitation year that exceeds $10,000 is not within the section 415(b)(4) alternative limitation (and therefore will not be excepted from the otherwise applicable limits of section 415(b)), even if the distribution is a single-sum distribution that is the actuarial equivalent of an accrued benefit with annual payments that are less than $10,000.

*H. Exclusion of annual benefit attributable to mandatory employee contributions from annual benefit*

The proposed regulations would retain the rules under existing final regulations that the annual benefit does not include the annual benefit attributable to mandatory employee contributions. For this purpose, the term "mandatory employee contributions" means amounts contributed to the plan by the employee that are required as a condition of employment, as a condition of participation in the plan, or as a condition of obtaining benefits (or additional benefits) under the plan attributable to employer contributions. See section 411(c)(2)(C). Employee contributions to a defined benefit plan that are not maintained in a separate account as described in section 414(k) constitute mandatory employee contributions (even if section 411 does not apply to the plan) because, depending upon the investment performance of plan assets, employer contributions may be needed to pay a portion of the participant's benefit that is conditioned upon these employee contributions. The rules covering mandatory employee contributions do not extend to voluntary contributions because voluntary employee contributions (plus earnings thereon) are treated as a separate defined contribution plan rather than as part of a defined benefit plan.

The proposed regulations would retain the rule under the existing regulations that the annual benefit attributable to mandatory employee contributions is determined using the factors described in section 411(c)(2)(B) and the regulations thereunder, regardless of whether section 411 applies to the plan. The proposed regulations also would clarify that the following are not treated as employee contributions: (1) contributions that are picked up by a governmental employer as provided under section 414(h)(2), (2) repayment of any loan made to a participant from the plan, and (3) repayment of any amount that was previously distributed.

*I. Exclusion of annual benefit attributable to rollover contributions from annual benefit*

The proposed regulations would clarify that the annual benefit does not include the annual benefit attributable to rollover contributions made to a defined benefit plan (*i.e.*, rollover contributions that are not maintained in a separate account that is treated as a separate defined contribution plan under section 414(k)). In such a case, the annual benefit attributable to rollover contributions is determined by applying the rules of section 411(c) treating the rollover contributions as employee contributions (regardless of whether section 411 applies to the plan). This will occur, for example, if a distribution is rolled over from a defined contribution plan to a defined benefit plan to provide an annuity distribution. Thus, in the case of rollover contributions from a defined contribution plan to a defined benefit plan to provide an annuity distribution, the annual benefit attributable to those rollover contributions for purposes of section 415 is determined by applying the rules of section 411(c), regardless of the assumptions used to compute the annuity distribution under the plan. Accordingly, in such a case, if the plan uses more favorable factors than those specified in section 411(c) to determine the amount of annuity payments arising from a rollover contribution, the annual benefit under the plan would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c)(3).

Rollover contributions to an account that is treated as a separate defined contribution plan under section 414(k) do not give rise to an annual benefit because the separate account is not treated as a defined benefit plan under section 415(b). Furthermore, under the rules relating to defined contribution plans, these rollover contributions to a separate account are excluded from the definition of annual additions to a defined contribution plan.

*J. Treatment of benefits transferred among plans*

The proposed regulations would modify the rules of the existing final regulations for determining the amount of transferred benefits that are excluded from the annual benefit under a defined benefit plan in the event of a transfer from another defined benefit plan. These modifications are designed to ensure that transferred benefits are not counted twice by the same employer toward the limitations of section 415(b) and, similarly, to prevent the circumvention of the limitations of section 415(b) through benefit transfers to plans of unrelated employers. Under the proposed regulations, if the transferee plan's benefits are required to be taken into account pursuant to section 415(f) and §1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b), then the transferred benefits are included in determining the annual benefit under the transferee plan and are disregarded in determining the annual benefit under the transferor plan. Accordingly, in such a case, the annual benefit under each plan is determined taking into account the actual benefits provided under that plan after the transfer.

In contrast, if the transferee plan's benefits are not required to be taken into account pursuant to section 415(f) and §1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b), then the assets associated with those transferred liabilities (other than surplus assets) are treated by the transferor plan as distributed as a single-sum distribution. This will occur, for example, if the employer sponsoring the transferor plan is a predecessor employer with respect to the participant whose benefits are transferred to the transferee plan, where the transferee plan's benefits are not required to be taken into account pursuant to section 415(f) and §1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b). Although such a transfer is treated as a distribution in computing the annual benefit under the transferor plan, no corresponding adjustment to the annual benefit under

the transferee plan is made to reflect the fact that some of the benefits provided under the transferee plan are attributable to the transfer. Thus, the actual benefit provided under the transferee plan is used to determine the annual benefit under the transferee plan even though the transferred amount is included as a distribution in determining the annual benefit under the transferor plan. In most such cases, however, a participant whose benefits have been transferred would accrue no additional benefit under the transferor plan that would be required to be tested under the plan (in combination with the transferred benefits).

*K. 10-year phase-in of limitations based on years of participation and years of service*

The proposed regulations would provide rules for applying the 10-year phase-in of the dollar limitation based on years of participation in the plan, as added by TRA '86, and would modify the rules set forth in final regulations for applying the 10-year phase-in of the compensation limit based on years of service. The proposed regulations follow the guidance set forth in Notice 87–21 for determining years of participation, and apply analogous rules for determining years of service for this purpose.

*§1.415(b)–2: Multiple annuity starting dates*

Section 1.415(b)–2 of the proposed regulations sets forth rules that apply in computing the annual benefit under one or more defined benefit plans in the case of multiple annuity starting dates (*i.e.*, in cases in which a participant has received one or more distributions in limitation years prior to an increase in the accrued benefit occurring during the current limitation year or prior to the annuity starting date for a distribution that commences during the current limitation year). These rules apply, for example, where benefit distributions to a participant have previously commenced under a plan that is aggregated with a plan from which the participant receives current accruals, or where a new distribution election is effective during the current limitation year with respect to a distribution that commenced in a prior limitation year. These rules also apply where benefit payments are increased as a result of plan terms applying a cost-of-living adjustment pursuant to an adjustment of the dollar limit of section 415(b)(1)(A) made pursuant to section 415(d), if the plan does not provide for application of the safe harbor methodology set forth in the proposed regulations for determining the adjusted amount of the benefit.

In the case of multiple annuity starting dates, the annual benefit that is subject to the limits of section 415(b) and §1.415(b)–1(a) is equal to the sum of (1) the annual benefit determined with respect to any accrued benefit with respect to which distribution has not yet commenced as of the current determination date, computed pursuant to the rules of §1.415(b)–1, (2) the annual benefit determined with respect to any distribution with an annuity starting date that occurs within the current limitation year and on or before the current determination date, computed pursuant to the rules of §1.415(b)–1, (3) the annual benefit determined with respect to the remaining amounts payable under any distribution with an annuity starting date that occurred during a prior limitation year, computed pursuant to the rules of §1.415(b)–1, and (4) the annual benefit attributable to prior distributions. For this purpose, the current determination date is the last day of period for which an increase in the participant's benefit accrues if an increase in the participant's accrued benefit occurs during the limitation year, and if there is no such increase, the current determination date is the annuity starting date for the distribution that commences during the limitation year. The annual benefit determined using this formula is tested for compliance with section 415(b) as of the current determination date, applying the dollar limitation (which is adjusted under section 415(d) to the current determination date and is also adjusted for the participant's age as of the current determination date) and the compensation limitation applicable as of that date (which is adjusted under section 415(d) to the current determination date but is not adjusted based on the participant's age).

Under the proposed regulations, the annual benefit attributable to prior distributions is determined by adjusting the amounts of prior distributions to an actuarially equivalent straight life annuity commencing at the current determination date. The proposed regulations apply rules that are analogous to the rules for adjusting other benefits to determine the amount of the actuarially equivalent straight life annuity for purposes of determining the annual benefit attributable to prior distributions. Under these rules, the amount and time of prior distributions made to the participant is taken into account, and the prior distributions are adjusted to the actuarially equivalent straight life annuity commencing at the current determination date using interest and mortality assumptions that apply generally for purposes of applying the limitations of section 415(b) to a benefit in a form other than a straight life annuity. For this purpose, the actuarially equivalent straight life annuity commencing at the current determination date must reflect an actuarial increase to the present value of payments to reflect that the participant has survived during the interim period.

The actuarial assumptions used to calculate the annual benefit attributable to a prior distribution are determined as of the current determination date, and are based on the form of the prior distribution. For a prior distribution to which section 417(e)(3) did not apply, the annual benefit attributable to the prior distribution is the greater of the annual amount of a straight life annuity commencing at the current determination date that is the actuarial equivalent of that prior distribution, computed using the actuarial factors specified under the plan that provides for the current distribution or current accrual that are used to determine offsets, if any, for prior distributions, or the annual amount of a straight life annuity commencing at the current determination date that is the actuarial equivalent of that prior distribution, computed using the currently applicable statutory actuarial factors under section 415(b)(2)(E)(i) and (v). Similarly, for a prior distribution to which section 417(e)(3) applied, the annual benefit attributable to the prior distribution is the greater of the annual amount of a straight life annuity commencing at the current determination date that is the actuarial equivalent of that prior distribution, computed using the actuarial factors specified under the plan that provides for the current distribution or current accrual that are used to determine offsets, if any, for prior

distributions, or the annual amount of a straight life annuity commencing at the current determination date that is the actuarial equivalent of that prior distribution, computed using the currently applicable statutory actuarial factors under section 415(b)(2)(E)(ii) and (v).

Apart from determining the actuarial factors applicable to calculating the annual benefit attributable to prior distributions, the form of the prior distribution does not otherwise affect the determination of the annual benefit attributable to prior distributions. Thus, for example, if a participant has received $50,000 per year for the past four years, the determination of the annual benefit attributable to prior distributions will be the same if those distributions are part of a 10-year certain and life annuity or are part of a straight life annuity because both of those distribution forms are subject to the same actuarial factors for determining the annual benefit attributable to prior distributions. In either case, the determination of the annual benefit attributable to prior distributions will be determined by applying the interest and mortality assumptions used under the plan to determine offsets, if any, for prior distributions to determine a straight life annuity that is actuarially equivalent to the four prior payments of $50,000, applying the statutory actuarial assumptions to determine a straight life annuity that is actuarially equivalent to the four prior payments of $50,000, and then taking the greater of the two straight life annuity amounts. Determining the annual benefit attributable to prior distributions on the basis of the amount of distributions made rather than on the form of those distributions (or on the basis of the accrued benefit that underlies those distributions) is designed to simplify the application of the multiple annuity starting date rules.

The proposed regulations provide that a prior distribution is not reflected in the annual benefit attributable to prior distributions to the extent the prior distribution has been repaid to the plan with interest (because the amounts attributable to such a prior distribution are reflected in the annual benefit in other ways). Thus, a prior distribution that has been entirely repaid to the plan (with interest) does not give rise to an annual benefit attributable to prior distributions. Similarly, if a prior distribution was made, and a repayment was subsequently made that was less than the amount of the prior distribution (including reasonable interest), the annual benefit attributable to prior distributions is determined by multiplying the annual benefit attributable to the prior distribution by one minus a fraction, the numerator of which is the amount of the repayment and the denominator of which is the amount of the prior distribution plus reasonable interest.

The proposed regulations provide an additional requirement that applies where a stream of annuity payments is modified by a new distribution election. This additional requirement is also imposed in §1.401(a)(9)–6, Q&A–13(c)(3). Under this additional requirement, which is intended to limit the extent to which benefits can increase as a result of a change in market interest rates, if a stream of annuity payments is modified by a new distribution election, the payments under the annuity that are paid before the modification plus the modified payments must satisfy the requirements of §1.415(b)–1 determined as of the original annuity starting date, using the interest rates and mortality table applicable to such date. Following the issuance of the regulations under section 401(a)(9), commentators suggested that the rule should be modified to permit a plan to reflect cost-of-living adjustments under section 415(d) that occur between the original annuity starting date and the date of modification in applying the additional test. These proposed regulations adopt this suggestion, and provide that a plan will not fail to satisfy the additional requirement merely because payments reflect cost-of-living adjustments pursuant to section 415(d) for payments no earlier than the time those adjustments are effective and in amounts no greater than amounts determined under §1.415(d)–1(a)(5). In addition, the proposed regulations include an amendment to §1.401(a)(9)–6, Q&A–13(c)(3), to reflect this change.

*§1.415(c)–1: Limitations applicable to defined contribution plans*

Section 1.415(c)–1 of these proposed regulations sets forth rules that apply to limitations on annual additions under a defined contribution plan. Under these limitations, annual additions must not be greater than the lesser of $40,000 (as adjusted pursuant to section 415(d)) or 100% of the participant's compensation for the limitation year. The term "annual additions" generally means the sum for any year of employer contributions, employee contributions, and forfeitures. In addition to applying to qualified defined contribution plans, the limitations on defined contribution plans apply to section 403(b) annuity contracts, simplified employee pensions described in section 408(k), mandatory employee contributions to qualified defined benefit plans, and contributions to certain medical accounts.

The proposed regulations reflect a number of statutory changes to section 415(c) that were made after the issuance of existing final regulations. Among these changes are the revised limitation amounts under section 415(c), the revised rules applicable to employee stock ownership plans, and the rules applying the limitations of section 415(c) to certain medical benefit plans. The proposed regulations also would make some other changes to existing regulations, as discussed below.

If annual additions under an annuity contract that otherwise satisfies the requirements of section 403(b) exceed the limitations of section 415(c), then the portion of the contract that includes that excess annual addition fails to be a section 403(b) annuity contract (and instead is a contract to which section 403(c) applies), and the remaining portion of the contract is a section 403(b) annuity contract. As under regulations recently proposed under section 403(b) (REG–155608–02, 2004–49 I.R.B. 924) (69 FR 67075, November 16, 2004), the proposed regulations include a provision under which the status of the remaining portion of the contract as a section 403(b) contract is not retained unless, for the year of the excess and each year thereafter, the issuer of the contract maintains separate accounts for each such portion. In addition, consistent with the change to section 403(b)(1) made in JCWAA, the proposed regulations provide that the limitations under section 415(c) apply to any section 403(b) annuity contract, regardless of whether the contract satisfies the requirements of section 414(i) to be a defined contribution plan. Thus, the limitations under section 415(c) apply to a section 403(b) annuity contract even if the limitations of section 415(b) also apply to the

contract (*i.e.*, if the contract is a church plan that is covered by the grandfather rule of section 251(e)(5) of TEFRA).

The proposed regulations clarify that the IRS will treat a sale or exchange by the employee or the employer that transfers assets to a plan where the consideration paid by the plan is less than the fair market value of the assets transferred to the plan as giving rise to an annual addition in the amount of the difference between the value of the assets transferred and the consideration.

Consistent with Rev. Rul. 2002–45, the proposed regulations provide that a restorative payment that is allocated to a participant's account does not give rise to an annual addition for any limitation year. For this purpose, restorative payments are payments made to restore losses to a plan resulting from actions by a fiduciary for which there is reasonable risk of liability for breach of a fiduciary duty under Title I of ERISA, where plan participants who are similarly situated are treated similarly with respect to the payments. Generally, payments to a defined contribution plan are restorative payments only if the payments are made in order to restore some or all of the plan's losses due to an action (or a failure to act) that creates a reasonable risk of liability for such a breach of fiduciary duty. The proposed regulations provide that, in addition to payments to a plan made pursuant to Department of Labor order or court-approved settlement to restore losses to a qualified defined contribution plan on account of the breach of fiduciary duty, restorative payments include payments made pursuant to the Department of Labor's Voluntary Fiduciary Correction Program to restore losses to a qualified defined contribution plan on account of the breach of fiduciary duty. However, payments made to a plan to make up for losses due merely to market fluctuations and other payments that are not made on account of a reasonable risk of liability for breach of a fiduciary duty under Title I of ERISA are contributions that give rise to annual additions and are not restorative payments.

The proposed regulations would retain the rule for taxable employers under existing regulations that the deadline for making a contribution to the plan that is credited to a participant's account for a limitation year for purposes of section 415(c). Under this rule, employer contributions are not treated as credited to a participant's account for a particular limitation year unless the contributions are actually made to the plan no later than 30 days after the end of the period described in section 404(a)(6) applicable to the taxable year with or within which the particular limitation year ends. The proposed regulations would modify the corresponding rule for tax-exempt employers. Under the proposed regulations, the deadline for a tax-exempt employer to make a contribution to the plan that is credited to a participant's account for a limitation year for purposes of section 415(c) is the 15th day of the tenth calendar month following the close of the taxable year with or within which the particular limitation year ends. This date corresponds to the due date for Form 5500 (with extensions) in cases in which the taxable year coincides with the plan year, and generally corresponds to the contribution due date for taxable employers who request filing extensions. The deadline for contributions for tax-exempt employers under the proposed regulations would be an extension from the earlier deadline now applicable under existing regulations (*i.e.*, the 15th day of the sixth calendar month following the close of the taxable year with or within which the particular limitation year ends). The extent to which elective contributions constitute plan assets for purposes of the prohibited transaction provisions of section 4975 and Title I of ERISA is determined in accordance with regulations and rulings issued by the Department of Labor. See 29 CFR 2510.3–102.

The proposed regulations clarify the operation of the special increased limitation applicable to church plans under section 415(c)(7). Under this rule, notwithstanding the generally applicable limitations, annual additions for a section 403(b) annuity contract for a year with respect to an individual who is a church employee are treated as not exceeding the limitation of section 415(c) if such annual additions for the year are not in excess of $10,000. However, the total amount of additions with respect to any participant that are permitted to be taken into account for purposes of this rule for all years may not exceed $40,000. In addition, for any individual who is a church employee performing any services for the church outside the United States, additions for a section 403(b) annuity contract for any year are not treated as exceeding the limitations of section 415(c) if those annual additions for the year do not exceed the greater of $3,000 or the employee's includible compensation. The proposed regulations would clarify that the $40,000 cumulative total only applies to excesses over what would have been permitted to be contributed without regard to this special rule, and clarifies the interaction between the generally applicable church employee rule and the rule for church employees performing services outside the United States. In addition, the proposed regulations would clarify that the special rule that applies to services for a church performed abroad applies to the employee's includible compensation only with respect to services for the church outside the United States.

The correction mechanism in current §1.415–6(b)(6) for handling excess annual additions is not included in the proposed regulations. It is anticipated that this correction mechanism will be included in the Employee Plans Compliance Resolution System (see Rev. Proc. 2003–44, 2003–1 C.B. 1051) in the future.

The proposed regulations generally would retain the rules under existing regulations providing that a contribution to reduce accumulated funding deficiencies or a contribution made pursuant to a funding waiver relates to the limitation year of the initial funding obligation. However, the proposed regulations would provide that any interest paid by the employer with respect to such a contribution that is in excess of a reasonable amount is taken into account as an annual addition for the limitation year when the contribution is made (in contrast to existing regulations, which require interest in excess of a reasonable amount to be taken into account as an annual addition for the limitation year for which the contribution was originally required). Rev. Rul. 78–223, 1978–1 C.B. 125, provides a method for determining contributions required to amortize waived contributions under a defined contribution plan. The application of any of the methods described in Rev. Rul. 78–223 will result in reasonable interest payments for purposes of applying the rules of section 415 (provided that, if a fixed interest rate in excess of 5% is used to amortize waived

contributions, the interest rate is reasonable). Thus, for example, the actual yield method (under which the adjusted account balance is increased or decreased periodically at the actual rate of investment return experienced by the plan for such period) can be used for this purpose.

*§1.415(c)–2: Definition of compensation*

Section 1.415(c)–2 of these proposed regulations defines the term *compensation*, which is defined in section 415(c)(3) and used for purposes of applying the limitations of section 415 as well as for various other purposes specified under the Internal Revenue Code. The proposed regulations reflect a number of statutory changes to section 415(c)(3) that were made after the issuance of existing final regulations. Among these changes are the inclusion in compensation of certain deemed amounts for disabled participants and nontaxable elective amounts for deferrals under sections 401(k), 403(b), and 457, cafeteria plan elections under section 125, and qualified transportation fringe elections under section 132(f)(4). In addition to these changes, the proposed regulations would make some other changes to existing regulations, as discussed below.

The proposed regulations provide specific guidelines regarding when amounts received following severance from employment are considered compensation for purposes of section 415. The following are types of post-severance payments that are not excluded from compensation because of timing if they are paid within 2½ months following severance from employment: (1) payments that, absent a severance from employment, would have been paid to the employee while the employee continued in employment with the employer and are regular compensation for services during the employee's regular working hours, compensation for services outside the employee's regular working hours (such as overtime or shift differential), commissions, bonuses, or other similar compensation; and (2) payments for accrued *bona fide* sick, vacation, or other leave, but only if the employee would have been able to use the leave if employment had continued. Under the proposed regulations, the rule generally excluding payments after severance from employment from compensation does not apply to payments to an individual who does not currently perform services for the employer by reason of qualified military service (as that term is used in section 414(u)(1)) to the extent those payments do not exceed the amounts the individual would have received if the individual had continued to perform services for the employer rather than entering qualified military service. This notice of proposed rulemaking also contains corresponding proposed amendments to the regulations under sections 401(k), 403(b), and 457 that would provide that amounts received following severance from employment can be deferred only if they are considered compensation under the rules of section 415.

*§1.415(d)–1: Cost-of-living adjustments*

Section 1.415(d)–1 of these proposed regulations sets forth rules that apply to cost-of-living adjustments to the various limitations of section 415 pursuant to section 415(d). Section 415(d) provides for the dollar and compensation limitations on annual benefits and the dollar limitation on annual additions to be adjusted annually for increases in the cost of living based on adjustment procedures similar to the procedures used to adjust social security benefit amounts. These adjustments also apply for other purposes as specified in the Internal Revenue Code. The proposed regulations specify the manner in which these adjustments are determined each year, and reflect statutory changes to the adjustment methodology made after the 1981 regulations were issued. In addition, the proposed regulations make several other changes to existing final regulations, as discussed below.

The proposed regulations would specify the circumstances under which an adjusted limit is permitted to be applied to participants who have previously commenced receiving benefits under a defined benefit plan. Under the proposed regulations, the adjusted dollar limitation is applicable to current employees who are participants in a defined benefit plan and to former employees who have retired or otherwise terminated their service under the plan and have a nonforfeitable right to accrued benefits, regardless of whether they have actually begun to receive such benefits. A plan is permitted to provide that the annual increase applies for a participant who has previously commenced receiving benefits only to the extent that benefits have not been paid. Thus, for example, a plan cannot provide that this annual increase applies to a participant who has previously received the entire plan benefit in a single-sum distribution. However, a plan is permitted to provide for an increase in benefits to a participant who accrues additional benefits under the plan that could have been accrued without regard to the adjustment of the dollar limitation (including benefits that accrue as a result of a plan amendment) on or after the effective date of the adjusted limitation.

The proposed regulations provide for a safe harbor under which the annual benefit will satisfy the limitations of section 415(b) for the current limitation year following an adjustment to benefit payments that is made to reflect the cost-of-living adjustment made pursuant to section 415(d). If such adjustments are made in accordance with this safe harbor, the multiple annuity starting date rules of §1.415(b)–2 do not apply on account of such adjustments. Under this safe harbor, if a participant has received one or more distributions under an annuity stream that satisfies the requirements of section 415(b) before the adjustment, the plan's benefits will satisfy the limitations of section 415(b) if the amounts payable to the employee for the limitation year and subsequent limitation years are not greater than the amounts that would otherwise be payable under the annuity stream without regard to the adjustment, multiplied by a fraction. The numerator of this fraction is the limitation under section 415(b) (*i.e.*, the lesser of the applicable dollar limitation under section 415(b)(1)(A), as adjusted for age at commencement, and the applicable compensation-based limitation under section 415(b)(1)(B)) in effect for the distribution following the adjustment, and the denominator of this fraction is such limitation under section 415(b) in effect for the distribution immediately before the adjustment.

*§1.415(f)–1: Combining and aggregating plans*

Section 1.415(f)–1 of these proposed regulations sets forth rules for combining and aggregating plans pursuant to section 415(f). Under section 415(f) and these

proposed regulations, for purposes of applying the limitations of section 415(b) and (c), all defined benefit plans of an employer are treated as one defined benefit plan, and all defined contribution plans of an employer are treated as one defined contribution plan. The controlled group rules of section 414(b) and (c) (as modified by section 415(h)), the affiliated service group rules of section 414(m), and the leased employee rules of section 415(n) apply for purposes of determining whether a plan that is maintained by an entity other than the employer is considered maintained by the employer for purposes of applying the aggregation rules of section 415(f).

The proposed regulations would also make various changes and clarifications to the existing regulations. The proposed regulations would clarify that an employer's plan must be aggregated with all plans maintained by a predecessor employer (see section 414(a)), regardless of whether any such plan is assumed by the employer. Pursuant to section 414(a)(1), the proposed regulations would provide that, for purposes of section 415, a former employer is a predecessor employer with respect to a participant in a plan maintained by an employer if the employer maintains a plan under which the participant had accrued a benefit while performing services for the former employer, but only if that benefit is provided under the plan maintained by the employer. In addition, the proposed regulations would provide pursuant to section 414(a)(2) that, with respect to an employer of a participant, a former entity that antedates the employer is a predecessor employer with respect to the participant if, under the facts and circumstances, the employer constitutes a continuation of all or a portion of the trade or business of the former entity. This will occur, for example, where formation of the employer constitutes a mere formal or technical change in the employment relationship and continuity otherwise exists in the substance and administration of the business operations of the former entity and the employer. See *Lear Eye Clinic, Ltd. v. Commissioner*, 106 T.C. 418, 425–429 (1996).

The proposed regulations provide rules for aggregating participation and service for purposes of the 10-year phase-in of the limitations on defined benefit plans. Under these rules, years of participation in all aggregated plans and years of service for employers maintaining all aggregated plans are counted for purposes of applying the 10-year phase-in rules.

The proposed regulations clarify the aggregation rules that apply to section 403(b) annuity contracts, other plans of the employer, and plans of related employers, in light of changes made in EGTRRA. Generally a section 403(b) annuity contract is not aggregated with plans that are maintained by the participant's employer because the section 403(b) annuity contract is deemed maintained by the participant and not the employer for purposes of section 415. However, if a participant on whose behalf a section 403(b) annuity contract is purchased is in control of any employer for a limitation year, the annuity contract for the benefit of the participant is treated as a defined contribution plan maintained by both the controlled employer and the participant for that limitation year and accordingly, the section 403(b) annuity contract is aggregated with all other defined contribution plans maintained by the employer. Accordingly, the employer that contributes to the section 403(b) annuity contract must obtain information from participants regarding employers controlled by those participants and plans maintained by those controlled employers to monitor compliance with applicable limitations to comply with applicable reporting and withholding obligations. In addition to applying the rules under existing final regulations for purposes of determining control for purposes of section 415(f), the proposed regulations would apply the rules under proposed §1.414(c)–5 (regarding aggregation rules for tax-exempt employers), as published in the **Federal Register** on November 16, 2004 (69 FR 67075).

The proposed regulations also provide that a multiemployer plan, as defined in section 414(f), is not aggregated with other multiemployer plans for purposes of determining any section 415 limitation. In addition, a multiemployer plan will not be aggregated with non-multiemployer plans for purposes of applying the 100% of compensation benefit limit to non-multiemployer plans under section 415(b)(1)(B). In general, under the proposed regulations, benefits of all employers are taken into account in applying the limitations of section 415 to a multiemployer plan. However, a multiemployer plan is permitted to provide that, where a participating employer maintains both a plan which is not a multiemployer plan and a multiemployer plan, only the benefits provided by the employer under the multiemployer plan are aggregated with the benefits under the non-multiemployer plan.

*§1.415(g)–1: Disqualification of plans and trusts*

Section 1.415(g)–1 of these proposed regulations sets forth rules regarding disqualification of plans and trusts, including plans and trusts that are aggregated pursuant to §1.415(f)–1. In large part, proposed §1.415(g)–1 replicates the rules of §1.415–9 of the existing final regulations regarding ordering rules for disqualifying plans and trusts that are aggregated for purposes of compliance with section 415. In addition, the proposed regulations provide rules for disqualification where an individual medical account (as described in section 415(l)) and a post-retirement medical benefits account for key employees (as described in section 419A(d)) is combined with a qualified defined contribution plan for purposes of applying section 415(c). If the combined plan exceeds those limitations for a particular limitation year, the qualified defined contribution plan (rather than the medical account) is disqualified for the limitation year.

*§1.415(j)–1: Limitation year*

Section 1.415(j)–1 of these proposed regulations sets forth rules regarding limitation years that are used as the period for demonstrating compliance with section 415. In addition to setting forth general rules that generally correspond to rules under existing regulations, the proposed regulations provide specific guidelines with respect to overlapping limitation years for aggregated plans. These rules reflect the guidance provided in Rev. Rul. 79–5, 1979–1 C.B. 165. Where defined contribution plans with different limitations years are aggregated, the rules of section 415(c) must be applied with respect to each limitation year of each such plan. For each such limitation year, the requirements of section 415(c) are applied to annual additions that are made for that time period with respect to the participant under all

aggregated plans. Similarly, where defined benefit plans with different limitations years are aggregated, the rules of section 415(c) must be applied with respect to each limitation year of each such plan. Thus, for example, the dollar limitation of section 415(b)(1)(A) applicable to the limitation year for each plan must be applied to annual benefits under all aggregated plans to determine whether the plan satisfies the requirements of section 415(b).

*Sections 415(m) and 415(n)*

These proposed regulations do not contain provisions relating to section 415(m) (regarding treatment of qualified governmental excess benefit arrangements) and section 415(n) (regarding the purchase of permissive service credit from a governmental defined benefit plan). Comments are requested regarding the need for regulations or other guidance on issues arising under these statutory provisions.

*Other changes: section 457 regulations*

These proposed regulations also include revisions to the regulations under section 457 that are in addition to the revisions to reflect the treatment of compensation paid after severance from employment. The additional revisions do not include any substantive changes, but would merely make clarifications, including corrections in an example illustrating the section 457 catch-up rules and a correction in the rules relating to unforeseeable emergencies to reflect recent revisions in the definition of a dependent (made under the Working Families Tax Relief Act of 2004, which modified the definition of the term *dependent* under section 152).

**Proposed Effective Dates**

The regulations under section 415 are proposed to apply to limitation years beginning on or after January 1, 2007. Except as described below, until these regulations are issued as final regulations, the existing regulations remain in effect (to the extent not modified by statutory changes). A defined benefit plan that was adopted and effective before May 31, 2005, will be considered to satisfy the limitations of section 415(b) for a participant with respect to benefits accrued or payable under the plan as of the effective date of final regulations implementing these proposed regulations pursuant to plan provisions adopted and in effect on May 31, 2005, but only if such plan provisions meet the requirements of statutory provisions, regulations, and other published guidance in effect on May 31, 2005. Thus, plans that were in compliance with the rules of section 415 as in effect prior to the finalization of these regulations will not be disqualified based on benefits that arise pursuant to plan provisions that were adopted and in effect on May 31, 2005, and that accrue prior to the effective date of final regulations implementing these proposed regulations, even if those benefits no longer comply with the requirements of section 415 as set forth under those final regulations. However, such a plan will not be permitted to provide for the accrual of additional benefits for a participant on or after the effective date of final regulations implementing these proposed regulations unless such additional benefits, together with the participant's other accrued benefits, comply with those new final regulations.

*Reliance on Compensation Timing Rules and Changes to Regulations Under Sections 401(a)(9) and 457*

Pending issuance of final regulations, taxpayers may rely on the modifications in these proposed regulations contained in §1.401(k)–1(e)(8), §1.415(c)–2(e), and §1.457–4(d) regarding post-severance compensation payments and other compensation timing rules, §1.401(a)(9)–6 regarding certain changes in form of payment, and §§1.457–5, –6, and –10 providing corrective and clarifying changes. Pursuant to this reliance, taxpayers may apply the proposed amendments described in this paragraph for periods prior to the effective date of final regulations.

*Sunset of EGTRRA Changes*

The proposed regulations do not provide rules for the application of the EGTRRA sunset provision (section 901 of EGTRRA), under which the provisions of EGTRRA do not apply to taxable, plan, or limitation years beginning after December 31, 2010. Unless the EGTRRA sunset provision is repealed before it becomes effective, additional guidance will be needed to clarify its application.

**Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for August 17, 2005, at 10 a.m. in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must use the main building entrance on Constitution Avenue. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For more information about having your name placed on the list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written (signed original and eight (8) copies) or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic by July 27, 2005. A period of 10 minutes will be

allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

**Drafting Information**

The principal authors of these regulations are Vernon S. Carter and Linda S. F. Marshall, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in the development of these regulations.

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**Proposed Amendments to the Regulations**

Accordingly, 26 CFR parts 1 and 11 are proposed to be amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Par. 2. Section 1.401(a)(9)–6, Q&A–13(c)(3) is revised to read as follows:

*§1.401(a)(9)–6 Required minimum distributions for defined benefit plans and annuity contracts.*

A–13. * * * * *

(c) * * *

(3) In accordance with §1.415(b)–2(c), after taking into account the modification, the payments under the annuity that are paid before the modification plus the modified payments must satisfy the requirements of §1.415(b)–1 determined as of the original annuity starting date, using the interest rates and mortality table applicable to such date, except that, for this purpose, payments will not fail to satisfy the requirements of §1.415(b)–1 determined as of the original annuity starting date merely because the payments are adjusted to reflect cost-of-living adjustments pursuant to section 415(d) that are determined in accordance with §1.415(d)–1(a)(5); and

* * * * *

Par. 3. Section 1.401(k)–1 is amended by adding paragraph (e)(8) to read as follows:

*§1.401(k)–1 Certain cash or deferred arrangements.*

* * * * *

(e) * * *

(8) *Section 415 compensation required.* A cash or deferred arrangement satisfies this paragraph (e) only if cash or deferred elections can only be made with respect to amounts that are compensation within the meaning of section 415(c)(3) and §1.415(c)–2. Thus, for example, the arrangement is not a qualified cash or deferred arrangement if an eligible employee who is not in qualified military service (as that term is defined in section 414(u)) can make a cash or deferred election with respect to an amount paid after severance from employment, unless the amount is paid within 2½ months following the eligible employee's severance from employment and is described in §1.415(c)–2(e)(3)(ii).

* * * * *

Par. 4. Section 1.403(b)–3(b)(4)(ii) (as proposed on November 16, 2004 (69 FR 67087) is revised to read as follows:

*§1.403(b)–3 Exclusion for contributions to purchase section 403(b) contracts.*

(b) * * *

(4) * * *

(ii) *Exceptions.* The exclusion from gross income provided by section 403(b) applies to contributions made for former employees with respect to compensation described in §1.415(c)–2(e)(3)(ii) (relating to certain compensation paid within 2½ months following severance from employment), compensation described in §1.415(c)–2(g)(4) (relating to compensation paid to participants who are permanently and totally disabled), and compensation relating to qualified military service under section 414(u).

* * * * *

**§1.415–1 thru §1.415–10 [Removed]**

Par. 5. Sections 1.415–1 through 1.415–10 are removed.

Par. 6. Section 1.415(a)–1 is added to read as follows:

*§1.415(a)–1 General rules with respect to limitations on benefits and contributions under qualified plans.*

(a) *Trusts.* Under sections 415 and 401(a)(16), a trust that forms part of a pension, profit-sharing, or stock bonus plan will not be qualified under section 401(a) if any of the following conditions exists—

(1) In the case of a defined benefit plan, the annual benefit with respect to any participant for any limitation year exceeds the limitations of section 415(b) and §1.415(b)–1 (taking into account the rules of §1.415(b)–2);

(2) In the case of a defined contribution plan, the annual additions credited with respect to any participant for any limitation year exceed the limitations of section 415(c) and §1.415(c)–1; or

(3) The trust has been disqualified under section 415(g) and §1.415(g)–1 for any year.

(b) *Certain annuities and accounts*—(1) *In general.* Under section 415, an employee annuity plan described in section 403(a), an annuity contract described in section 403(b), or a simplified employee pension described in section 408(k) will not be considered to be described in the otherwise applicable section if any of the following conditions exists—

(i) The annual benefit under a defined benefit plan with respect to any participant for any limitation year exceeds the limitations of section 415(b) and §1.415(b)–1 (taking into account the rules of §1.415(b)–2);

(ii) The contributions and other additions credited under a defined contribution plan with respect to any participant for any limitation year exceed the limitations of section 415(c) and §1.415(c)–1; or

(iii) The employee annuity plan, annuity contract, or simplified employee pension has been disqualified under section 415(g) and §1.415(g)–1 for any year.

(2) *Special rule for section 403(b) annuity contracts*—(i) *In general.* If the contributions and other additions under an annuity contract that otherwise satisfies the requirements of section 403(b) with respect to any participant for any limitation year exceed the limitations of section 415(c) and §1.415(c)–1, then the portion of the contract that includes such excess annual addition fails to be a section 403(b) contract (and instead is a contract to which

section 403(c) applies), and the remaining portion of the contract is a section 403(b) contract. The status of the remaining portion of the contract as a section 403(b) contract is not retained unless, for the year of the excess and each year thereafter, the issuer of the contract maintains separate accounts for each such portion. See also §1.403(b)–3(c)(3).

(ii) *Defined benefit plans*. If the annual benefit under an annuity contract that otherwise satisfies the requirements of section 403(b) and that is a defined benefit plan with respect to any participant for any limitation year exceeds the limitations of section 415(b) and §1.415(b) (taking into account the rules of §1.415(b)–2), then the portion of the contract that includes such excess annual benefit fails to be a section 403(b) annuity contract (and instead is a contract to which section 403(c) applies), and the remaining portion of the contract is a section 403(b) annuity contract. The status of the remaining portion of the contract as a section 403(b) annuity contract is not retained unless, for the year of the excess and each year thereafter, the issuer of the contract maintains separate accounts for each such portion.

(3) *Section 403(b) annuity contract*. For purposes of section 415 and regulations thereunder, the term *section 403(b) annuity contract* includes arrangements that are treated as annuity contracts for purposes of section 403(b). For example, such term includes custodial accounts described in section 403(b)(7) and retirement income accounts described in section 403(b)(9).

(c) *Regulations*—(1) *In general*. This section provides general rules regarding the application of section 415. For further rules regarding the application of section 415, see—

(i) Section 1.415(b)–1 (for general rules regarding the limit applicable to defined benefit plans);

(ii) Section 1.415(b)–2 (for special rules for defined benefit plans where a participant has multiple annuity starting dates);

(iii) Section 1.415(c)–1 (for general rules regarding the limit applicable to defined contribution plans);

(iv) Section 1.415(c)–2 (for rules regarding the definition of compensation for purposes of section 415);

(v) Section 1.415(d)–1 (for rules regarding cost-of-living adjustments to the various limits of section 415);

(vi) Section 1.415(f)–1 (for rules for aggregating plans for purposes of section 415);

(vii) Section 1.415(g)–1 (for rules regarding disqualification of plans that fail to satisfy the requirements of section 415); and

(viii) Section 1.415(j)–1 (for rules regarding limitation years).

(2) *Cross references to additional rules for section 403(b) annuity contracts*. For additional rules relating to section 403(b) annuity contracts, see—

(i) Section 1.415(c)–2(g)(1) and (3) (relating to the definition of compensation for such annuity contracts);

(ii) Section 1.415(f)–1(g) (relating to rules for such annuity contracts for purposes of combining plans);

(iii) Section 1.415(g)–1(b)(3)(iv)(C) (regarding disqualification of section 403(b) annuity contract aggregated with a qualified defined contribution plan if the combined plans exceed the limitations of section 415(c));

(iv) Section 1.415(g)–1(e) (relating to the plan year for such annuity contracts); and

(v) Section 1.415(j)–1(e) (relating to the limitation year for such annuity contracts).

(3) *Cross references to additional rules for governmental plans*. For additional rules relating to governmental plans, see—

(i) Section 1.415(b)–1(a)(6)(i) (providing an exception from the compensation-based limit of section 415(b)(1)(B) for governmental plans);

(ii) Section 1.415(b)–1(a)(7)(ii) (regarding a special limitation for governmental plans making an election during 1990);

(iii) Section 1.415(b)–1(b)(4) (regarding qualified governmental excess benefit arrangements);

(iv) Section 1.415(b)–1(d)(3) and (4) (regarding age adjustments to the dollar limit of section 415(b)(1)(A) in the case of employees of police departments and fire departments and former members of the United States Armed Forces, and in the case of survivor and disability benefits);

(v) Section 1.415(b)–1(g)(3) (regarding adjustments to applicable limitations for years of participation, and adjustments to applicable limitations for years of service for survivor and disability benefits); and

(vi) Section 1.415(c)–1(b)(3)(iii) (regarding amounts not treated as annual additions).

(4) *Cross references to additional rules for multiemployer plans*. For additional rules relating to multiemployer plans, see—

(i) Paragraph (e) of this section (regarding benefits or contributions taken into account where a plan is maintained by more than one employer);

(ii) Section 1.415(b)–1(a)(6)(ii) (providing an exception from the compensation-based limit for multiemployer plans);

(iii) Section 1.415(b)–1(f)(3) (regarding the application of the minimum $10,000 limitation on benefits in the case of a multiemployer plan);

(iv) Section 1.415(f)–1(h) (providing special rules for aggregating multiemployer plans with other plans); and

(v) Section 1.415(g)–1(b)(3)(ii) (regarding plan disqualification rules where a multiemployer plan is aggregated with a plan that is not a multiemployer plan and the combined plans exceed the limitations of section 415).

(d) *Plan provisions*—(1) *In general*. Although no specific plan provision is required under section 415 in order for a plan to establish or maintain its qualification, the plan provisions must preclude the possibility that any accrual, distribution, or annual addition will exceed the limitations of section 415. For example, a plan may include provisions that automatically freeze or reduce the rate of benefit accrual (in the case of a defined benefit plan) or the annual addition (in the case of a defined contribution plan) to a level necessary to prevent the limitations from being exceeded with respect to any participant. For rules relating to this type of plan provision and the definitely determinable benefit requirement for pension plans, see §1.401(a)–1(b)(1).

(2) *Special rule for profit-sharing and stock bonus plans*. A provision of a profit-sharing or stock bonus plan that automatically freezes or reduces the amount of annual additions to ensure that the limitations of section 415 will not be exceeded must comply with the requirement set forth in §1.401–1(b)(1)(ii) or (iii) (as applicable) that such plans provide a definite predetermined formula for allocating the contri-

butions made to the plan among the participants. If the operation of a provision that automatically freezes or reduces the amount of annual additions to ensure that the limitations of section 415 are not exceeded does not involve discretionary action on the part of the employer, the definite predetermined allocation formula requirement is not violated by the provision. If the operation of such a provision involves discretionary action on the part of the employer, the definite predetermined allocation formula requirement is violated. For example, if two profit-sharing plans of one employer otherwise provide for aggregate contributions which may exceed the limits of section 415(c), the plan provisions must specify (without involving employer discretion) under which plan contributions and allocations will be reduced to prevent an excess annual addition and how the reduction will occur.

(3) *Incorporation by reference*—(i) *In general*. A plan is permitted to incorporate by reference the limitations of section 415, and will not fail to meet the definitely determinable benefit requirement or the definite predetermined allocation formula requirement, whichever applies to the plan, merely because it incorporates the limits of section 415 by reference.

(ii) *Section 415 can be applied in more than one manner, but a statutory or regulatory default rule exists*. Where a provision of section 415 is permitted to be applied in more than one manner but is to be applied in a specified manner in the absence of contrary plan provisions (*i.e.*, a default rule exists), if a plan incorporates the limitations of section 415 by reference with respect to that provision of section 415 and does not specifically vary from the default rule, then the default rule applies. With respect to a provision of section 415 for which a default rule exists, if the limitations of section 415 are to be applied in a manner other than using the default rule, the plan must specify the manner in which the limitation is to be applied in addition to generally incorporating the limitations of section 415 by reference. For example, if a plan generally incorporates the limitations of section 415 by reference and does not restrict the accrued benefits to which the amendments to section 415(b)(2)(E) made by GATT apply (as permitted by Q&A–12 of Rev. Rul. 98–1, 1998–1 C.B. 249 (see §601.601(d) of this chapter), which reflects the amendments to section 767 of GATT made by section 1449 of SBJPA), then the amendments to section 415(b)(2)(E) made by GATT apply to all benefits under the plan.

(iii) *Section 415 can be applied in more than one manner with no statutory or regulatory default*. If a limitation of section 415 may be applied in more than one manner, and there is no governing principle pursuant to which that limitation is applied in the absence of contrary plan provisions, then the plan must specify the manner in which the limitation is to be applied in addition to generally incorporating the limitations of section 415 by reference. For example, if an employer maintains two profit-sharing plans, and if any participant participates in more than one such plan, then both plans must specify (in a consistent manner) under which of the employer's two profit-sharing plans annual additions must be reduced if aggregate annual additions would otherwise exceed the limitations of section 415(c)).

(iv) *Former requirements*. A plan cannot incorporate by reference formerly applicable requirements of section 415 that are no longer in force (such as the limits of former section 415(e)).

(v) *Cost-of-living adjustments*—(A) *In general*. A plan is permitted to incorporate by reference the annual adjustments to the limitations of section 415 that are made pursuant to section 415(d). See §1.415(d)–1 for additional rules relating to cost-of-living adjustments under section 415(d).

(B) *Cost-of-living adjustments not included in accrued benefit until effective*. Notwithstanding that a plan incorporates the increases to the applicable limits under section 415(d) by reference, the accrued benefit of a participant for purposes of section 411 and the annual benefit payable to a participant for purposes of §1.415(b)–1(a)(1) are not permitted to reflect increases pursuant to the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) or the compensation limit described in section 415(b)(1)(B) for any period before the annual increase becomes effective. A plan amendment does not violate the requirements of section 411(d)(6) merely because it eliminates the incorporation by reference of the increases under section 415(d) with respect to increases that have not yet occurred. Pursuant to §1.415(d)–1(a)(3), the increase in each limit that is adjusted pursuant to section 415(d) is effective as of January 1 of each calendar year, and applies with respect to limitation years ending with or within that calendar year. Thus, where an increase in the dollar limitation under section 415(b)(1)(A) results in an increase to the participant's accrued benefit, the increase to the accrued benefit is permitted to occur as of a date no earlier than January 1 of the calendar year for which the increase in the dollar limitation is effective.

(C) *Application of increase in defined benefit dollar limit to participants who have commenced receiving benefits*. The annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) does not apply in limitation years beginning after the annuity starting date to a participant who has previously commenced receiving benefits unless the plan specifies that this annual increase applies to such a participant. Similarly, the annual increase under section 415(d) of the compensation-based limitation described in section 415(b)(1)(B) does not apply in limitation years beginning after the annuity starting date to a participant who has previously commenced receiving benefits unless the plan specifies that this annual increase applies to such a participant.

(D) *Treatment of cost-of-living adjustments for funding purposes*. In general, the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) and the compensation limitation described in section 415(b)(1)(B) is treated as a plan amendment for purposes of applying sections 404 and 412, regardless of whether the plan is amended to reflect the increase or the plan reflects the increase automatically through operation of plan provisions. However, where a plan reflects the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) or the compensation limitation described in section 415(b)(1)(B) automatically through operation of plan provisions, the funding method for the plan is permitted to provide for this annual increase to be treated as an experience loss for purposes of applying sections 404 and 412.

(e) *Rules for plans maintained by more than one employer*. Except as provided

in §1.415(f)–1(h)(2)(i) (regarding aggregation of multiemployer plans with plans other than multiemployer plans), for purposes of applying the limitations of section 415 with respect to a participant in a plan maintained by more than one employer, benefits and contributions attributable to such participant from all of the employers maintaining the plan must be taken into account. Furthermore, in applying the limitations of section 415 with respect to such a participant, the total compensation received by the participant from all of the employers maintaining the plan is permitted to be taken into account under any such plan if the plan so provides.

(f) *Special rules*—(1) *Affiliated employers*. Pursuant to section 414(b) and §1.414(b)–1, all employees of all corporations that are members of a controlled group of corporations (within the meaning of section 1563(a), as modified by section 1563(f)(5), and determined without regard to section 1563(a)(4) and (e)(3)(C)) are treated as employed by a single employer for purposes of section 415. Similarly, pursuant to section 414(c) and §§1.414(c)–1 through 1.414(c)–6, all employees of trades or businesses that are under common control are treated as employed by a single employer. Thus, any defined benefit plan or defined contribution plan maintained by any member of a controlled group of corporations (within the meaning of section 414(b)) or by any trade or business (whether or not incorporated) under common control (within the meaning of section 414(c)) is deemed maintained by all such members or such trades or businesses. Pursuant to section 415(h), for purposes of section 415, sections 414(b) and 414(c) are applied by using the phrase "more than 50 percent" instead of the phrase "at least 80 percent" each place the latter phrase appears in section 1563(a)(1), in §1.414(c)–2, and in §1.414(c)–5.

(2) *Affiliated service groups*. Any defined benefit plan or defined contribution plan maintained by any member of an affiliated service group (within the meaning of section 414(m)) is deemed maintained by all members of that affiliated service group.

(3) *Leased employees*—(i) *In general*. Pursuant to section 414(n), except as provided in paragraph (f)(3)(ii) of this section, with respect to any person (referred to as the recipient) for whom a leased employee (within the meaning of section 414(n)(2)) performs services, the leased employee is treated as an employee of the recipient, but contributions or benefits provided by the leasing organization that are attributable to services performed for the recipient are treated as provided under a plan maintained by the recipient.

(ii) *Exception for leased employees covered by safe harbor plans*. Pursuant to section 414(n)(5), the rule of paragraph (f)(3)(i) of this section does not apply to a leased employee with respect to services performed for a recipient if—

(A) The leased employee is covered by a plan that is maintained by the leasing organization and that meets the requirements of section 414(n)(5)(B); and

(B) Leased employees (determined without regard to this paragraph (f)(3)(ii)) do not constitute more than 20% of the recipient's nonhighly compensated workforce.

(4) *Permissive service credit under governmental plans*. See section 415(n) for rules regarding the application of the limitations of sections 415(b) and (c) where an employee makes contributions (including a transfer described in section 403(b)(13) or section 457(e)(17)) to a defined benefit governmental plan to purchase permissive service credit under the plan.

(5) *Qualified domestic relations orders*. A benefit provided to an alternate payee (as defined in section 414(p)(8)) of a participant pursuant to a qualified domestic relations order (as defined in section 414(p)(1)(A)) is treated as if it were provided to the participant for purposes of applying the limitations of section 415.

(6) *Effect on other requirements*. Except as provided in §1.417(e)–1(d)(1), the application of section 415 does not relieve a plan from the obligation to satisfy other applicable qualification requirements. Accordingly, the terms of the plan must provide for the plan to satisfy section 415 as well as all other applicable requirements. For example, if a defined benefit plan has a normal retirement age of 62, and if a participant's benefit remains unchanged between the ages of 62 and 65 because of the application of the section 415(b)(1)(A) dollar limit, the plan satisfies the requirements of section 411 only if the plan either commences distribution of the participant's benefit at normal retirement age (without regard to severance from employment) or provides for a suspension of benefits at normal retirement age that satisfies the requirements of section 411(a)(3)(B) and 29 CFR 2530.203–3. Similarly, if the increase to a participant's benefit under a defined benefit plan in a year after the participant has attained normal retirement age is less than the actuarial increase to the participant's previously accrued benefit because of the application of the section 415(b)(1)(B) compensation limitation (which is not adjusted for commencement after age 65), the plan satisfies the requirements of section 411 only if the plan either commences distribution of the participant's benefit at normal retirement age (without regard to severance from employment) or provides for a suspension of benefits at normal retirement age that satisfies the requirements of section 411(a)(3)(B) and 29 CFR 2530.203–3.

(g) *Effective date*—(1) *General rule*. Except as otherwise provided, §§1.415(a)–1, 1.415(b)–1, 1.415(b)–2, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 apply to limitation years beginning on or after January 1, 2007.

(2) *Option to apply regulations earlier*. A plan that was adopted and in effect before January 1, 2007, is permitted to apply the provisions of §§1.415(a)–1, 1.415(b)–1, 1.415(b)–2, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 to limitation years beginning after the date final regulations are published in the **Federal Register**.

(3) *Grandfather rule for preexisting benefits*. A defined benefit plan that was adopted and effective before May 31, 2005, is considered to satisfy the limitations of section 415(b) for a participant with respect to benefits accrued or payable under the plan as of the effective date of final regulations under §§1.415(a)–1, 1.415(b)–1, 1.415(b)–2, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 (as provided under paragraph (g)(1) and (2) of this section) pursuant to plan provisions that were adopted and in effect on May 31, 2005, but only if such plan provisions meet the requirements of statutory provisions, regulations, and other published guidance in effect on May 31, 2005.

(4) *Sunset of EGTRRA amendments*. Sections 1.415(a)–1, 1.415(b)–1,

1.415(b)–2, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 do not address the application of section 901 of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107–16, 115 Stat. 38 (under which the amendments made by that Act do not apply to limitation years beginning after December 31, 2010).

Par. 7. Section 1.415(b)–1 is added to read as follows:

*§1.415(b)–1 Limitations for defined benefit plans.*

(a) *General rules*—(1) *Maximum limitations*. Except as otherwise provided under this section, a defined benefit plan fails to satisfy the requirements of section 415(a) for a limitation year if, during the limitation year, either the annual benefit (as defined in paragraph (b)(1)(i) of this section) accrued by a participant or the annual benefit payable to a participant at any time under the plan exceeds the lesser of—

(i) $160,000 (as adjusted pursuant to section 415(d), §1.415(d)–1(a), and this section); or

(ii) 100% of the participant's average compensation for the period of the participant's high 3 years of service (as adjusted pursuant to section 415(d), §1.415(d)–1(a), and this section).

(2) *Defined benefit plan*. For purposes of section 415 and regulations thereunder, a defined benefit plan is any plan, contract, or account to which section 415 applies pursuant to §1.415(a)–1(a) or (b) (or any portion thereof) that is not a defined contribution plan within the meaning of §1.415(c)–1(a)(2). In addition, a section 403(b) contract that is not described in section 414(i) is treated as a defined benefit plan for purposes of section 415 and regulations thereunder.

(3) *Plan provisions*. As required in §1.415(a)–1(d)(1), in order to satisfy the limitations on benefits under this section, the plan provisions (including the provisions of any annuity) must preclude the possibility that any annual benefit exceeding these limitations will be accrued, distributed, or otherwise payable in any optional form of benefit (including the normal form of benefit) at any time (from the plan, from an annuity contract that will make distributions to the participant on behalf of the plan, or from an annuity contract that has been distributed under the plan). Thus, for example, a plan will fail to satisfy the limitations of this section if the plan does not contain terms that preclude the possibility that any annual benefit exceeding these limitations will be accrued or payable in any optional form of benefit (including the normal form of benefit) at any time, even though no participant has actually accrued a benefit in excess of these limitations.

(4) *Adjustments to dollar limitation for commencement before age 62 or after age 65*. The age-adjusted section 415(b)(1)(A) dollar limit computed pursuant to paragraph (d) or (e) of this section is used in place of the dollar limitation described in section 415(b)(1)(A) and paragraph (a)(1)(i) of this section in the case of a benefit with an annuity starting date that occurs before the participant attains age 62 or after the participant attains age 65.

(5) *Period of high 3 years of service*—(i) *In general*. For purposes of applying the limitation on benefits described in this section, the period of a participant's high 3 years of service is the period of 3 consecutive calendar years during which the employee was an active participant in the plan and had the greatest aggregate compensation (as defined in §1.415(c)–2) from the employer. For purposes of this paragraph (a)(5), in determining a participant's high 3 years of service, the plan may use any 12-month period to determine a year of service instead of the calendar year, provided that it is uniformly and consistently applied in a manner that is specified under the terms of the plan. As provided under §1.415(c)–2(f), because a plan may not base benefit accruals (in the case of a defined benefit plan) on compensation in excess of the limitation under section 401(a)(17), a plan's definition of compensation for a limitation year that is used for purposes of applying the limitations of section 415 is not permitted to reflect compensation for a plan year that is in excess of the limitation under section 401(a)(17) that applies to that plan year.

(ii) *Short periods of service*. For those employees who are employed with the employer while an active participant for less than 3 consecutive calendar years, the period of a participant's high 3 years of service is the actual number of consecutive years of employment (including fractions of years) while an active participant in the plan. In such a case, the limitation of section 415(b)(1)(B) of 100% of the participant's compensation for the period of the participant's high 3 years of service is computed by dividing the participant's compensation during the participant's longest consecutive period of employment while a plan participant by the number of years in that period (including fractions of years, but not less than one year).

(iii) *Examples*: The following examples illustrate the rules of this paragraph (a)(5):

*Example 1.* (i) Plan A, which was established on January 1, 2004, covers Participant M, who was hired on January 1, 2000. The limitation year for Plan A is the calendar year. Participant M's compensation (as defined in §1.415(c)–2) from the employer maintaining the plan is $120,000 for 2000, $120,000 for 2001, $120,000 for 2002, $120,000 for 2003, $100,000 for 2004, $100,000 for 2005, $100,000 for 2006, and $80,000 for 2007. Plan A does not specify a period other than the calendar year for determining the period of a participant's high 3 years of service while a plan participant.

(ii) As of the end of the 2004 limitation year, the period of M's highest 3 consecutive years of service while a plan participant (or fewer, if applicable) runs from January 1, 2004, through December 31, 2004. As of the end of the 2005 limitation year, the period of M's highest 3 consecutive years of service while a plan participant (or fewer, if applicable) runs from January 1, 2004, through December 31, 2005. As of the end of the 2006 limitation year and the 2007 limitation year, the period of M's highest 3 consecutive years of service while a plan participant (or fewer, if applicable) runs from January 1, 2004, through December 31, 2006. For all of those periods, M's average compensation is $100,000. Thus, the limitation under section 415(b)(1)(B) for 2004 through 2007 is applied using $100,000 as M's average compensation for the period of M's high 3 consecutive years of service while a plan participant (or fewer, if applicable).

*Example 2.* Participant P has participated in Plan A, maintained by Employer M, for more than 10 years. P's average compensation for P's high 3 years while a participant in Plan A (determined before the application of section 401(a)(17)) is $220,000. On January 1, 2007, P commences receiving benefits from Plan A at the age of 75, 10 years after attaining P's normal retirement age under Plan A. Distributions to P under Plan A are actuarially adjusted to reflect commencement 10 years after normal retirement age using a 5% interest rate and the applicable mortality table under section 417(e)(3) that applies as of January 1, 2003. The limitation year and the plan year for Plan A are the calendar year.

(ii) Pursuant to §1.415(c)–2(f) and section 401(a)(17), Plan A is not permitted to provide for a definition of compensation that includes compensation for a plan year that is in excess of the limitation under section 401(a)(17) that applies to that plan year. Accordingly, the limitation under section 415(b)(1)(B) based on P's average compensation for P's high three consecutive years must not reflect

compensation for any plan year that is in excess of the limitation under section 401(a)(17) that applies to that plan year. Thus, for example, if the limitation under section 401(a)(17) for plan years beginning in 2004, 2005, and 2006 is $205,000, and if P had compensation in excess of $205,000 in each of those years, then the limitation under section 415(b)(1)(B) based on P's average compensation for P's high three consecutive years is $205,000.

(6) *Exceptions from compensation limit*. The limit under paragraph (a)(1)(ii) of this section (*i.e.*, 100% of the participant's average compensation for his high 3 years of service) does not apply to—

(i) A governmental plan (as defined in section 414(d));

(ii) A multiemployer plan (as defined in section 414(f)); or

(iii) A collectively bargained plan that is described in section 415(b)(7).

(7) *Special rules*—(i) *Total benefits not in excess of $10,000*. See section 415(b)(4) and paragraph (f) of this section for an exception from the limits of section 415(b)(1) and paragraph (a)(1) of this section with respect to retirement benefits that do not exceed $10,000 for the limitation year.

(ii) *Governmental plans electing during 1990*. For a special limitation applicable to certain governmental plans electing the application of this rule during the first plan year beginning after December 31, 1989, see section 415(b)(10).

(b) *Annual benefit*—(1) *In general*—(i) *Definition of annual benefit*. For purposes of this section and §1.415(b)–2, the term *annual benefit* means a benefit that is payable annually in the form of a straight life annuity. With respect to a benefit payable in a form other than a straight life annuity, the annual benefit is determined as the straight life annuity that is actuarially equivalent to the benefit payable in such other form, determined under the rules of paragraph (c) of this section.

(ii) *Rules for determination of annual benefit*. The annual benefit does not include the annual benefit attributable to either employee contributions or rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), and 408(d)(3), and 457(e)(16)), determined pursuant to the rules of paragraph (b)(2) of this section. The treatment of transferred benefits is determined under the rules of paragraph (b)(3) of this section. Paragraph (b)(4) of this section discusses the treatment of qualified governmental excess benefit arrangements.

(iii) *Determination of annual benefit in the case of multiple annuity starting dates*. See §1.415(b)–2 for rules regarding the determination of the annual benefit from one or more plans in cases in which a participant has received one or more distributions in limitation years prior to an increase in the accrued benefit occurring during the current limitation year or prior to the annuity starting date for a distribution that commences during the current limitation year. The rules of §1.415(b)–2 apply, for example, to multiple annuity starting dates that result from the commencement of an additional distribution and to multiple annuity starting dates that result from a new distribution election with respect to a distribution that commenced in a prior limitation year. For purposes of §1.415(b)–2, the determination of whether a new annuity starting date has occurred is made without regard to the rule of §1.401(a)–20, Q&A–10(d) (under which the commencement of certain distributions may not give rise to a new annuity starting date).

(2) *Determination of annual benefit attributable to employee contributions and rollover contributions*—(i) *In general*. If employee contributions (other than contributions described in paragraph (b)(2)(ii) of this section) or rollover contributions are made to the plan, the annual benefit attributable to these contributions is determined as provided in this paragraph (b)(2).

(ii) *Certain employee contributions disregarded*. For purposes of this paragraph (b)(2), the following are not treated as employee contributions—

(A) Contributions that are picked up by a governmental employer as provided under section 414(h)(2);

(B) Repayment of any loan made to a participant from the plan;

(C) Repayment of a previously distributed amount as described in section 411(a)(7)(B) in accordance with section 411(a)(7)(C); and

(D) Repayment of a withdrawal of employee contributions as provided under section 411(a)(3)(D).

(iii) *Annual benefit attributable to mandatory employee contributions*. In the case of mandatory employee contributions as defined in section 411(c)(2)(C) and §1.411(c)–1(c)(4) (or contributions that would be mandatory employee contributions if section 411 applied to the plan), the annual benefit attributable to those contributions is determined by applying the factors applicable to mandatory employee contributions as described in section 411(c)(2)(B) and (C) and the regulations thereunder to those contributions to determine the amount of a straight life annuity commencing at the annuity starting date, regardless of whether section 411 applies to that plan. See §1.415(c)–1(a)(2)(ii)(B) and (b)(3) for rules regarding treatment of mandatory employee contributions to a defined benefit plan as annual additions under a defined contribution plan.

(iv) *Voluntary employee contributions*. If voluntary employee contributions are made to the plan, the portion of the plan to which voluntary employee contributions are made is treated as a defined contribution plan pursuant to section 414(k) and, accordingly, is a defined contribution plan pursuant to §1.415(c)–1(a)(2)(i). Accordingly, the portion of a plan to which voluntary employee contributions are made is not a defined benefit plan within the meaning of paragraph (a)(2) of this section and is not taken into account in determining the annual benefit under the portion of the plan that is a defined benefit plan.

(v) *Annual benefit attributable to rollover contributions*. The annual benefit attributable to rollover contributions from another qualified plan (for example, a contribution received pursuant to a direct rollover under section 401(a)(31)) is determined in the same manner as the annual benefit attributable to mandatory employee contributions if the plan provides for a benefit derived from the rollover contribution (other than a benefit derived from a separate account to be maintained with respect to the rollover contribution and actual earnings and losses thereon). Thus, in the case of rollover contributions from a defined contribution plan to a defined benefit plan to provide an annuity distribution, the annual benefit attributable to those rollover contributions for purposes of section 415 is determined by applying the rules of section 411(c), regardless of the assumptions used to compute the annuity distribution under the plan. Accordingly, in such a case, if the plan uses more favorable factors than those specified in section 411(c) to determine the amount of annuity payments

arising from rollover contributions, the annual benefit under the plan would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c)(3). See §1.415(c)–1(b)(3)(i) for rules excluding rollover contributions maintained in a separate account that is treated as a defined contribution plan pursuant to section 414(k) from annual additions to a defined contribution plan.

(3) *Treatment of transferred benefits*—(i) *In general*—(A) *Transferor plan and transferee plan aggregated*. For the limitation year that includes the date of a transfer between defined benefit plans, if the transferee plan's benefits are required to be taken into account pursuant to section 415(f) and §1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b) for that limitation year, then the transferred benefits are included in determining the annual benefit under the transferee plan and are disregarded in determining the annual benefit under the transferor plan. This will occur, for example, if the employer sponsoring the transferor plan and the employer sponsoring the transferee plan are in the same controlled group within the meaning of section 414(b). Similarly, with respect to a transfer between defined benefit plans that occurred in a previous limitation year, if the transferee plan's benefits are required to be taken into account pursuant to section 415(f) and §1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b), then the transferred benefits are included in determining the annual benefit under the transferee plan and are disregarded in determining the annual benefit under the transferor plan for the current limitation year. Accordingly, if the transferee plan's benefits are required to be taken into account pursuant to section 415(f) and §1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b) for the limitation year with respect to a transfer occurring in the current limitation year or a prior limitation year, no adjustment is made to the benefits actually provided under either plan for purposes of determining the annual benefit under the plans as aggregated.

(B) *Transferor plan and transferee plan not aggregated*. When there has been a transfer of liabilities from one qualified plan to another, the benefits associated with those transferred liabilities are treated by the transferor plan as distributed as a single-sum distribution in an amount determined under paragraph (b)(3)(ii) of this section if the transferee plan's benefits are not required to be taken into account pursuant to section 415(f) and §1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b). Although such a transfer is treated as a distribution in computing the annual benefit under the transferor plan, no adjustment is made to reflect the transfer for purposes of determining the annual benefit under the transferee plan. This will occur, for example, if the employer sponsoring the transferor plan is a predecessor employer with respect to the participant whose benefits are transferred to the transferee plan, where the transferee plan's benefits are not required to be taken into account pursuant to section 415(f) and §1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b).

(ii) *Amount of deemed distribution on account of transfer of benefits*—(A) *In general*. Where there has been a transfer of liabilities from one qualified defined benefit plan to another, the amount of the single-sum distribution that is deemed distributed from the transferor plan pursuant to paragraph (b)(3)(i)(B) of this section is the amount of the assets transferred (other than surplus assets transferred). Thus, where the fair market value of assets transferred from another defined benefit plan in connection with the transfer of liabilities equals or exceeds the actuarial present value of liabilities transferred, the annual benefit attributable to the liabilities transferred is determined taking into account the entire amount of liabilities transferred as a single-sum distribution.

(B) *Amount of assets transferred*. Where assets are transferred with respect to more than one participant, the assets transferred with respect to each participant (other than surplus assets transferred) are determined as the actuarial present value of the straight life annuity that is actuarially equivalent to the amount the participant would receive if the plan terminated immediately before the transfer (if the plan had then terminated) under the rules of section 414(l) or Subtitle E of Title IV of ERISA, whichever applies to the transferor plan. If neither the rules of section 414(l) nor the rules of Subtitle E of Title IV of ERISA apply to the plan, then the assets transferred with respect to each participant are determined as the actuarial present value of the straight life annuity that is actuarially equivalent to the amount the participant would receive if the plan terminated immediately before the transfer, determined by allocating the assets, to the extent possible, so that employees who are not officers, shareholders, or highly compensated employees receive from the plan at least the same proportion of the present value of their accrued benefits (whether or not nonforfeitable) as employees who are officers, shareholders, or highly compensated employees.

(iii) *Transfer of immediately distributable amount*. Where an immediately distributable amount is transferred from either a defined contribution plan or a defined benefit plan to a defined benefit plan (see §1.411(d)–4, Q&A–3(c) regarding certain elective transfers of immediately distributable benefits), the annual benefit attributable to the benefits transferred is determined pursuant to the rules of paragraph (b)(2)(v) of this section regarding rollover contributions.

(4) *Treatment of qualified governmental excess benefit arrangements*. Pursuant to section 415(m), in determining whether a governmental plan (as defined in section 414(d)) meets the requirements of this section and §1.415(b)–2, the annual benefit does not include benefits provided under a qualified governmental excess benefit arrangement, as defined in section 415(m)(3).

(c) *Adjustment to form of benefit for forms other than a straight life annuity*—(1) *In general*. This paragraph (c) provides rules for adjusting a form of benefit other than a straight life annuity to an actuarially equivalent straight life annuity beginning at the same time for purposes of determining the annual benefit described in paragraph (b) of this section. Examples of benefits that are not in the form of a straight life annuity include an annuity with a post-retirement death benefit and an annuity providing for a guaranteed number of payments. Paragraph (c)(2) of this section describes how to adjust a form of benefit to which section 417(e)(3) does not apply. Paragraph (c)(3) of this section describes how to adjust a form of benefit to which section 417(e)(3) applies.

Paragraph (c)(4) of this section describes benefit forms for which no adjustment is required. Paragraph (c)(5) of this section sets forth examples illustrating the application of this paragraph (c). The Commissioner may, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin set forth simplified methods for adjusting a form of benefit other than a straight life annuity to an actuarially equivalent straight life annuity beginning at the same time for purposes of determining the annual benefit described in paragraph (b) of this section. See §601.601(d) of this chapter.

(2) *Benefits to which section 417(e)(3) does not apply*. For a benefit to which section 417(e)(3) does not apply, the actuarially equivalent straight life annuity benefit is the greater of—

(i) The annual amount of the straight life annuity (if any) payable to the participant under the plan commencing at the same annuity starting date as the form of benefit payable to the participant; or

(ii) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using a 5% interest assumption and the applicable mortality table described in §1.417(e)–1(d)(2) for that annuity starting date.

(3) *Benefits to which section 417(e)(3) applies*—(i) *In general*. Except as provided in paragraph (c)(3)(ii) of this section, for a benefit to which section 417(e) applies, the actuarially equivalent straight life annuity benefit is the greater of—

(A) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence; or

(B) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the applicable interest rate for the distribution under §1.417(d)–1(d)(3) and the applicable mortality table for the distribution under §1.417(e)–1(d)(2).

(ii) *Special rule for 2004 and 2005*. For distributions to which section 417(e) applies and which have annuity starting dates beginning in 2004 or 2005, except as provided in section 101(d)(3) of the Pension Funding Equity Act of 2004 (118 Stat. 596), the actuarially equivalent straight life annuity benefit is the greater of—

(A) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence; or

(B) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using a 5.5% interest assumption and the applicable mortality table for the distribution under §1.417(e)–1(d)(2).

(4) *Certain benefit forms for which no adjustment is required*—(i) *In general*. For purposes of the adjustments described in this paragraph (c), the following benefits are not taken into account—

(A) Survivor benefits payable to a surviving spouse under a qualified joint and survivor annuity (as defined in section 417(b)) to the extent that such benefits would not be payable if the participant's benefit were not paid in the form of a qualified joint and survivor annuity; and

(B) Ancillary benefits that are not directly related to retirement benefits, such as preretirement disability benefits not in excess of the qualified disability benefit, preretirement incidental death benefits (including a qualified preretirement survivor annuity), and post-retirement medical benefits.

(ii) *Rules of application*—(A) *Social security supplements*. Although a social security supplement described in section 411(a)(9) and §1.411(a)–7(c)(4) may be an ancillary benefit, it is included in determining the annual benefit because it is payable upon retirement and therefore is directly related to retirement income benefits.

(B) *QJSAs combined with other distributions*. If benefits are paid partly in the form of a qualified joint and survivor annuity and partly in some other form (such as a single-sum distribution), the rule of paragraph (c)(4)(i)(A) of this section (under which survivor benefits are not included in determining the annual benefit) applies to the survivor annuity payments under the portion of the benefit that is paid in the form of a QJSA.

(5) *Examples*. The following examples illustrate the provisions of this paragraph (c). For purposes of these examples, except as otherwise stated, actuarial equivalence under the plan is determined using a 5% interest assumption and the mortality table that applies under section 417(e)(3) as of January 1, 2003. It is assumed for purposes of these examples that the interest rate that applies under section 417(e)(3) for relevant time periods is 5.25% and that the mortality table that applies under section 417(e)(3) for relevant time periods is the mortality table that applies under section 417(e)(3) as of January 1, 2003. In addition, it is assumed that all participants discussed in these examples have at least ten years of service with the employer and at least ten years of participation in the plan at issue, and that all payments other than a payment of a single sum are made monthly, on the first day of each calendar month. The examples are as follows:

*Example 1.* (i) Plan A provides a single-sum distribution determined as the actuarial present value of the straight life annuity payable at the actual retirement date. Plan A provides that a participant's single sum is determined as the greater of the present value using 5% interest and the applicable mortality table under section 417(e)(3) as of January 1, 2003, and the present value using the applicable interest rate and the applicable mortality table under section 417(e). In accordance with §1.417(e)–1(d)(1), Plan A also provides that the single sum is not less than the actuarial present value of the accrued benefit payable at normal retirement age, determined using the applicable interest rate and the applicable mortality table. Participant M retires at age 65 with a formula benefit of $152,619 and elects to receive a distribution in the form of a single sum. Under the plan formula, and before the application of section 415 under the plan, the amount of the single sum is $1,800,002 (which is based on the 5% interest rate and applicable mortality table as of January 1, 2003, since that is greater than the amount that would have been determined using the 5.25% interest rate and the applicable mortality table).

(ii) For purposes of this section, the annual benefit is the greater of the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the plan's actuarial factors), and the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the applicable interest rate and applicable mortality table). Based on the factors used in the plan to determine the actuarially equivalent lump sum (in this case, an interest rate of 5% and the applicable mortality table as of January 1, 2003), $1,800,002 payable as a single sum is actuarially equivalent to an immediate straight life annuity at age 65 of $152,619. Based on the applicable inter-

est rate and the applicable mortality table, $1,800,002 payable as a single sum is actuarially equivalent to an immediate straight life annuity at age 65 of $155,853. With respect to the single-sum distribution, M's annual benefit is equal to the greater of the two resulting amounts ($152,619 and $155,853), or $155,853.

*Example 2*. (i) The facts are the same as in *Example 1*, except that Participant M elects to receive his benefit in the form of a 10-year certain and life annuity. Applying the plan's actuarial equivalence factors determined using 5% interest and the applicable mortality table as of January 1, 2003, the benefit payable in this form is $146,100.

(ii) For purposes of this section, the annual benefit is the greater of the annual amount of the plan's straight life annuity commencing at the same age or the annual amount of the actuarially equivalent straight life annuity commencing at the same age, determined using a 5% interest rate and the applicable mortality table. In this case, the straight life annuity payable under the plan commencing at the same age is $152,619. Because the plan's factors for actuarial equivalence in this case are the same standardized actuarial factors required to be applied to determine the actuarially equivalent straight life annuity, the actuarially equivalent straight life annuity using the required standardized factors is also $152,619. With respect to the 10-year certain and life annuity distribution, M's annual benefit is equal to the greater of the two resulting amounts ($152,619 and $152, 619), or $152,619.

*Example 3*. (i) The facts are the same as in *Example 1*. Participant N retires at age 62 with a formula benefit, after application of the plan's early retirement factors, of $100,000 and a Social Security supplement of $10,000 per year payable until age 65. N chooses to receive the accrued benefit in the form of a straight life annuity. The Plan has no provisions under which the actuarial value of the Social Security supplement can be paid as a level annuity for life.

(ii) Because the plan does not provide for a straight life annuity beginning at age 62, the annual benefit for purposes of this section is the annual amount of the straight life annuity commencing at age 62 that is actuarially equivalent to the distribution stream of $110,000 for three years and $100,000 thereafter, where actuarial equivalence is determined using a 5% interest rate and the applicable mortality table. In this case, the actuarially equivalent straight life annuity is $102,180. Accordingly, with respect to this distribution stream, N's annual benefit is equal to $102,180.

*Example 4*. (i) Plan B is a defined benefit plan that provides a benefit equal to 100% of a participant's compensation for the participant's high 3 years of service while a participant, payable as a straight life annuity. For a married participant who does not elect another form of benefit, the benefit is payable in the form of a joint and 100% survivor annuity benefit that is reduced from the straight life annuity and is a QJSA within the meaning of section 417. For purposes of determining the amount of this QJSA, the plan provides that the reduction is only half of the reduction that would normally apply under the actuarial assumptions specified in the plan for determining actuarial equivalence of optional forms. The plan also provides that a married participant can elect to receive the plan benefits as a straight life annuity, or in the form of a single sum distribution that is the actuarial equivalent of the joint and 100% survivor annuity. Participant O elects, with spousal consent, a single-sum distribution.

(ii) The special rule that disregards the value of the survivor portion of a QJSA set forth in paragraph (c)(4)(i) of this section only applies to a benefit that is payable in the form of a qualified joint and survivor annuity. Any other form of benefit must be adjusted to a straight life annuity in accordance with paragraph (c)(1) of this section. Accordingly, because the benefit payable under the plan in the form of a single-sum distribution is the actuarial equivalent of a straight life annuity that is greater than 100% of a participant's compensation for his high 3 years, the limitation of section 415(b)(1)(B) has been exceeded.

*Example 5*. (i) Plan C is a defined benefit plan that provides an option to receive the benefit in the form of a joint and 100% survivor annuity with a 10-year certain feature, where the survivor beneficiary is the participant's spouse.

(ii) For a participant at age 65, the annual benefit with respect to the joint and 100% survivor annuity with a 10-year certain feature is determined as the greater of the annual amount of the straight life annuity payable to the participant under the plan at age 65 (if any), or the annual amount of the straight life annuity commencing at age 65 that has the same actuarial present value as the joint and 100% survivor annuity with a 10 year certain feature (but excluding the survivor annuity payments pursuant to paragraph (c)(4)(i)(A) of this section), computing using a 5% interest assumption and the applicable mortality table described in §1.417(e)–1(d)(2) for that annuity starting date. This latter amount is equal to the product of the annual payments under this optional form of benefit and the factor that provides for actuarial equivalence between a straight life annuity and a 10-year certain and life annuity (with no annuity for the survivor) computed using a 5% interest rate and the applicable mortality table.

*Example 6*. (i) Plan D is a defined benefit plan with a normal retirement age of 65. The normal retirement benefit under Plan D (and the only life annuity available under Plan D) is a life annuity with a fixed increase of 2% per year. The increase applies to the benefit provided in the prior year and is thus compounded. The plan provides that the benefit is limited to the lesser of 84% of the participant's average compensation for the participant's high 3 consecutive years of service while a plan participant or 84% of the section 415(b)(1)(A) dollar limit (which is assumed to be $170,000). Participant P's retires at age 65, at which time P's average compensation for P's high 3 consecutive years of service is $165,000. Accordingly, P commences receiving benefits in the form of a life annuity of $138,600 with a fixed increase of 2% per year.

(ii) Because Plan D does not provide for a straight life annuity, P's annual benefit for purposes of section 415(b) is the annual amount of the straight life annuity, commencing at age 65, that is actuarially equivalent to the distribution stream of $138,600 with a fixed increase of 2% per year, where actuarial equivalence is determined using a 5% interest rate and the applicable mortality table. In order to satisfy the requirements of section 415 and this section, this annual benefit must not exceed 100% of average compensation for the participant's high 3 consecutive years, or $165,000. Using a 5% interest rate and the section 417(e)(3) mortality table, the actuarially equivalent straight life annuity is $165,453, which exceeds $165,000. Accordingly, the plan fails to satisfy the compensation-based limitation of section 415(b)(1)(B).

*Example 7*. (i) Plan E provides a benefit at age 65 of a straight life annuity equal to the lesser of 90% of the participant's average compensation for the participant's highest 3 consecutive years of service while a plan participant and $148,500. Upon retirement at age 65, the optional forms of benefit available to a participant include payment of a QJSA with annual payments equal to 50% of the annual payments under the straight life annuity, along with a single-sum distribution that is actuarially equivalent (determined as the greater of the single sum calculated using a 5% interest assumption and the section 417(e)(3) mortality table in effect on January 1, 2003, and the single sum calculated using the section 417(e)(3) interest rate and the section 417(e)(3) mortality table) to 50% of the annual payments under the straight life annuity. Participant Q retires at age 65. Q's average compensation for Q's highest 3 consecutive years is $100,000. Q elects to receive a distribution in the optional form of benefit described above, under which the annual payments under the QJSA are $45,000 and the single-sum distribution is equal to $530,734. Q's spouse is 3 years younger than Q.

(ii) Q's annual benefit under Plan E is determined as the sum of the annual benefit attributable to the QJSA portion of the distribution and the annual benefit attributable to the single-sum portion of the distribution.

(iii) Because survivor benefits are not taken into account in determining the annual benefit attributable to the QJSA portion of the distribution, the annual benefit attributable to the QJSA portion of the distribution is determined as if that distribution were a straight life annuity of $45,000 per year commencing at age 65. Thus, no form adjustment is needed to determine the annual benefit attributable to the QJSA portion of the distribution, and the annual benefit attributable to the QJSA portion of the benefit is $45,000.

(iv) The annual benefit attributable to the single sum portion of the distribution is determined as the greater of the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the plan's actuarial factors), and the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the applicable interest rate and applicable mortality table). With respect to the single-sum distribution, the annual amount of the actuarially equivalent straight life annuity commencing at the same age determined using the plan's actuarial factors is equal to $45,954, and the actuarially equivalent straight life annuity commencing at the same age determined using the applicable interest rate and the applicable mortality table is equal to $45,954. Thus, the annual benefit attributable to the single sum portion of the benefit is $45,954.

(v) Q's annual benefit under the optional form of benefit is equal to the sum of the annual benefit attributable to the QJSA portion of the distribution and the annual benefit attributable to the single sum portion of the distribution, or $90,954. Because Q's average compensation for Q's highest 3 consecutive years is

$100,000, the distribution satisfies the compensation limit of section 415(b)(1)(B).

*Example 8.* (i) R is a participant in a defined benefit plan maintained by A's employer. Under the terms of the plan, R must make contributions to the plan in a stated amount to accrue benefits derived from employer contributions.

(ii) R's contributions are mandatory employee contributions within the meaning of section 411(c)(2)(C) and, thus, the annual benefit attributable to these contributions does not have to be taken into account for purposes of testing the annual benefit derived from employer contributions against the applicable limitation on benefits. However, these contributions are treated as contributions to a defined contribution plan maintained by R's employer for purposes of section 415(c). See §1.415(c)–1(a)(2)(ii)(B). Accordingly, with respect to the current limitation year, the limitation on benefits (as described in paragraph (a)(1) of this section) is applicable to the annual benefit attributable to employer contributions to the defined benefit plan, and the limitation on contributions and other additions (as described in §1.415(c)–1) is applicable to the portion of the plan treated as a defined contribution plan, which consists of R's mandatory contributions. These same limitations would also apply if, instead of providing for mandatory employee contributions, the plan permitted voluntary employee contributions, because the portion of the plan attributable to voluntary employee contributions and earnings thereon is treated as a defined contribution plan maintained by the employer pursuant to section 414(k), and thus is not subject to the limitations of section 415(b).

(d) *Adjustment to section 415(b)(1)(A) dollar limit for commencement before age 62*—(1) *General rule*. For a distribution with an annuity starting date that occurs before the participant attains the age of 62, the age-adjusted section 415(b)(1)(A) dollar limit is determined as the lesser of—

(i) The section 415(b)(1)(A) dollar limit (as adjusted pursuant to section 415(d) and §1.415(d)–1(a) for the limitation year) multiplied by the ratio of the annual amount of the immediately commencing straight life annuity under the plan (if any) to the annual amount of the straight life annuity under the plan commencing at age 62, if any (with both annual amounts determined without applying the rules of section 415); or

(ii) The annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as a deferred straight life annuity commencing at age 62, where annual payments under the straight life annuity commencing at age 62 are equal to the dollar limitation of section 415(b)(1)(A), and where the actuarially equivalent straight life annuity is computed using a 5% interest rate and the applicable mortality table under §1.417(e)–1(d)(2) that is effective for that annuity starting date.

(2) *Mortality adjustments*—(i) *In general*. For purposes of determining the amount described in paragraph (d)(1)(ii) of this section, to the extent that a forfeiture does not occur upon the participant's death, no adjustment is made to reflect the probability of the participant's death between the annuity starting date and the participant's attainment of age 62. To the extent that a forfeiture occurs upon the participant's death, an adjustment must be made to reflect the probability of the participant's death between the annuity starting date and the participant's attainment of age 62.

(ii) *No forfeiture deemed to occur where QPSA payable*. For purposes of paragraphs (d)(2)(i) and (e)(2)(i) of this section, a plan is permitted to treat no forfeiture as occurring upon a participant's death if the plan does not charge participants for providing a qualified preretirement survivor annuity (as defined in section 417(c)) on the participant's death, but only if the plan applies this treatment both for adjustments before age 62 and adjustments after age 65. Thus, in such a case, the plan is permitted to provide that, in computing the adjusted dollar limitation under section 415(b)(1)(A), no adjustment is made to reflect the probability of a participant's death between the annuity starting date and the participant's attainment of age 62 or between the age of 65 and the annuity starting date.

(3) *Exception for certain participants of certain governmental plans*. Pursuant to section 415(b)(2)(G) and (H), no age adjustment is made to the dollar limit for commencement before age 62 for any qualified participant. For this purpose, a qualified participant is a participant in a defined benefit plan that is maintained by a state or local government with respect to whom the service taken into account in determining the amount of the benefit under the defined benefit plan includes at least 15 years of service of the participant—

(i) As a full-time employee of any police department or fire department that is organized and operated by the state or political subdivision maintaining such defined benefit plan to provide police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such state or political subdivision; or

(ii) As a member of the Armed Forces of the United States.

(4) *Exception for survivor and disability benefits under governmental plans*. Pursuant to section 415(b)(2)(I), no age adjustment is made to the dollar limit for commencement before age 62 for a distribution from a governmental plan (as defined in section 414(d)) on account of the participant's becoming disabled by reason of personal injuries or sickness, or as a result of the death of the participant.

(5) *Special rule for commercial airline pilots*. Pursuant to section 415(b)(9), no age adjustment is made to the dollar limit for early commencement after age 60 for a participant if—

(i) The participant is a commercial airline pilot;

(ii) The participant separates from service after attaining age 60; and

(iii) As of the time of the participant's retirement, regulations prescribed by the Federal Aviation Administration require an individual to separate from service as a commercial airline pilot after attaining any age occurring on or after age 60 and before age 62.

(6) *Examples*. The following examples illustrate the application of this paragraph (d). For purposes of these examples, it is assumed that the dollar limitation under section 415(b)(1)(A) for all relevant years is $180,000, that the normal form of benefit under the plan is a straight life annuity payable beginning at age 65, and that all payments other than a payment of a single sum are made monthly, on the first day of each calendar month. The examples are as follows:

*Example 1.* (i) Plan A provides that early retirement benefits are determined by reducing the accrued benefit by 4% for each year that the early retirement age is less than age 65. Participant M retires at age 60 after 30 years of service with a benefit (prior to the application of section 415) in the form of a straight life annuity of $100,000 payable at age 65, and is permitted to elect to commence benefits at any time between M's retirement and M's attainment of age 65. For example, M can elect to commence benefits at age 60 in the amount of $80,000, can wait until age 62 and commence benefits in the amount of $88,000, or can wait until age 65 and commence benefits in the amount of $100,000. Plan A provides a QPSA to all married participants without charge. Plan A provides (consistent with paragraph (d)(2)(ii) of this section) that, for purposes of adjusting the dollar limitation under section 415(b)(1)(A) for commencement before age 62 or after age 65, no forfeiture is treated as occurring upon

a participant's death before retirement and, therefore, in computing the adjusted dollar limitation under section 415(b)(1)(A), no adjustment is made to reflect the probability of a participant's death between the annuity starting date and the participant's attainment of age 62 or between the age of 65 and the annuity starting date.

(ii) The age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 60 to the annuity payable at age 62, or the straight life annuity payable at age 60 that is actuarially equivalent, using 5% interest and the applicable mortality table, to the deferred annuity payable at age 62. In this case, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 is $156,229 (the lesser of $163,636 ($180,000* $80,000/$88,000) and $156,229 (the straight life annuity at age 60 that is actuarially equivalent to a deferred annuity of $180,000 commencing at age 62, determined using 5% interest and the applicable mortality table, without a mortality decrement for the period between 60 and 62)).

*Example 2*. (i) The facts are the same as in *Example 1*, except the plan provides that, if a participant has 30 or more years of service, no reduction applies for benefits commencing at age 62 and later.

(ii) The age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 60 to the annuity payable at age 62, or the straight life annuity payable at age 60 that is actuarially equivalent, using 5% interest and the applicable mortality table, to the deferred annuity payable at age 62. In this case, because M has 30 years of service and would be eligible for the unreduced early retirement benefit at age 62, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 is $144,000 (the lesser of $144,000 ($180,000* $80,000/$100,000) and $156,229 (the straight life annuity at age 60 that is actuarially equivalent to a deferred annuity of $180,000 commencing at age 62, determined using 5% interest and the applicable mortality table).

*Example 3*. (i) Participant O is a full-time civilian employee of the State of X Police Department who performs clerical services. O is a participant in the defined benefit plan that is maintained by the State of X with respect to whom the years of service taken into account in determining the amount of the benefit under the plan includes 15 years of service working for the State of X Police Department.

(ii) For a distribution with an annuity starting date that occurs before O attains the age of 62, there is no age adjustment to the section 415(b)(1)(A) dollar limit.

*Example 4*. (i) Participant R is a full-time employee of the Emergency Medical Service Department of County Y (which is not a part of a police or fire department) who performs services as a driver of an ambulance. R is a participant in the defined benefit plan that is maintained by County Y with respect to whom the years of service taken into account in determining the amount of the benefit under the plan includes 15 years of service working for County Y. R does not have service credit for time in Armed Forces of the United States.

(ii) The age adjustments to the limitations of section 415(b)(1)(A) pursuant to section 415(b)(2)(C) and (D) will apply if R commences receiving a distribution at an age to which either of those adjustments applies.

*Example 5*. (i) The facts are the same as in *Example 1* except that Participant M chooses to receive benefits in the form of a 10-year certain and life annuity under which payments are 97% of the periodic payments that would be made under the immediately commencing straight life annuity. Annual payments to M are 97% of $80,000, or $77,600. As in *Example 1*, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 is $156,229.

(ii) For purposes of this section, the annual benefit is the greater of the annual amount of the plan's straight life annuity commencing at the same age or the annual amount of the actuarially equivalent straight life annuity commencing at the same age, determined using a 5% interest rate and the applicable mortality table. In this case, the straight life annuity payable under the plan commencing at the same age is $80,000. The annual amount of the actuarially equivalent straight life annuity determined by applying the required standardized factors (*i.e.*, a 5% interest assumption and the applicable mortality under section 417(e)(3)) is $79,416. With respect to the 10-year certain and life annuity commencing at age 62, M's annual benefit is equal to the greater of the two resulting amounts ($80,000 and $79,416), or $80,000.

(e) *Adjustment to section 415(b)(1)(A) dollar limit for commencement after age 65*—(1) *General rule*. For a distribution with an annuity starting date that occurs after the participant attains the age of 65, the age-adjusted section 415(b)(1)(A) dollar limit is determined as the lesser of—

(i) The section 415(b)(1)(A) dollar limit (as adjusted pursuant to section 415(d) and §1.415(d)–1 for the limitation year) multiplied by the ratio of the annual amount of the immediately commencing straight life annuity under the plan (if any) to the annual amount of the straight life annuity that would be payable under the plan to a hypothetical participant who is 65 years old and has the same accrued benefit (*i.e.*, with no actuarial increases for commencement after age 65) as the participant receiving the distribution (with both annual amounts determined without applying the rules of section 415); or

(ii) The annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as a straight life annuity commencing at age 65, where annual payments under the straight life annuity commencing at age 65 are equal to the dollar limitation of section 415(b)(1)(A), and where actuarially equivalent straight life annuity is computed using a 5% interest rate and the applicable mortality table under §1.417(e)–1(d)(2) that is effective for that annuity starting date.

(2) *Mortality adjustments*—(i) *In general*. For purposes of determining the amount described in paragraph (e)(1)(ii) of this section, to the extent that a forfeiture does not occur upon the participant's death, no adjustment is made to reflect the probability of the participant's death between the participant's attainment of age 65 and the annuity starting date. To the extent that a forfeiture occurs upon the participant's death, an adjustment must be made to reflect the probability of the participant's death between the participant's attainment of age 65 and the annuity starting date.

(ii) *No forfeiture deemed to occur where QPSA payable*. See paragraph (d)(2)(ii) of this section for a rule deeming no forfeiture to occur if the plan does not charge participants for providing a qualified preretirement survivor annuity on the participant's death.

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

*Example*. (i) Plan A provides that monthly benefits payable upon commencement after normal retirement age (which is age 65) are increased by 0.5% for each month of delay in commencement after attainment of normal retirement age. Plan A provides a QPSA to all married participants without charge. Plan A provides (consistent with paragraph (d)(2)(ii) of this section) that, for purposes of adjusting the dollar limitation under section 415(b)(1)(A) for commencement before age 62 or after age 65, no adjustment is made to reflect the probability of a participant's death between the annuity starting date and the participant's attainment of age 62 or between the age of 65 and the annuity starting date. The normal form of benefit under Plan A is a straight life annuity commencing at age 65. Participant M retires at age 70 on January 1, 2007, after 30 years of service with a benefit (prior to the application of section 415) that is payable monthly in the form of a straight life annuity of $195,000, which reflects the actuarial increase of 30% applied to the accrued benefit of $150,000.

(ii) The age-adjusted section 415(b)(1)(A) dollar limit at age 70 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 70 to the annuity that would be payable at age 65 based on the same accrued benefit (both determined before the application of section 415), or the straight life annuity payable at age 70 that is actuarially equivalent, using 5% interest and the applicable mortality table, to the straight life annuity payable at age 65. In this case, the age-adjusted section 415(b)(1)(A) dollar limit at age 70 is $234,000 (the lesser of $234,000 ($180,000* $195,000/$150,000) and $264,109 (the straight life annuity at age 70 that is actuarially equivalent to an annuity of $180,000 commencing at age 65, deter-

mined using 5% interest and the applicable mortality table, without a mortality decrement for the period between 65 and 70)).

(f) *Total annual payments not in excess of $10,000*—(1) *In general*. Pursuant to section 415(b)(4), the annual benefit (without regard to the age at which benefits commence) payable with respect to a participant under any defined benefit plan is not considered to exceed the limitations on benefits described in section 415(b)(1) and in paragraph (a)(1) of this section if—

(i) The benefits (other than benefits not taken into account in the computation of the annual benefit under the rules of paragraph (b) or (c) of this section) payable with respect to the participant under the plan and all other defined benefit plans of the employer do not in the aggregate exceed $10,000 (as adjusted under paragraph (g)) for the limitation year, or for any prior limitation year; and

(ii) The employer (or a predecessor employer) has not at any time, either before or after the effective date of section 415, maintained a defined contribution plan in which the participant participated.

(2) *Computation of benefits for purposes of applying the $10,000 amount*. For purposes of paragraph (f)(1)(i) of this section, the benefits (other than benefits not taken into account in the computation of the annual benefit under the rules of paragraph (b) or (c) of this section) payable with respect to the participant under a plan for a limitation year reflect all amounts payable under the plan for the limitation year, and are not adjusted for form of benefit or commencement date.

(3) *Special rule with respect to participants in multiemployer plans*. The special $10,000 exception set forth in paragraph (f)(1) of this section is applicable to a participant in a multiemployer plan described in section 414(f) without regard to whether that participant ever participated in one or more other plans maintained by an employer who also maintains the multiemployer plan, provided that none of such other plans were maintained as a result of collective bargaining involving the same employee representative as the multiemployer plan.

(4) *Special rule with respect to employee contributions*. For purposes of paragraph (f)(1)(ii) of this section, mandatory employee contributions under a defined benefit plan are not considered a separate defined contribution plan maintained by the employer. Thus, a contributory defined benefit plan may utilize the special dollar limitation provided for in this paragraph (f). Similarly, for purposes of this paragraph (f), an individual medical account under section 401(h) or an account for postretirement medical benefits established pursuant to section 419A(d)(1) is not considered a separate defined contribution plan maintained by the employer.

(5) *Examples*. The application of this paragraph (f) may be illustrated by the following examples. For purposes of these examples, it is assumed that each participant has 10 years of participation in the plan and service with the employer. The examples are as follows:

*Example 1*. (i) B is a participant in a defined benefit plan maintained by X Corporation, which provides for a benefit payable in the form of a straight life annuity beginning at age 65. B's average compensation for B's high 3 consecutive years of service while a participant in the plan is $6,000. The plan does not provide for employee contributions, and at no time has B been a participant in a defined contribution plan maintained by X. With respect to the current limitation year, B's benefit under the plan (before the application of section 415) is $9,500.

(ii) Because annual payments under B's benefit do not exceed $10,000, and because B has at no time participated in a defined contribution plan maintained by X, the benefits payable under the plan are not considered to exceed the limitation on benefits otherwise applicable to B ($6,000).

(iii) This result would remain the same even if, under the terms of the plan, B's normal retirement age was age 60, or if the plan provided for employee contributions.

*Example 2*. (i) The facts are the same as in *Example 1*, except that the plan provides for a benefit payable in the form of a life annuity with a 10-year certain feature with annual payments of $9,500. Assume that, after the adjustment described in paragraph (c) of this section, B's actuarially equivalent straight life annuity (which is the annual benefit used for demonstrating compliance with section 415) for the current limitation year is $10,400.

(ii) For purposes of applying the special rule provided in this paragraph for total benefits not in excess of $10,000, there is no adjustment required if the retirement benefit payable under the plan is not in the form of a straight life annuity. Therefore, because B's retirement benefit does not exceed $10,000, B may receive the full $9,500 benefit without the otherwise applicable benefit limitations of this section being exceeded.

*Example 3*. (i) The facts are the same as in *Example 1*, except that the plan provides for a benefit payable in the form of a single sum and that the amount of the single sum that is the actuarial equivalent of the straight life annuity payable to B (*i.e.*, $9,500 annually), determined in accordance with the rules of section 417(e)(3) and §1.417(e)–1(d) is $95,000.

(ii) Because the amount payable to B for the limitation year would exceed $10,000, the rule of this paragraph (f) does not provide an exception from the generally applicable limits of section 415(b)(1) for the single-sum distribution. Thus, the otherwise applicable limits apply to the single-sum distribution, and a single-sum distribution of $95,000 would not satisfy the requirements of section 415(b). Limiting the single-sum distribution to $60,000 (the present value of the annuity that complies with the compensation-based limitation of section 415(b)(1)(B)) in order to satisfy section 415 would be an impermissible forfeiture under the requirements of section 411(a). Accordingly, the plan should not provide for a single-sum distribution in these circumstances.

(g) *Special rule for participation or service of less than 10 years*—(1) *Proration of dollar limit based on years of participation*—(i) *In general*. Pursuant to section 415(b)(5)(A), where a participant has less than 10 years of participation in the plan, the dollar limit described in paragraph (a)(1)(i) of this section (as adjusted pursuant to section 415(d), §1.415(d)–1, and paragraphs (d) and (e) of this section) is to be reduced by multiplying the otherwise applicable limitation by a fraction—

(A) The numerator of which is the number of years of participation in the plan (or 1, if greater); and

(B) The denominator of which is 10.

(ii) *Years of participation*. The following rules apply for purposes of determining a participant's years of participation for purposes of this paragraph (g)(1)—

(A) A participant is credited with a year of participation (computed to fractional parts of a year) for each accrual computation period for which the participant is credited with at least the number of hours of service (or period of service if the elapsed time method is used for benefit accrual purposes) required under the terms of the plan in order to accrue a benefit for the accrual computation period, and the participant is included as a plan participant under the eligibility provisions of the plan for at least one day of the accrual computation period. If these two conditions are met, the portion of a year of participation credited to the participant is equal to the amount of benefit accrual service credited to the participant for such accrual computation period. For example, if under the terms of a plan, a participant receives 1/10 of a year of benefit accrual service for an accrual computation period for each 200 hours of service, and the participant is credited with 1,000 hours of service for the period, the participant is credited with

1/2 a year of participation for purposes of section 415(b)(5)(A).

(B) A participant who is permanently and totally disabled within the meaning of section 415(c)(3)(C)(i) for an accrual computation period is credited with a year of participation with respect to that period for purposes of section 415(b)(5)(A).

(C) For a participant to receive a year of participation (or part thereof) for an accrual computation period for purposes of section 415(b)(5)(A), the plan must be established no later than the last day of such accrual computation period.

(D) No more than one year of participation may be credited for any 12-month period for purposes of section 415(b)(5)(A).

(2) *Proration of compensation limit and special rule for total annual payments less than $10,000 based on years of service*—(i) *In general*. Pursuant to section 415(b)(5)(B), where a participant has less than 10 years of service with the employer, the compensation limit described in paragraph (a)(1)(ii) of this section and the $10,000 amount under the special rule for small annual payments under paragraph (f) of this section are reduced by multiplying the otherwise applicable limitation by a fraction—

(A) The numerator of which is the number of years of service with the employer (or 1, if greater); and

(B) The denominator of which is 10.

(ii) *Years of service*—(A) *In general*. For purposes of applying this paragraph (g)(2), the term *year of service* is to be determined on a reasonable and consistent basis. A plan is considered to be determining years of service on a reasonable and consistent basis for this purpose if, subject to the limits of paragraph (g)(2)(ii)(B) of this section, a participant is credited with a year of service (computed to fractional parts of a year) for each accrual computation period for which the participant is credited with at least the number of hours of service (or period of service if the elapsed time method is used for benefit accrual purposes) required under the terms of the plan in order to accrue a benefit for the accrual computation period.

(B) *Rules of application*. No more than one year of service may be credited for any 12-month period for purposes of section 415(b)(5)(B). In addition, only the participant's service with the employer or a predecessor employer (as defined in §1.415(f)–1(c)) may be taken into account in determining the participant's years of service for this purpose.

(C) *Period of disability*. Notwithstanding the rules of paragraph (g)(2)(ii)(B) of this section, a plan is permitted to provide that a participant who is permanently and totally disabled within the meaning of section 415(c)(3)(C)(i) for an accrual computation period is credited with a year of service with respect to that period for purposes of section 415(b)(5)(B).

(3) *Exception for survivor and disability benefits under governmental plans*. The requirements of this paragraph (g) (regarding participation or service of less than 10 years) do not apply to a distribution from a governmental plan on account of the participant's becoming disabled by reason of personal injuries or sickness, or as a result of the death of the participant.

(4) *Examples*. The provision of this paragraph (g) may be illustrated by the following examples:

*Example 1*. (i) C begins employment with Employer A on January 1, 2005, at the age of 58. Employer A maintains only a noncontributory defined benefit plan which provides for a straight life annuity beginning at age 65 and uses the calendar year for the limitation and plan year. Employer A has never maintained a defined contribution plan. C becomes a participant in Employer A's plan on January 1, 2006, and works through December 31, 2011, when C is age 65. C begins to receive benefits under the plan in 2012. C's average compensation for C's high 3 consecutive years of service is $40,000. Furthermore, under the terms of Employer A's plan, for purposes of computing C's nonforfeitable percentage in C's accrued benefit derived from employer contributions, C has only 7 years of service with Employer A (2005–2011).

(ii) Because C has only 7 years of service with Employer A at the time he begins to receive benefits under the plan, the maximum permissible annual benefit payable with respect to C is $28,000 ($40,000 multiplied by 7/10).

*Example 2*. (i) The facts are the same as in *Example 1*, except that C's average compensation for his high 3 years is $8,000.

(ii) Because C has only 7 years of service with Employer A at the time he begins to receive benefits, the maximum benefit payable with respect to C would be reduced to $5,600 ($8,000 multiplied by 7/10). However, the special rule for total benefits not in excess of $10,000, provided in paragraph (f) of this section, is applicable in this case. Accordingly, C may receive an annual benefit of $7,000 ($10,000 multiplied by 7/10) without the benefit limitations of this section being exceeded.

*Example 3*. (i) Employer B maintains a defined benefit plan. Benefits under the plan are computed based on months of service rather than years of service. Accordingly, for purposes of applying the reduction based on years of service less than 10 to the limitations under section 415(b), the otherwise applicable limitation is multiplied by a fraction, the numerator of which is the number of completed months of service with the employer (but not less than 12 months), and the denominator of which is 120. The plan further provides that months of service are computed in the same manner for this purpose as for purposes of computing plan benefits.

(ii) The manner in which the plan applies the reduction based on years of service less than 10 to the limitations under section 415(b) is consistent with the requirements of this paragraph (g).

*Example 4*. (i) G begins employment with Employer D on January 1, 2003, at the age of 58. Employer D maintains only a noncontributory defined benefit plan which provides for a straight life annuity beginning at age 65 and uses the calendar year for the limitation and plan year. Employer D has never maintained a defined contribution plan. G becomes a participant in Employer D's plan on January 1, 2004, and works through December 31, 2009, when G is age 65. G performs sufficient service to be credited with a year of service under the plan for each year during 2003 through 2009 (although G is not credited with a year of service for 2003 because G is not yet a plan participant). G begins to receive benefits under the plan during 2010. The plan's accrual computation period is the plan year. The plan provides that, for purposes of applying the rules of section 415(b)(5)(B), a participant is credited with a year of service (computed to fractional parts of a year) for each plan year for which the participant is credited with sufficient service to accrue a benefit for the plan year. G's average compensation for G's high 3 years of service is $200,000. It is assumed for purposes of this example that the dollar limitation of section 415(b)(1)(A) for limitation years ending in 2010 is $180,000.

(ii) G has 7 years of service and 6 years of participation in the plan at the time G begins to receive benefits under the plan. Accordingly, the limitation under section 415(b)(1)(B) based on G's average compensation for G's high 3 years of service that applies pursuant to the adjustment required under section 415(b)(5)(B) is $140,000 ($200,000 multiplied by 7/10), and the dollar limitation under section 415(b)(1)(A) that applies to G pursuant to the adjustment required under section 415(b)(5)(A) is $108,000 ($180,000 multiplied by 6/10).

(h) *RPA '94 transition rules*. For special rules affecting the actuarial adjustment for form of benefit under paragraph (c) of this section and the adjustment to the dollar limit for early or late commencement under paragraphs (d) and (e) of this section for certain plans adopted and in effect before December 8, 1994, see section 767(d)(3)(A) of the Retirement Protection Act of 1994, as amended by section 1449(a) of the Small Business Job Protection Act of 1996. The Commissioner may provide guidance regarding these special rules in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin. See §601.601(d) of this chapter.

Par. 8. Section 1.415(b)–2 is added to read as follows:

*§1.415(b)–2 Multiple annuity starting dates.*

(a) *Determination of annual benefit where distributions have occurred before the current determination date*—(1) *In general*. This section provides rules for determining the annual benefit of a participant for purposes of applying the limitations of section 415(b) and §1.415(b)–1 in cases in which a participant has received one or more distributions in limitation years prior to an increase in the accrued benefit occurring during the current limitation year or prior to the annuity starting date for a distribution that commences during the current limitation year. This section applies, for example, where benefit distributions to a participant have previously commenced under a plan that is aggregated for purposes of section 415 with a plan from which the participant receives current accruals, or where a new distribution election is effective during the current limitation year with respect to a distribution that commenced in a prior limitation year. This section also applies where benefit payments are increased as a result of plan terms applying a cost-of-living adjustment pursuant to an increase of the dollar limit of section 415(b)(1)(A), if the plan does not provide for application of the rules of §1.415(d)–1(a)(5) to determine the adjusted amount of the benefit. Paragraph (b) of this section provides rules for computing the annual benefit in the case of multiple annuity starting dates as described in this paragraph (a)(1). Paragraph (c) of this section provides an additional rule for multiple annuity starting dates that occur when a stream of annuity payments is modified by a new distribution election. Paragraph (d) of this section provides examples to illustrate the rules of this section.

(2) *Annuity starting date*. For purposes of this section, the determination of whether a new annuity starting date has occurred is made pursuant to the rules of §1.401(a)–20, Q&A–10, but without regard to the rule of §1.401(a)–20, Q&A–10(d) (under which the commencement of certain distributions may not give rise to a new annuity starting date).

(3) *Annual benefit*—(i) *In general*. Where a participant has received one or more distributions before a current accrual or before the annuity starting date for a currently payable distribution, except as provided in paragraph (a)(3)(iii) of this section (regarding mandatory employee contributions and rollover contributions), the annual benefit that is subject to the limits of section 415(b) and §1.415(b)–1(a) is equal to the sum of—

(A) The annual benefit determined with respect to any accrued benefit with respect to which distribution has not yet commenced as of the current determination date, computed pursuant to the rules of §1.415(b)–1(b) and (c);

(B) The annual benefit determined with respect to any distribution with an annuity starting date that occurs within the current limitation year and on or before the current determination date, computed pursuant to the rules of §1.415(b)–1(b) and (c);

(C) The annual benefit determined with respect to the remaining amounts payable under any distribution with an annuity starting date that occurred during a prior limitation year, computed pursuant to the rules of §1.415(b)–1(b) and (c) (subject to paragraph (a)(3)(ii) of this section); and

(D) The annual benefit attributable to prior distributions (computed pursuant to the rules of paragraph (b) of this section).

(ii) *Determining actuarial equivalence with respect to remaining amounts payable*. For purposes of computing the annual benefit determined with respect to the remaining amounts payable under any distribution with an annuity starting date that occurred during a prior limitation year under paragraph (a)(3)(i)(C) of this section, §1.415(b)–1(c)(2) is applied by substituting for the amount described in §1.415(b)–1(c)(2)(i) the annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence for the particular form of benefit payable.

(iii) *Mandatory employee contributions and rollover contributions*. If mandatory employee contributions or rollover contributions have been made to the plan with respect to a distribution that commenced before the current determination date, the annual benefit is determined by applying the rules of paragraph (a)(3)(i)(C) and (D) of this section and then subtracting the annual benefit attributable to mandatory employee contributions computed pursuant to §1.415(b)–1(b)(2)(iii) and the annual benefit attributable to rollover contributions computed pursuant to §1.415(b)–1(b)(2)(v), with both amounts computed as of the annuity starting date for the distribution.

(iv) *Repayments of prior distributions*—(A) *Total repayments*. A prior distribution that has been repaid to the plan with interest does not give rise to an annual benefit attributable to prior distributions for purposes of paragraph (a)(3)(i)(D) of this section (because amounts attributable to those repayments are reflected instead in amounts included in the annual benefit pursuant to paragraphs (a)(3)(i)(A), (B), and (C) of this section).

(B) *Partial repayments*. If a prior distribution was made, and a repayment was subsequently made that was less than the amount of the prior distribution (including reasonable interest), the annual benefit attributable to prior distributions is determined by multiplying the annual benefit attributable to the prior distribution (computed assuming that no repayment occurred) by one minus a fraction, the numerator of which is the amount of the repayment and the denominator of which is the amount of the prior distribution plus reasonable interest.

(b) *Annual benefit attributable to prior distributions*—(1) *In general*—(i) *Adjustment to actuarially equivalent straight life annuity*—(A) *Method of adjustment*. To compute the annual benefit attributable to a prior distribution, the prior distribution is adjusted to an actuarially equivalent straight life annuity commencing at the current determination date in accordance with the rules of paragraph (b)(2) of this section (for a prior distribution to which section 417(e)(3) did not apply) or paragraph (b)(3) of this section (for a prior distribution to which section 417(e)(3) applied).

(B) *Current determination date*. The current determination date is the last day of period for which an increase in the participant's benefit accrues if an increase in the participant's accrued benefit occurs during the limitation year. If there is no such increase, the current determination date is the annuity starting date for the distribution that commences during the limitation year.

(ii) *Rules of application*—(A) *Amount of distribution taken into account*. In applying the rules of paragraphs (b)(2) and (3) of this section to compute the annual benefit attributable to a prior distribution, only the actual amount received as a prior distribution (without regard to either the form of benefits paid, or the form or amount of remaining payments under the prior distribution) is taken into account. Thus, for example, in determining the annual benefit attributable to a prior distribution of $100,000 per year over the past four years, paragraph (b)(2) of this section will apply if the distribution was part of a 10-year certain and life annuity, and paragraph (b)(3) of this section will apply if the distribution was part of installment payments over 10 years. However, in both instances, the amounts taken into account in determining the annual benefit attributable to the prior distribution are the four $100,000 payments already made, without regard to remaining payments.

(B) *Application of mortality adjustments*—(*1*) *Application of mortality adjustments when standardized assumptions are used*. Under the rules of paragraphs (b)(2)(ii), (b)(3)(i)(B), and (b)(3)(ii)(B) of this section (under which standardized actuarial assumptions are applied), a prior distribution is adjusted to an actuarially equivalent straight life annuity commencing at the current determination date using the specified interest and mortality assumptions to convert the payment stream to an actuarially equivalent straight life annuity commencing at the current determination date. For this purpose, the actuarially equivalent straight life annuity commencing at the current determination date must reflect an actuarial increase to the present value of payments to reflect that the participant has survived during the interim period.

(*2*) *Application of mortality adjustments when the plan's assumptions for computing offsets are used*. Under the rules of paragraphs (b)(2)(i), (b)(3)(i)(A), and (b)(3)(ii)(A) of this section (under which the plan's assumptions for computing offsets for prior distributions are applied), the actuarially equivalent straight life annuity must reflect mortality adjustment in the same manner as those mortality adjustments are reflected in computing offsets for prior distributions.

(2) *Prior distributions to which section 417(e)(3) did not apply*. For a prior distribution to which section 417(e)(3) did not apply, the actuarially equivalent straight life annuity commencing at the current determination date is the greater of—

(i) The annual amount of a straight life annuity commencing at the current determination date that is the actuarial equivalent of that prior distribution, computed using the interest rate and mortality table specified under the plan that provides for the current distribution or current accrual that are used to determine offsets, if any, for prior distributions; and

(ii) The annual amount of a straight life annuity commencing at the current determination date that is the actuarial equivalent of that prior distribution, computed using a 5% interest assumption and the applicable mortality table described in §1.417(e)–1(d)(2) that would apply to a distribution to which section 417(e) applies with an annuity starting date of the current determination date.

(3) *Prior distributions to which section 417(e)(3) applied*—(i) *In general*. For a prior distribution to which section 417(e)(3) applied, the actuarially equivalent straight life annuity commencing at the current determination date is the greater of—

(A) The annual amount of a straight life annuity commencing at the current determination date that is the actuarial equivalent of that prior distribution, computed using the interest rate and mortality table specified under the plan that provides for the current distribution or current accrual that are used to determine offsets, if any, for prior distributions; and

(B) The annual amount of a straight life annuity commencing at the current determination date that is the actuarial equivalent of that prior distribution, computed using the applicable interest rate under §1.417(e)–1(d)(3) and the applicable mortality table under §1.417(e)–1(d)(2) that would apply to a distribution with an annuity starting date of the current determination date.

(ii) *Special rule for 2004 and 2005*. For a prior distribution to which section 417(e)(3) applied, and for current determination dates or current accruals in 2004 and 2005, except as provided in section 101(d)(3) of the Pension Funding Equity Act of 2004, the actuarially equivalent straight life annuity commencing at the current determination date is the greater of—

(A) The annual amount of a straight life annuity commencing at the current determination date that is the actuarial equivalent of that prior distribution, computed using the interest rate and mortality table specified under the plan that provides for the current distribution or current accrual that are used to determine offsets, if any, for prior distributions; and

(B) The annual amount of a straight life annuity commencing at the current determination date that is the actuarial equivalent of that prior distribution, computed using a 5.5% interest assumption and the applicable mortality table under §1.417(e)–1(d)(2) that would apply to a distribution with an annuity starting date of the current determination date.

(4) *Benefit forms for which no adjustment is required*. The annual benefit attributable to prior distributions is computed disregarding the portion of prior distributions described in §1.415(b)–1(c)(4) (regarding benefits for which no adjustment is required). Thus, for example, the annual benefit attributable to prior distributions is computed disregarding the payment of preretirement disability benefits not in excess of the qualified disability benefit.

(c) *Change in distribution form*—(1) *In general*. If a stream of annuity payments is modified by a new distribution election, the requirements of this section are applied treating the modification as a new annuity starting date. In addition, in such a case, the requirements of paragraph (c)(2) of this section must be satisfied.

(2) *Test total annuity stream as of original annuity starting date*. If a stream of annuity payments is modified by a new distribution election, the payments under the annuity that are paid before the modification plus the modified payments must satisfy the requirements of §1.415(b)–1 determined as of the original annuity starting date, using the interest rates and mortality table applicable to such date. A plan will not fail to satisfy the requirements of this paragraph (c)(2) merely because payments reflect cost-of-living adjustments pursuant to section 415(d) determined in accordance with §1.415(d)–1(a)(5).

(d) *Examples*. The following examples illustrate the application of this section. For purposes of these examples, ex-

cept as otherwise stated, actuarial equivalence under the plan (including for purposes of determining offsets for prior distributions and for purposes of determining the amount of annuity distributions commencing after normal retirement age) is determined using a 6% interest assumption and the mortality table that applies under section 417(e)(3) as of January 1, 2003, and all payments other than a payment of a single sum are made monthly, on the first day of each calendar month. It is assumed for purposes of these examples that the interest rate that applies under section 417(e)(3) for relevant time periods is 5.25% and that the mortality table that applies under section 417(e)(3) for relevant time periods is the mortality table that applies under section 417(e)(3) as of January 1, 2003. In addition, it is assumed that all participants discussed in these examples have at least ten years of service with the employer and at least ten years of participation in the plan at issue, and that the dollar limitation of section 415(b)(1)(A) as adjusted pursuant to section 415(d) for 2008 is equal to $180,000. It is further assumed that the product of the annual adjustment factors that apply in adjusting the compensation limitation of section 415(b)(1)(B) for 2005, 2006, 2007, and 2008 is 1.1. The examples are as follows:

*Example 1*. (i) Employer A previously maintained Plan D, a qualified defined benefit plan. Upon the termination of Plan D on January 1, 1997, Participant M received a single-sum distribution of $537,055 at the age of 54. As of January 1, 2008, Participant M has participated in Plan E (another defined benefit plan maintained by Employer A) for more than 10 years. On January 1, 2008, M retires at the age of 65 and receives a distribution from Plan E.

(ii) Pursuant to section 415(f) and §1.415(f)–1, distributions to M from Plan D and Plan E are aggregated for purposes of applying section 415(b). Pursuant to paragraph (a)(3) of this section, M's annual benefit that is subject to the limits of section 415(b) and §1.415(b)–1(a) is equal to the sum of the annual benefit determined with respect to the distribution commencing on January 1, 2008, and the annual benefit attributable to prior distributions (computed pursuant to the rules of paragraph (b) of this section).

(iii) M's annual benefit attributable to prior distributions is computed by adjusting the single-sum distribution made in 1995 to an actuarially equivalent straight life annuity commencing on January 1, 2008, in accordance with the rules set forth in paragraph (b)(3) of this section. Pursuant to those rules, that actuarially equivalent straight life annuity is computed using either the plan's actuarial assumptions for applying offsets for prior distributions (here, a 6% interest rate and the mortality table that applies under section 417(e)(3) as of January 1, 2003), or the applicable interest rate and the applicable mortality table under section 417(e)(3), both determined as of January 1, 2008, whichever set of actuarial assumptions produces the greater actuarially equivalent annuity. The actuarially equivalent straight life annuity computed using the plan's assumptions used for computing offsets is $100,027 per year, and the actuarially equivalent straight life annuity computed using the applicable interest rate and the applicable mortality table as of January 1, 2008, is $87,035 per year. Thus, M's annual benefit attributable to prior distributions is $100,027.

(iv) To comply with the limitations of section 415, M's annual benefit determined with respect to the distribution commencing on January 1, 2008, must be no greater than the otherwise applicable limit on the annual benefit (*i.e.*, the lesser of $180,000 or 100% of M's average compensation for the period of the participant's high 3 years of service) minus $100,027. Thus, for example, to comply with the dollar limitation of section 415(b)(1)(A), M's annual benefit determined with respect to the distribution commencing on January 1, 2008, must be no greater than $79,973.

*Example 2*. (i) Employer B maintains Plan F, a qualified defined benefit plan. On January 1, 2002, at the age of 59, Participant N separated from service and commenced receiving a benefit of $80,000 per year for ten years from Plan F. As of January 1, 2008, Plan F is amended to increase N's accrued benefit. N is offered a new QJSA election with respect to the new accrual.

(ii) Pursuant to paragraph (a)(3) of this section, as of January 1, 2008, N's annual benefit that is subject to the limits of section 415(b) and §1.415(b)–1(a) is equal to the sum of the annual benefit determined with respect to remaining amounts payable under the distribution that commenced on January 1, 2002, the annual benefit determined with respect to the accrued benefit with respect to which distribution has not yet commenced, and the annual benefit attributable to prior distributions (computed pursuant to the rules of paragraph (b) of this section).

(iii) N's annual benefit determined with respect to the remaining four annual payments of $80,000 is determined pursuant to §1.415(b)–1(c)(3) as the greater of the annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence for the particular form of benefit payable, or the annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the applicable interest rate and the applicable mortality table under section 417(e)(3). Using the plan's factors for actuarial equivalence, the actuarially equivalent straight life annuity is $26,334, and using the section 417(e)(3) factors for actuarial equivalence, the actuarially equivalent straight life annuity is $25,109. Accordingly, N's annual benefit determined with respect to the remaining four annual payments of $80,000 is equal to $26,334.

(iv) N's annual benefit attributable to prior distributions is computed by adjusting the six annual payments of $80,000 per year already made before January 1, 2008, to an actuarially equivalent straight life annuity commencing on January 1, 2008, in accordance with the rules set forth in paragraph (b)(3) of this section. Pursuant to those rules, that actuarially equivalent straight life annuity is computed using either the plan's actuarial assumptions for applying offsets for prior distributions (here, a 6% interest rate and the mortality table that applies under section 417(e)(3) as of January 1, 2003), or the applicable interest rate and the applicable mortality table under section 417(e)(3), both determined as of January 1, 2008, whichever set of actuarial assumptions produces the greater actuarially equivalent annuity. The actuarially equivalent straight life annuity computed using the plan's assumptions used for computing offsets is $54,494 per year, and the actuarially equivalent straight life annuity computed using the applicable interest rate and the applicable mortality table as of January 1, 2006, is $50,103 per year. Thus, N's annual benefit attributable to prior distributions is $54,494.

(v) To comply with the limitations of section 415, N's annual benefit determined with respect to the accrued benefit with respect to which distribution has not yet commenced must be no greater than the otherwise applicable limit on the annual benefit (*i.e.*, the lesser of $180,000 or 100% of N's average compensation for period of N's high 3 years of service) minus $80,828 (the $26,334 annual benefit attributable to the remaining payments under the existing form of distribution, plus the $54,494 annual benefit attributable to prior distributions). Thus, for example, to comply with the dollar limitation of section 415(b)(1)(A), N's annual benefit determined with respect to the accrued benefit with respect to which distribution has not yet commenced must be no greater than $99,172.

*Example 3*. (i) The facts are the same as in *Example 2*, except that, instead of receiving a benefit of $80,000 per year for ten years from Plan F, N receives annual payments of $80,000 under a 10-year certain and life annuity from Plan F.

(ii) Pursuant to paragraph (a)(3) of this section, as of January 1, 2008, N's annual benefit that is subject to the limits of section 415(b) and §1.415(b)–1(a) is equal to the sum of the annual benefit determined with respect to remaining amounts payable under the distribution that commenced on January 1, 2002, the annual benefit determined with respect to the accrued benefit with respect to which distribution has not yet commenced, and the annual benefit attributable to prior distributions (computed pursuant to the rules of paragraph (b) of this section).

(iii) N's annual benefit determined with respect to the remaining portion of the existing annuity (*i.e.*, a four-year certain and life annuity) is determined pursuant to §1.415(b)–1(c)(2) as the greater of the annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence for the particular form of benefit payable, or the annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using an interest rate of 5% and the applicable mortality table under section 417(e)(3). Using the plan's factors for actuarial equivalence, the actuarially equivalent straight life annuity is $80,608, and using the statutory factors for actuarial equivalence, the actuarially equiva-

lent straight life annuity is $80,577. Accordingly, N's annual benefit determined with respect to the remaining 4-year certain and life annuity is equal to $80,608.

(iv) N's annual benefit attributable to prior distributions is computed by adjusting the six annual payments of $80,000 per year already made before January 1, 2008, to an actuarially equivalent straight life annuity commencing on January 1, 2008, in accordance with the rules set forth in paragraph (b)(3) of this section. Pursuant to those rules, that actuarially equivalent straight life annuity is computed using either the plan's actuarial assumptions for applying offsets for prior distributions (here, a 6% interest rate and the mortality table that applies under section 417(e)(3) as of January 1, 2003), or the applicable interest rate and the applicable mortality table under section 417(e)(3), both determined as of January 1, 2008, whichever set of actuarial assumptions produces the greater actuarially equivalent annuity. The actuarially equivalent straight life annuity computed using the plan's assumptions used for computing offsets is $54,494 per year, and the actuarially equivalent straight life annuity computed using the applicable interest rate and the applicable mortality table as of January 1, 2008, is $48,689 per year. Thus, N's annual benefit attributable to prior distributions is $54,494.

(v) To comply with the limitations of section 415, N's annual benefit determined with respect to the accrued benefit with respect to which distribution has not yet commenced must be no greater than the otherwise applicable limit on the annual benefit (*i.e.*, the lesser of $180,000 or 100% of N's average compensation for the highest 3 years) minus $135,102 (the $80,608 annual benefit attributable to the remaining payments under the existing form of distribution, plus the $54,494 annual benefit attributable to prior distributions). Thus, for example, to comply with the dollar limitation of section 415(b)(1)(A), N's annual benefit determined with respect to the accrued benefit with respect to which distribution has not yet commenced must be no greater than $44,898.

*Example 4*. (i) Participant P retired on January 1, 2004, at age 65, with average compensation for the period of P's high 3 years service of $190,000. P commenced receiving a straight life annuity of $165,000 from Plan E as of January 1, 2004. Plan E adjusts benefit payments to reflect increases in the applicable limitations of section 415(b) in accordance with the safe harbor methodology set forth in §1.415(d)–1(a)(5). As of January 1, 2005, pursuant to an adjustment under section 415(d) that applies to P's benefit payments under the terms of the plan, annual payments to P from Plan E are adjusted to $170,000, and as of January 1, 2007, pursuant to another such adjustment (under which the section 415(b)(1)(A) dollar limit is assumed to increase to $175,000 for 2007), annual payments to P from Plan E are adjusted to $175,000. On December 1, 2007, P elected to change the form of the remainder of the benefit payable to P under Plan E to a single-sum distribution payable as of January 1, 2008. P receives a single-sum distribution of $1,769,157 on January 1, 2008. It is assumed for purposes of this example that the section 417(e)(3) interest rate that applies to a distribution from Plan E as of January 1, 2004, is 5.25%, and that the section 417(e)(3) interest rate that applies to a distribution from Plan E as of January 1, 2008, is 6%. The normal form of benefit under Plan E is a straight life annuity. Plan E provides a QPSA to all married participants without charge. Plan E provides that, for purposes of adjusting the dollar limitation under section 415(b)(1)(A) for commencement before age 62 or after age 65, no adjustment is made to reflect the probability of a participant's death between the annuity starting date and the participant's attainment of age 62 or between the participant's attainment of age 65 and the annuity starting date. Under Plan E, benefits commencing after the age of 65 are actuarially adjusted to reflect the later commencement date using the plan's generally applicable assumptions for actuarial equivalence.

(ii) To comply with the limitations of section 415 for the 2008 limitation year, Plan E must satisfy two requirements. First, under paragraph (c)(1) of this section, Plan E must limit payments to P so that the sum of the annual benefit attributable to the currently commencing distribution plus the annual benefit attributable to prior distributions is within the limitations of section 415(b) that apply to a benefit commencing at the annuity starting date for the distribution that commences in 2008. Second, under paragraph (c)(2) of this section, the payments under the annuity that are paid before January 1, 2008, plus the single-sum distribution made on January 1, 2008, must satisfy the requirements of §1.415(b)–1 determined as of January 1, 2004, using the interest rates and mortality table applicable as of January 1, 2004. Pursuant to paragraph (c)(2) of this section, Plan E does not fail to satisfy this latter requirement if payments reflect cost-of-living adjustments pursuant to section 415(d) for payments no earlier than the time those adjustments are effective and in amounts no greater than amounts determined under §1.415(d)–1(a)(5).

(iii) To satisfy the second requirement described in paragraph (ii) of this *Example 4*, the payments under the annuity that are paid before January 1, 2008 (*i.e.*, $165,000 during 2004, $170,000 during 2005, $170,000 during 2006, and $175,000 during 2007), plus the single-sum distribution of $1,769,157 made on January 1, 2008, must satisfy the requirements of §1.415(b)–1 determined as of January 1, 2004, using the interest rates and mortality table applicable as of January 1, 2004. As of January 1, 2004, the actuarially equivalent straight life annuity with respect to those payments is $176,698 using the applicable interest rate (assumed to be 5.25%) and the applicable mortality table for that date. As of January 1, 2004, the actuarially equivalent straight life annuity with respect to those payments is $170,239 using the plan's actuarial assumptions (a 6% interest rate and the applicable mortality table as of January 1, 2003). The annual benefit attributable to those payments is the greater of the two amounts, or $176,698. This amount exceeds the applicable dollar limitation as of January 1, 2004 (*i.e.*, $165,000). Accordingly, without application of the special rule for cost-of-living adjustments, Plan E would fail to satisfy this second requirement.

(iv) Pursuant to the special rule for cost-of-living adjustments under paragraph (c)(2) of this section, Plan E does not fail to satisfy the second requirement described in paragraph (ii) of this *Example 4* if payments reflect cost-of-living adjustments pursuant to section 415(d) for payments no earlier than the time those adjustments are effective and in amounts no greater than amounts determined under §1.415(d)–1(a)(5). Accordingly, the payment stream that must satisfy the requirements of §1.415(b)–1 determined as of January 1, 2004, using the interest rates and mortality table applicable as of January 1, 2004, is the payment stream consisting of $165,000 paid each year during 2004 through 2007, and $1,621,727 ($1,769,157 multiplied by 165,000/180,000) paid on January 1, 2008. As of January 1, 2004, the actuarially equivalent straight life annuity with respect to those payments is $158,930 using the applicable interest rate (assumed to be 5.25%) and the applicable mortality table for that date. As of January 1, 2004, the actuarially equivalent straight life annuity with respect to those payments is $165,000 using the plan's actuarial assumptions (a 6% interest rate and the applicable mortality table as of January 1, 2003). The annual benefit attributable to those payments is the greater of the two amounts, or $165,000, which satisfies the applicable limitations as of January 1, 2004. Accordingly, Plan E satisfies the second requirement described in paragraph (ii) of this *Example 4* using the special rule for cost-of-living adjustments under paragraph (c)(2) of this section.

(v) For purposes of determining compliance with the first requirement described in paragraph (ii) of this *Example 4*, P's annual benefit attributable to prior distributions is computed by adjusting the annual payments already received ($165,000 for 2004, $170,000 for 2005, $170,000 for 2006, and $175,000 for 2007) already made before January 1, 2008, to an actuarially equivalent straight life annuity commencing on January 1, 2008, in accordance with the rules set forth in paragraph (b)(3) of this section. Pursuant to those rules, that actuarially equivalent straight life annuity is computed using either the plan's actuarial assumptions for applying offsets for prior distributions (here, a 6% interest rate and the mortality table that applies under section 417(e)(3) as of January 1, 2003), or an interest rate of 5% and the applicable mortality table under section 417(e)(3), both determined as of January 1, 2008, whichever set of actuarial assumptions produces the greater actuarially equivalent annuity. The actuarially equivalent straight life annuity computed using the plan's assumptions used for computing offsets is $80,453 per year, and the actuarially equivalent straight life annuity computed using a 5% interest rate and the applicable mortality table as of January 1, 2008, is $75,046 per year. Thus, P's annual benefit attributable to prior distributions is $80,453.

(vi) P's annual benefit attributable to the single-sum distribution made on January 1, 2008, is determined as the greater of the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the plan's actuarial factors), and the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the applicable interest rate and applicable mortality table). Based on the factors used in the plan to determine the actuarially equivalent lump sum (in this case, an interest rate of 6% and the applicable mortality table as of January 1, 2003), $1,769,157 payable as a single sum at age 69 is actuarially equivalent to an immediate straight life annuity at age 69 of $180,000. Based on the applicable interest rate and the applicable mortality table, $1,769,157 payable as a single sum at age 69 is actuarially equivalent to an immediate straight life annuity at age 69 of $170,451. With respect to the sin-

gle-sum distribution, P's annual benefit is equal to the greater of the two resulting amounts, or $180,000.

(vii) To satisfy the first requirement described in paragraph (ii) of this *Example 4*, P's annual benefit attributable to prior distributions plus P's annual benefit attributable to the single-sum distribution, determined as of January 1, 2008, must not exceed the applicable limitations. The sum of those annual benefits is $260,453. The age-adjusted dollar limitation as of January 1, 2008, is determined as the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 69 to the annuity that would be payable at age 65 based on the same accrued benefit (both determined before the application of section 415), or the straight life annuity payable at age 69 that is actuarially equivalent, using 5% interest and the applicable mortality table, to the straight life annuity payable at age 65. In this case, the age-adjusted section 415(b)(1)(A) dollar limit at age 69 is $244,013, which is the lesser of 265,320 (the straight life annuity at age 69 that is actuarially equivalent to an annuity of $180,000 commencing at age 65, determined using the plan's interest rate of 6% and the applicable mortality table that applies as of January 1, 2003, without a mortality decrement for the period between 65 and 69) and $244,013 (the straight life annuity at age 69 that is actuarially equivalent to an annuity of $180,000 commencing at age 65, determined using 5% interest and the applicable mortality table, without a mortality decrement for the period between 65 and 69)). The compensation-based limitation of section 415(b)(1)(B) for P in 2008 is $209,000 ($190,000 multiplied by the product of the annual adjustment factors for 2005 through 2008, or 1.1). Accordingly, the limitation under section 415(b) for P as of January 1, 2008, is $209,000 (the lesser of the dollar limitation and the compensation limitation as of that date).

(viii) Because the sum of P's annual benefit attributable to prior distributions plus P's annual benefit attributable to the single-sum distribution ($260,453) exceeds the limitation under section 415(b) determined as of January 1, 2008 ($209,000), the plan fails to satisfy the requirements of section 415(b). In addition, if the plan limits the amount of the single-sum distribution in order to satisfy the requirements of section 415(b) in this case, there may be a forfeiture of a participant's accrued benefit in violation of section 411(a) in some cases where a participant converts annuity payments to a single-sum distribution.

Par. 9. Section 1.415(c)–1 is added to read as follows:

*§1.415(c)–1 Limitations for defined contribution plans.*

(a) *General rules*—(1) *Maximum limitations*. Under section 415(c) and this section, to satisfy the provisions of section 415(a) for any limitation year, except as provided by paragraph (a)(3) of this section, the annual additions (as defined in paragraph (b) of this section) credited to the account of a participant in a defined contribution plan for the limitation year must not exceed the lesser of—

(i) $40,000 (adjusted pursuant to section 415(d) and §1.415(d)–1(b)); or

(ii) 100% of the participant's compensation (as defined in §1.415(c)–2) for the limitation year.

(2) *Defined contribution plan*—(i) *Definition*. For purposes of section 415 and regulations thereunder, a *defined contribution plan* means a defined contribution plan within the meaning of section 414(i) (including the portion of a plan treated as a defined contribution plan under the rules of section 414(k)) that is—

(A) A plan described in section 401(a) which includes a trust which is exempt from tax under section 501(a);

(B) An annuity plan described in section 403(a); or

(C) A simplified employee pension described in section 408(k).

(ii) *Additional plans treated as defined contribution plans*—(A) *In general*. Contributions to the types of arrangements described in paragraphs (a)(2)(ii)(B) through (D) of this section are treated as contributions to defined contribution plans for purposes of section 415 and regulations thereunder.

(B) *Employee contributions to a defined benefit plan*. Mandatory employee contributions to a defined benefit plan are treated as contributions to a defined contribution plan. For this purpose, contributions that are picked up by the employer as described in section 414(h)(2) are not considered employee contributions.

(C) *Individual medical accounts under section 401(h)*. Pursuant to section 415(l)(1), contributions allocated to any individual medical account which is part of a pension or annuity plan established pursuant to section 401(h) are treated as contributions to a defined contribution plan.

(D) *Post-retirement medical accounts for key employees*. Pursuant to section 419A(d)(2), amounts attributable to medical benefits allocated to an account established for a key employee (*i.e.*, any employee who, at any time during the plan year or any preceding plan year, is or was a key employee as defined in section 416(i)) pursuant to section 419A(d)(1) are treated as contributions to a defined contribution plan.

(iii) *Section 403(b) annuity contracts*. Annual additions under an annuity contract described in section 403(b) are treated as annual additions under a defined contribution plan for purposes of this section.

(3) *Alternative contribution limitations*—(i) *Church plans*. For alternative contribution limitations relating to church plans, see paragraph (d) of this section.

(ii) *Special rules for medical benefits*. For alternative contribution limitations relating to certain medical benefits, see paragraph (e) of this section.

(iii) *Employee stock ownership plans*. For additional rules relating to employee stock ownership plans, see paragraph (f) of this section.

(b) *Annual additions*—(1) *In general*—(i) *General definition*. The term *annual addition* means, for purposes of this section, the sum, credited to a participant's account for any limitation year, of—

(A) Employer contributions;

(B) Employee contributions; and

(C) Forfeitures.

(ii) *Certain excess amounts treated as annual additions*. Contributions do not fail to be annual additions merely because they are excess contributions (as described in section 401(k)(8)(B)) or excess aggregate contributions (as described in section 401(m)(6)(B)), or merely because excess contributions or excess aggregate contributions are corrected through distribution.

(iii) *Direct transfers between defined contribution plans*. The direct transfer of funds or employee contributions from one defined contribution plan to another defined contribution plan does not give rise to an annual addition.

(iv) *Reinvested ESOP dividends*. The reinvestment of dividends on employer securities under an employee stock ownership plan pursuant to section 404(k)(2)(A)(iii)(II) does not give rise to an annual addition.

(2) *Employer contributions*—(i) *Amounts treated as annual additions*. For purposes of paragraph (b)(1)(i)(A) of this section, the term *annual additions* includes employer contributions credited to the participant's account for the limitation year and other allocations described in paragraph (b)(4) of this section that are made during the limitation year. See paragraph (b)(6) of this section for timing rules applicable to annual additions with respect to employer contributions.

(ii) *Amounts not treated as annual additions*—(A) *Certain restorations of accrued*

*benefits*. The restoration of an employee's accrued benefits by the employer in accordance with section 411(a)(3)(D) or section 411(a)(7)(C) or resulting from the repayment of cashouts under a governmental plan (as described in section 415(k)(3)) is not considered an annual addition for the limitation year in which the restoration occurs. (See §1.411(a)–7(d)(6)(iii)(B).)

(B) *Catch-up contributions*. Catch-up contributions made in accordance with section 414(v) and §1.414(v)–1 do not give rise to annual additions.

(C) *Restorative payments*. A restorative payment that is allocated to a participant's account does not give rise to an annual addition for any limitation year. For this purpose, restorative payments are payments made to restore losses to a plan resulting from actions by a fiduciary for which there is reasonable risk of liability for breach of a fiduciary duty under Title I of ERISA, where plan participants who are similarly situated are treated similarly with respect to the payments. Generally, payments to a defined contribution plan are restorative payments only if the payments are made in order to restore some or all of the plan's losses due to an action (or a failure to act) that creates a reasonable risk of liability for such a breach of fiduciary duty (other than a breach of fiduciary duty arising from failure to remit contributions to the plan). This includes payments to a plan made pursuant to a Department of Labor order, the Department of Labor's Voluntary Fiduciary Correction Program, or a court-approved settlement, to restore losses to a qualified defined contribution plan on account of the breach of fiduciary duty (other than a breach of fiduciary duty arising from failure to remit contributions to the plan). However, payments made to a plan to make up for losses due merely to market fluctuations and other payments that are not made on account of a reasonable risk of liability for breach of a fiduciary duty under Title I of ERISA are contributions that give rise to annual additions and are not restorative payments.

(D) *Excess deferrals*. Excess deferrals that are distributed in accordance with §1.402(g)–1(e)(2) or (3) do not give rise to annual additions.

(3) *Employee contributions.* For purposes of paragraph (b)(1)(i)(B) of this section, the term *annual additions* includes mandatory employee contributions (as defined in section 411(c)(2)(C) and the regulations thereunder) as well as voluntary employee contributions. The term "annual additions" does not include—

(i) Rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)).

(ii) Repayments of loans made to a participant from the plan;

(iii) Repayments of amounts described in section 411(a)(7)(B) (in accordance with section 411(a)(7)(C)) and section 411(a)(3)(D) (see §1.411(a)–7(d)(6)(iii)(B)) or repayment of contributions to a governmental plan as described in section 415(k)(3); or

(iv) Employee contributions to a qualified cost of living arrangement within the meaning of section 415(k)(2)(B).

(4) *Transactions with plan*. The Commissioner may in an appropriate case, considering all of the facts and circumstances, treat transactions between the plan and the employer, transactions between the plan and the employee, or certain allocations to participants' accounts as giving rise to annual additions. Further, the Commissioner will treat a sale or exchange by the employee or the employer that transfers assets to a plan where the consideration paid by the plan is less than the fair market value of the assets transferred to the plan as giving rise to an annual addition in the amount of the difference between the value of the assets transferred and the consideration. A transaction described in this paragraph (b)(4) may constitute a prohibited transaction with the meaning of section 4975(c)(1).

(5) *Contributions other than cash*. For purposes of this paragraph (b), a contribution by the employer or employee of property rather than cash is considered to be a contribution in an amount equal to the fair market value of the property on the date the contribution is made. For this purpose, the fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. In addition, the contribution described in this paragraph (b)(5) may constitute a prohibited transaction within the meaning of section 4975(c)(1).

(6) *Timing rules*—(i) *In general*—(A) *Date of allocation*. For purposes of this paragraph (b), an annual addition is credited to the account of a participant for a particular limitation year if it is allocated to the participant's account under the terms of the plan as of any date within that limitation year. However, if the allocation is dependent upon participation in the plan as of any date subsequent to the date as of which it is allocated, it is considered allocated only at the end of the period of participation upon which the allocation is conditioned.

(B) *Date of employer contributions*. For purposes of this paragraph (b), employer contributions are not treated as credited to a participant's account for a particular limitation year unless the contributions are actually made to the plan no later than 30 days after the end of the period described in section 404(a)(6) applicable to the taxable year with or within which the particular limitation year ends. If, however, contributions are made by an employer exempt from Federal income tax (including a governmental employer), the contributions must be made to the plan no later than the 15th day of the tenth calendar month following the close of the taxable year with or within which the particular limitation year ends. If contributions are made to a plan after the end of the period during which contributions can be made and treated as credited to a participant's account for a particular limitation year, allocations attributable to those contributions are treated as credited to the participant's account for the limitation year during which those contributions are made.

(C) *Date of employee contributions*. For purposes of this paragraph (b), employee contributions, whether voluntary or mandatory, are not treated as credited to a participant's account for a particular limitation year unless the contributions are actually made to the plan no later than 30 days after the close of that limitation year.

(D) *Date for forfeitures*. A forfeiture is treated as an annual addition for the limitation year that contains the date as of which it is allocated to a participant's account as a forfeiture.

(E) *Treatment of elective contributions as plan assets*. The extent to which elective contributions constitute plan assets for purposes of the prohibited transaction provisions of section 4975 and Title I of the Employee Retirement Income Security

Act of 1974 (88 Stat. 829), Public Law 93–406 (ERISA), is determined in accordance with regulations and rulings issued by the Department of Labor. See 29 CFR 2510.3–102.

(ii) *Special timing rules*—(A) *Corrective contributions*. For purposes of this section, if, in a particular limitation year, an employer allocates an amount to a participant's account because of an erroneous forfeiture in a prior limitation year, or because of an erroneous failure to allocate amounts in a prior limitation year, the allocation will not be considered an annual addition with respect to the participant for that particular limitation year, but will be considered an annual addition for the prior limitation year to which it relates. An example of a situation in which an employer contribution might occur under the circumstances described in the preceding sentence is a retroactive crediting of service for an employee under 29 CFR 2530.200b–2(a)(3) in accordance with an award of back pay. For purposes of this paragraph (b)(6)(ii), if the amount so contributed in the particular limitation year takes into account actual investment gains attributable to the period subsequent to the year to which the contribution relates, the portion of the total contribution that consists of such gains is not considered as an annual addition for any limitation year.

(B) *Contributions for accumulated funding deficiencies and previously waived contributions*—(*1*) *Accumulated funding deficiency*. In the case of a defined contribution plan to which the rules of section 412 apply, a contribution made to reduce an accumulated funding deficiency will be treated as if it were timely made for purposes of determining the limitation year in which the annual additions arising from the contribution are made, but only if the contribution is allocated to those participants who would have received an annual addition if the contribution had been timely made.

(2) *Previously waived contributions*. In the case of a defined contribution plan to which the rules of section 412 apply and for which there has been a waiver of the minimum funding standard in a prior limitation year in accordance with section 412(d), that portion of an employer contribution in a subsequent limitation year which, if not for the waiver, would have otherwise been required in the prior limitation year under section 412(a) will be treated as if it were timely made (without regard to the funding waiver) for purposes of determining the limitation year in which the annual additions arising from the contribution are made, but only if the contribution is allocated to those participants who would have received an annual addition if the contribution had been timely made (without regard to the funding waiver).

(*3*) *Interest*. For purposes of determining the amount of the annual addition under paragraphs (b)(6)(ii)(B)(*1*) and (*2*), a reasonable amount of interest paid by the employer is disregarded. However, any interest paid by the employer that is in excess of a reasonable amount, as determined by the Commissioner, is taken into account as an annual addition for the limitation year during which the contribution is made.

(C) *Simplified employee pensions (SEPs)*. For purposes of this paragraph (b), amounts contributed to a simplified employee pension described in section 408(k) are treated as allocated to the individual's account as of the last day of the limitation year ending with or within the taxable year for which the contribution is made.

(D) *Treatment of certain contributions made pursuant to veterans' reemployment rights*. If, in a particular limitation year, an employer contributes an amount to an employee's account with respect to a prior limitation year and such contribution is required by reason of such employee's rights under chapter 43 of title 38, United States Code, resulting from qualified military service, as specified in section 414(u)(1), then such contribution is not considered an annual addition with respect to the employee for that particular limitation year in which the contribution is made, but, in accordance with section 414(u)(1)(B), is considered an annual addition for the limitation year to which the contribution relates.

(c) *Examples*. The following examples illustrate the rules of paragraphs (a) and (b) of this section:

*Example 1*. (i) P is a participant in a qualified profit-sharing plan maintained by his employer, ABC Corporation. The limitation year for the plan is the calendar year. P's compensation (as defined in §1.415(c)–2) for the current limitation year is $30,000.

(ii) Because the compensation limitation described in section 415(c)(1)(B) applicable to P for the current limitation year is lower than the dollar limitation described in section 415(c)(1)(A), the maximum annual addition which can be allocated to P's account for the current limitation year is $30,000 (100% of $30,000).

*Example 2*. (i) Assume the same facts as in *Example 1*, except that P's compensation for the current limitation year is $140,000.

(ii) The maximum amount of annual additions that may be allocated to P's account in the current limitation year is the lesser of $140,000 (100% of P's compensation) or the dollar limitation of section 415(c)(1)(A) as in effect as of January 1 of the calendar year in which the current limitation year ends. If, for example, the dollar limitation of section 415(c)(1)(A) in effect as of January 1 of the calendar year in which the current limitation year ends is $44,000, then the maximum annual addition that can be allocated to P's account for the current limitation year is $44,000.

*Example 3*. (i) Employer N maintains a qualified profit-sharing plan that uses the calendar year as its plan year and its limitation year. N's taxable year is a fiscal year beginning June 1 and ending May 31. Under the terms of the profit-sharing plan maintained by N, employer contributions are made to the plan two months after the close of N's taxable year and are allocated as of the last day of the plan year ending within the taxable year (and are not conditioned on future participation). Thus, employer contributions for the 2007 calendar year limitation year are made on July 31, 2008 (the date that is two months after the close of N's taxable year ending May 31, 2008) and are allocated as of December 31, 2007.

(ii) Because the employer contributions are actually made to the plan no later than 30 days after the end of the period described in section 404(a)(6) with respect to N's taxable year ending May 31, 2008, the contributions will be considered annual additions for the 2007 calendar year limitation year.

*Example 4*. (i) Assume the same facts as in *Example 3*, except that the plan year for the profit-sharing plan maintained by N is the 12-month period beginning on February 1 and ending on January 31. The limitation year continues to be the calendar year. Under the terms of the plan, an employer contribution which is made to the plan on July 31, 2008, is allocated to participants' accounts as of January 31, 2008.

(ii) Because the last day of the plan year is in the 2008 calendar year limitation year, and because, under the terms of the plan, employer contributions are allocated to participants' accounts as of the last day of the plan year, the contributions are considered annual additions for the 2008 calendar year limitation year.

*Example 5*. (i) XYZ Corporation maintains a profit-sharing plan to which a participant may make voluntary employee contributions for any year not to exceed 10% of the participant's compensation for the year. The plan permits a participant to make retroactive make-up contributions for any year for which the participant contributed less than 10% of compensation. XYZ uses the calendar year as the plan year and the limitation year. Under the terms of the plan, voluntary employee contributions are credited to a participant's account for a particular limitation year if such contributions are allocated to the participant's account as of any date within that limitation year. Participant A's compensation is as follows—

| Limitation year | Compensation |
|---|---|
| 2007 | $30,000 |
| 2008 | $32,000 |
| 2009 | $34,000 |
| 2010 | $36,000 |

(ii) Participant A makes no voluntary employee contributions during limitation years 2007, 2008, and 2009. On October 1, 2010, participant A makes a voluntary employee contribution of $13,200 (10% of A's aggregate compensation for limitation years 2007, 2008, 2009, and 2010 of $132,000). Under the terms of the plan, $3,000 of this 2010 contribution is allocated to A's account as of limitation year 2007; $3,200 is allocated to A's account of limitation year 2008; $3,400 is allocated to A's account as of limitation year 2009, and $3,600 is allocated to A's account as of limitation year 2010.

(iii) Under the rule set forth in paragraph (c)(6)(ii)(C) of this section, employee contributions will not be considered credited to a participant's account for a particular limitation year for section 415 purposes unless the contributions are actually made to the plan no later than 30 days after the close of that limitation year. Thus, A's voluntary employee contribution of $13,200 made on October 1, 2010, would be considered as credited to A's account only for the 2010 calendar year limitation year, notwithstanding the plan provisions.

(d) *Special rules relating to church plans*—(1) *Alternative contribution limitation*—(i) *In general*. Pursuant to section 415(c)(7)(A), notwithstanding the general rule of paragraph (a)(1) of this section, additions for a section 403(b) annuity contract for a year with respect to a participant who is an employee of a church or a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), when expressed as an annual addition to such participant's account, are treated as not exceeding the limitation of paragraph (a)(1) of this section if such annual additions for the year are not in excess of $10,000.

(ii) *$40,000 aggregate limitation*. The total amount of annual additions with respect to any participant that are treated as not exceeding the limitation of paragraph (a)(1) of this section (taking into account the rule of paragraph (d)(3) of this section) pursuant to the rule of paragraph (d)(1)(i) of this section even though those annual additions would otherwise exceed that limitation cannot exceed $40,000. Thus, the aggregate of amounts for all limitation years that would exceed the limitation of this section but for this paragraph (d)(1) is limited to $40,000.

(2) *Years of service taken into account for duly ordained, commissioned, or licensed ministers or lay employees*. For purposes of this paragraph (d)—

(i) All years of service by an individual as an employee of a church, or a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), are considered as years of service for one employer; and

(ii) All amounts contributed for annuity contracts by each such church (or convention or association of churches) during such years for the employee are considered to have been contributed by one employer.

(3) *Foreign missionaries*. Pursuant to section 415(c)(7)(C), in the case of any individual described in paragraph (d)(1) of this section performing any services for the church outside the United States during the limitation year, additions for an annuity contract under section 403(b) for any year are not treated as exceeding the limitation of paragraph (a)(1) of this section if such annual additions for the year do not exceed the greater of $3,000 or the employee's includible compensation with respect to services for the church performed outside the United States during the limitation year.

(4) *Church, convention or association of churches*. For purposes of this paragraph (d), the terms *church* and *convention or association of churches* have the same meaning as when used in section 414(e).

(5) *Examples*. The following examples illustrate the rules of this paragraph (d).

*Example 1*. (i) E is an employee of ABC Church earning $7,000 during each calendar year. E participates in a section 403(b) annuity contract maintained by ABC Church beginning in 2007. The limitation year for the plan coincides with the calendar year. ABC Church contributes $10,000 to be allocated to E's account under the plan for 2007.

(ii) Under paragraph (d)(1) of this section, this allocation is treated as not violating the limits established in paragraph (a)(1) of this section because it does not exceed $10,000. Moreover, since an annual addition of $10,000 would otherwise exceed the limitation of paragraph (a)(1) of this section by $3,000, $3,000 is counted toward the aggregate limitation specified in paragraph (d)(1)(ii) of this section for 2007. Accordingly, ABC Church may make such allocations for 13 years (*e.g.*, for 2007 through 2019) without exceeding the aggregate limitation of $40,000 specified in paragraph (d) of this section. For the fourteenth year, ABC Church could allocate only $8,000 to E's account (*i.e.*, the $7,000 limitation computed under paragraph (a)(1)(ii) of this section, plus the remaining $1,000 of the $40,000 aggregate limitation under paragraph (d)(1)(ii) of this section on annual additions in excess of the limits under paragraph (a)(1) of this section).

*Example 2*. (i) F is an employee of XYZ Church. F earns $2,000 during each calendar year for services he provides to XYZ Church, all of which are performed outside the United States during each calendar year. F participates in a section 403(b) annuity contract maintained by ABC Church beginning in 2007. The limitation year for the plan coincides with the calendar year. ABC Church contributes $10,000 to be allocated to F's account under the plan for 2007.

(ii) Under paragraph (d)(1) of this section, this allocation is treated as not violating the limits established in paragraph (a)(1) of this section because it does not exceed $10,000. Moreover, since an annual addition of $10,000 would otherwise exceed the limitation of paragraph (a)(1) of this section by $7,000 (*i.e.*, the excess of $10,000 over the greater of the $2,000 compensation limitation under section 415(c)(1)(B) or the $3,000 section 415(c)(7)(C) amount), XYZ Church may make such allocations for 5 years (*e.g.*, for 2006 through 2010) without exceeding the aggregate limitation of $40,000 specified in paragraph (d) of this section. In 2012, XYZ Church may contribute $8,000 to be allocated to F's account under the plan (*i.e.*, the $3,000 limitation computed under paragraph (d)(3) of this section, plus the remaining $5,000 of the $40,000 aggregate limitation under paragraph (d)(1)(ii) of this section on annual additions in excess of the limits under paragraph (a)(1) of this section). For years after 2012, pursuant to paragraph (d)(3) of this section, XYZ Church could allocate $3,000 per year to F's account.

(e) *Special rules for medical benefits*. The limit under paragraph (a)(1)(ii) of this section (*i.e.*, 100% of the participant's compensation for the limitation year) does not apply to—

(1) An individual medical account (as defined in section 415(l)); or

(2) A post-retirement medical benefits account for key employees (as defined in section 419A(d)(1)).

(f) *Special rules for employee stock ownership plans*—(1) *In general*. Special rules apply to employee stock ownership

plans, as provided in paragraphs (f)(2) through (f)(4) of this section.

(2) *Determination of annual additions for leveraged ESOP*—(i) *In general*. Except as provided in this paragraph (f), in the case of an employee stock ownership plan to which an exempt loan as described in §54.4975–7(b) has been made, the amount of employer contributions that is considered an annual addition for the limitation year is calculated with respect to employer contributions of both principal and interest used to repay that exempt loan for the limitation year.

(ii) *Employer stock that has decreased in value*. A plan may provide that, in lieu of computing annual additions in accordance with paragraph (f)(2)(i) of this section, annual additions with respect to a loan repayment described in paragraph (f)(2)(i) of this section are determined as the fair market value of shares released from the suspense account on account of the repayment and allocated to participants for the limitation year if that amount is less than the amount determined in accordance with paragraph (f)(2)(i) of this section.

(3) *Exclusions from annual additions for certain ESOPs that allocate to a broad range of participants*—(i) *General rule*. Pursuant to section 415(c)(6), in the case of an employee stock ownership plan (as described in section 4975(e)(7)) that meets the requirements of paragraph (f)(3)(ii) of this section for a limitation year, the limitations imposed by this section do not apply to—

(A) Forfeitures of employer securities (within the meaning of section 409(l)) under such an employee stock ownership plan if such securities were acquired with the proceeds of a loan (as described in section 404(a)(9)(A)); or

(B) Employer contributions to such an employee stock ownership plan which are deductible under section 404(a)(9)(B) and charged against the participant's account.

(ii) *Employee stock ownership plans to which the special exclusion applies*. An employee stock ownership plan meets the requirements of this paragraph (f)(3)(ii) for a limitation year if no more than one-third of the employer contributions for the limitation year that are deductible under section 404(a)(9) are allocated to highly compensated employees (within the meaning of section 414(q)).

(4) *Gratuitous transfers under section 664(g)(1)*. The amount of any qualified gratuitous transfer (as defined in section 664(g)(1)) allocated to a participant for any limitation year is not taken into account in determining whether any other annual addition exceeds the limitations imposed by this section, but only if the amount of the qualified gratuitous transfer does not exceed the limitations imposed by section 415.

Par. 10. Section 1.415(c)–2 is added to read as follows:

*§1.415(c)–2 Compensation.*

(a) *General definition*. Except as otherwise provided in this section, compensation from the employer within the meaning of section 415(c)(3), which is applied for purposes of section 415 and regulations thereunder, means all items of remuneration described in paragraph (b) of this section, but excludes the items of remuneration described in paragraph (c) of this section. Paragraph (d) of this section provides safe harbor definitions of compensation that are permitted to be provided in a plan in lieu of the generally applicable definition of compensation. Paragraph (e) of this section provides timing rules relating to compensation. Paragraph (f) of this section provides rules regarding the application of the rules of section 401(a)(17) to the definition of compensation for purposes of section 415. Paragraph (g) of this section provides special rules relating to the determination of compensation, including rules for determining compensation for a section 403(b) annuity contract, rules for determining the compensation of employees of controlled groups or affiliated service groups, rules for disabled employees, rules relating to foreign compensation, rules regarding deemed section 125 compensation, and rules for employees in qualified military service.

(b) *Items includible as compensation*. For purposes of applying the limitations of section 415, except as otherwise provided in this section, the term *compensation* means remuneration for services of the following types—

(1) The employee's wages, salaries, fees for professional services, and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the employer maintaining the plan, to the extent that the amounts are includible in gross income (or to the extent amounts deferred at the election of the employee would be includible in gross income but for the rules of section 402(e)(3), 402(h)(1)(B), 402(k), 125(a), 132(f)(4), or 457(b)). These amounts include, but are not limited to, commissions paid to salespersons, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, bonuses, fringe benefits, and reimbursements or other expense allowances under a nonaccountable plan as described in §1.62–2(c).

(2) In the case of an employee who is an employee within the meaning of section 401(c)(1) and the regulations thereunder, the employee's earned income (as described in section 401(c)(2) and the regulations thereunder), plus amounts deferred at the election of the employee that would be includible in gross income but for the rules of section 402(e)(3), 402(h)(1)(B), 402(k), or 457(b).

(3) Amounts described in section 104(a)(3), 105(a), or 105(h), but only to the extent that these amounts are includible in the gross income of the employee.

(4) Amounts paid or reimbursed by the employer for moving expenses incurred by an employee, but only to the extent that at the time of the payment it is reasonable to believe that these amounts are not deductible by the employee under section 217.

(5) The value of a nonqualified option granted to an employee by the employer, but only to the extent that the value of the option is includible in the gross income of the employee for the taxable year in which granted.

(6) The amount includible in the gross income of an employee upon making the election described in section 83(b).

(c) *Items not includible as compensation*. The term *compensation* does not include—

(1) Contributions (other than elective contributions described in section 402(e)(3), section 408(k)(6), section 408(p)(2)(A)(i), or section 457(b)) made by the employer to a plan of deferred compensation (including a simplified employee pension described in section 408(k) or a simple retirement account described in section 408(p), and whether or not qual-

ified) to the extent that the contributions are not includible in the gross income of the employee for the taxable year in which contributed. Additionally, any distributions from a plan of deferred compensation (whether or not qualified) are not considered as compensation for section 415 purposes, regardless of whether such amounts are includible in the gross income of the employee when distributed. However, if the plan so provides, any amounts received by an employee pursuant to an unfunded nonqualified plan are permitted to be considered as compensation for section 415 purposes in the year the amounts are actually received.

(2) Amounts realized from the exercise of a nonqualified option, or when restricted stock or other property held by an employee either becomes freely transferable or is no longer subject to a substantial risk of forfeiture (see section 83 and the regulations thereunder).

(3) Amounts realized from the sale, exchange, or other disposition of stock acquired under a qualified stock option.

(4) Other amounts that receive special tax benefits, such as premiums for group-term life insurance (but only to the extent that the premiums are not includible in the gross income of the employee and are not salary reduction amounts that are described in section 125).

(5) Other items of remuneration that are similar to any of the items listed in paragraphs (c)(1) through (c)(4) of this section.

(d) *Safe harbor rules with respect to plan's definition of compensation*—(1) *In general*. Paragraphs (d)(2) through (4) of this section contain safe harbor definitions of compensation that are automatically considered to satisfy section 415(c)(3) if specified in the plan. The Commissioner may, in revenue rulings, notices, and other guidance of general applicability published in the Internal Revenue Bulletin (see §601.601(d) of this chapter), provide additional definitions of compensation that are treated as satisfying section 415(c)(3).

(2) *Simplified compensation*. The safe harbor definition of compensation under this paragraph (d)(2) includes only those items specified in paragraph (b)(1) or (2) of this section and excludes all those items listed in paragraph (c) of this section.

(3) *Section 3401(a) wages*. The safe harbor definition of compensation under this paragraph (d)(3) includes wages within the meaning of section 3401(a) (for purposes of income tax withholding at the source), plus amounts deferred at the election of the employee that would be included in wages if not deferred pursuant to the rules of section 402(e)(3), 402(h)(1)(B), 402(k), or 457(b). However, any rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in section 3401(a)(2)) are disregarded for this purpose.

(4) *Information required to be reported under sections 6041, 6051 and 6052*. The safe harbor definition of compensation under this paragraph (d)(4) includes amounts that are compensation under the safe harbor definition of paragraph (d)(3) of this section, plus all other payments of compensation to an employee by his employer (in the course of the employer's trade or business) for which the employer is required to furnish the employee a written statement under sections 6041(d), 6051(a)(3), and 6052. See §§1.6041–1(a), 1.6041–2(a)(1), 1.6052–1, and 1.6052–2, and also see §31.6051–1(a)(1)(i)(C) of this chapter. This safe harbor definition of compensation may be modified to exclude amounts paid or reimbursed by the employer for moving expenses incurred by an employee, but only to the extent that, at the time of the payment, it is reasonable to believe that these amounts are deductible by the employee under section 217.

(e) *Timing rules*—(1) *In general*—(i) *Payment during the limitation year*. Except as otherwise provided in this paragraph (e), in order to be taken into account for a limitation year, compensation within the meaning of section 415(c)(3) must be actually paid or made available to an employee (or, if earlier, includible in the gross income of the employee) within the limitation year. For this purpose, compensation is treated as paid on a date if it is actually paid on that date or it would have been paid on that date but for an election under section 401(k), 403(b), 408(k), 408(p)(2)(A)(i), 457(b), 132(f), or 125.

(ii) *Payment prior to severance from employment*. In order to be taken into account for a limitation year, compensation within the meaning of section 415(c)(3) must be paid or treated as paid to the employee (in accordance with the rules of paragraph (e)(1)(i) of this section) prior to severance from employment (within the meaning of section 401(k)(2)(B)(i)(I)) with the employer maintaining the plan.

(2) *Certain de minimis timing differences*. Notwithstanding the provisions of paragraph (e)(1) of this section, a plan may provide that compensation for a limitation year includes amounts earned during that limitation year but not paid during that limitation year solely because of the timing of pay periods and pay dates if—

(i) These amounts are paid during the first few weeks of the next limitation year;

(ii) The amounts are included on a uniform and consistent basis with respect to all similarly situated employees; and

(iii) No compensation is included in more than one limitation year.

(3) *Compensation paid after severance from employment*—(i) *In general*. Any compensation described in paragraph (e)(3)(ii) of this section that is paid within 2½ months after an employee's severance from employment does not fail to be compensation (within the meaning of section 415(c)(3)) pursuant to the rule of paragraph (e)(1)(ii) of this section merely because it is paid after the employee's severance from employment.

(ii) *Certain payments made within 2½ months after severance from employment*. The following are types of post-severance payments that are not excluded from compensation because of timing if they are paid within 2½ months following severance from employment—

(A) Payments that, absent a severance from employment, would have been paid to the employee while the employee continued in employment with the employer and are regular compensation for services during the employee's regular working hours, compensation for services outside the employee's regular working hours (such as overtime or shift differential), commissions, bonuses, or other similar compensation; and

(B) Payments for accrued *bona fide* sick, vacation, or other leave, but only if the employee would have been able to use the leave if employment had continued.

(iii) *Other post-severance payments are not compensation*. Any payment that is not described in paragraph (e)(3)(ii) of this section is not considered compensation if paid after severance from employment, even if it is paid within 2½ months following severance from employment.

Thus, for example, compensation does not include amounts paid after severance from employment that are severance pay, unfunded nonqualified deferred compensation, or parachute payments within the meaning of section 280G(b)(2).

(4) *Certain military service*. The rule of paragraph (e)(1)(ii) of this section does not apply to payments to an individual who does not currently perform services for the employer by reason of qualified military service (as that term is used in section 414(u)(1)) to the extent those payments do not exceed the amounts the individual would have received if the individual had continued to perform services for the employer rather than entering qualified military service.

(f) *Interaction with section 401(a)(17)*. Because a plan may not base allocations (in the case of a defined contribution plan) or benefit accruals (in the case of a defined benefit plan) on compensation in excess of the limitation under section 401(a)(17), a plan's definition of compensation for a limitation year that is used for purposes of applying the limitations of section 415 is not permitted to reflect compensation for a plan year that is in excess of the limitation under section 401(a)(17) that applies to that plan year.

(g) *Special rules*—(1) *Compensation for section 403(b) annuity contract*. In the case of an annuity contract described in section 403(b), the term *participant's compensation* means the participant's includible compensation determined under section 403(b)(3) and §1.403(b)–2(a)(11). Accordingly, the rules for determining a participant's compensation pursuant to section 415(c)(3) (other than section 415(c)(3)(E)) and this section do not apply to a section 403(b) annuity contract.

(2) *Employees of controlled groups of corporations, etc*. In the case of an employee of two or more corporations which are members of a controlled group of corporations (as defined in section 414(b) as modified by section 415(h)), the term "compensation" for such employee includes compensation from all employers that are members of the group, regardless of whether the employee's particular employer has a qualified plan. This special rule is also applicable to an employee of two or more trades or businesses (whether or not incorporated) that are under common control (as defined in section 414(c) as modified by section 415(h)), to an employee of two or more members of an affiliated service group as defined in section 414(m), and to an employee of two or more members of any group of employers who must be aggregated and treated as one employer pursuant to section 414(o).

(3) *Aggregation of section 403(b) annuity with qualified plan of controlled employer*. If a section 403(b) annuity contract is combined or aggregated with a qualified plan of a controlled employer in accordance with §1.415(f)–1(f)(2), then, in applying the limitations of section 415(c) in connection with the combining of the section 403(b) annuity with a qualified plan, the total compensation from both employers is permitted to be taken into account.

(4) *Permanent and total disability of defined contribution plan participant*—(i) *In general*. Pursuant to section 415(c)(3)(C), if the conditions set forth in paragraph (g)(4)(ii) of this section are satisfied, then, in the case of a participant in any defined contribution plan who is permanently and totally disabled (as defined in section 22(e)(3)), the *participant's compensation* means the compensation the participant would have received for the year if the participant was paid at the rate of compensation paid immediately before becoming permanently and totally disabled, if such compensation is greater than the participant's compensation determined without regard to this paragraph (g)(4).

(ii) *Conditions for deemed disability compensation*. The rule of paragraph (g)(4)(i) of this section applies only if the following conditions are satisfied—

(A) Either the participant is not a highly compensated employee (as defined in section 414(q)) immediately before becoming disabled, or the plan provides for the continuation of contributions on behalf of all participants who are permanently and totally disabled for a fixed or determinable period;

(B) The plan provides that the rule of this paragraph (g)(4) (treating certain amounts as compensation for a disabled participant) applies with respect to the participant; and

(C) Contributions made with respect to amounts treated as compensation under this paragraph (g)(4) are nonforfeitable when made.

(5) *Foreign compensation*. Compensation described in paragraphs (b)(1) and (2) of this section includes foreign earned income (as defined in section 911(b)), whether or not excludable from gross income under section 911. Compensation described in paragraph (b)(1) of this section is to be determined without regard to the exclusions from gross income in sections 931 and 933. Similar principles are to be applied with respect to income subject to sections 931 and 933 in determining compensation described in paragraph (b)(2) of this section.

(6) *Deemed section 125 compensation*—(i) *General rule*. A plan is permitted to provide that deemed section 125 compensation (as defined in paragraph (g)(6)(ii) of this section) is compensation within the meaning of section 415(c)(3), provided that the plan applies this rule uniformly to all employees with respect to whom amounts subject to section 125 are included in compensation.

(ii) *Definition of deemed section 125 compensation*. Deemed section 125 compensation is an amount that is excludable from the income of the participant under section 106 that is not available to the participant in cash in lieu of group health coverage under a section 125 arrangement solely because that participant is not able to certify that the participant has other health coverage. Under this definition, amounts are deemed section 125 compensation only if the employer does not otherwise request or collect information regarding the participant's other health coverage as part of the enrollment process for the health plan.

(7) *Employees in qualified military service*. See section 414(u)(7) for special rules regarding compensation of employees who are in qualified military service within the meaning of section 414(u)(5).

Par. 11. Section 1.415(d)–1 is added to read as follows:

*§1.415(d)–1 Cost of living adjustments.*

(a) *Defined benefit plans*—(1) *Dollar limitation*—(i) *Determination of adjusted limit*. Under section 415(d)(1)(A), the dollar limitation described in section 415(b)(1)(A) applicable to defined benefit plans is adjusted annually to take into account increases in the cost of living. The adjustment of the dollar limitation is made by multiplying the adjustment factor for the year, as described in paragraph

(a)(1)(ii)(A) of this section, by $160,000, and rounding the result in accordance with paragraph (a)(1)(iii) of this section. The adjusted dollar limitation is prescribed by the Commissioner and published in the Internal Revenue Bulletin. See §601.601(d) of this chapter.

(ii) *Determination of adjustment factor*—(A) *Adjustment factor*. The adjustment factor for a calendar year is equal to a fraction, the numerator of which is the value of the applicable index for the calendar quarter ending September 30 of the preceding calendar year, and the denominator of which is the value of such index for the base period. The applicable index is determined consistent with the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act, Public Law 92–336 (86 Stat. 406), as amended. If, however, the value of that fraction is less than one for a calendar year, then the adjustment factor for the calendar year is equal to one.

(B) *Base period*. For the purpose of adjusting the dollar limitation pursuant to paragraph (a)(1)(ii)(A) of this section, the base period is the calendar quarter beginning July 1, 2001.

(iii) *Rounding*. Any increase in the $160,000 amount specified in section 415(b)(1)(A) which is not a multiple of $5,000 is rounded to the next lowest multiple of $5,000.

(2) *Average compensation for high 3 years of service limitation*—(i) *Determination of adjusted limit*. Under section 415(d)(1)(B), with regard to participants who have separated from service with a nonforfeitable right to an accrued benefit, the compensation limitation described in section 415(b)(1)(B) is adjusted annually to take into account increases in the cost of living. For any limitation year beginning after the separation occurs, the adjustment of the compensation limitation is made by multiplying the annual adjustment factor (as defined in paragraph (a)(2)(ii) of this section) by the compensation limitation applicable to the participant in the prior limitation year. The annual adjustment factor is prescribed by the Commissioner and published in the Internal Revenue Bulletin. See §601.601(d) of this chapter.

(ii) *Annual adjustment factor*. The annual adjustment factor for a calendar year is equal to a fraction, the numerator of which is the value of the applicable index for the calendar quarter ending September 30 of the preceding calendar year, and the denominator of which is the value of such index for the calendar quarter ending September 30 of the calendar year prior to that calendar year. The applicable index is determined consistent with the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act. If the value of the fraction described in the first sentence of this paragraph (a)(2)(ii) is less than one for a calendar year, then the adjustment factor for the calendar year is equal to one. In such a case, the annual adjustment factor for future calendar years will be determined in accordance with revenue rulings, notices, or other published guidance prescribed by the Commissioner and published in the Internal Revenue Bulletin. See §601.601(d) of this chapter.

(3) *Effective date of adjustment*. The adjusted dollar limitation applicable to defined benefit plans is effective as of January 1 of each calendar year and applies with respect to limitation years ending with or within that calendar year. Benefit payments and accrued benefits for a limitation year cannot exceed the currently applicable dollar limitation (as in effect before the January 1 adjustment) prior to January 1.

(4) *Application of adjusted figure*—(i) *In general*. If the dollar limitation of section 415(b)(1)(A) or the compensation limitation of section 415(b)(1)(B) is adjusted pursuant to section 415(d) for a limitation year, the adjustment is applied as provided in this paragraph (a)(4).

(ii) *Application of adjusted limitations to benefits that have not commenced*. An adjustment to the dollar limitation of section 415(b)(1)(A) applies to any distribution of accrued benefits that did not commence before the beginning of the limitation year for which the adjustment is effective. Annual adjustments to the compensation limit of section 415(b)(1)(B) as described in paragraph (a)(2) of this section are made for all limitation years that begin after the participant's severance from employment, and apply to distributions that commence after the effective dates of such adjustments. However, no adjustment to the compensation limit of section 415(b)(1)(B) is made for any limitation year that begins on or before the date of the participant's severance from employment with the employer maintaining the plan.

(iii) *Application of adjusted dollar limitation to benefits that have commenced*. With respect to a distribution of accrued benefits that commenced before the beginning of the limitation year, a plan is permitted to apply the adjusted limitations to that distribution, but only to the extent that benefits have not been paid. Thus, for example, a plan cannot provide that the adjusted dollar limitation applies to a participant who has previously received the entire plan benefit in a single-sum distribution. However, a plan can provide for an increase in benefits to a participant who accrues additional benefits under the plan that could have been accrued without regard to the adjustment of the dollar limitation (including benefits that accrue as a result of a plan amendment) on or after the effective date of the adjusted limitation.

(iv) *Manner of adjustment for benefits that have commenced*. If a plan adjusts benefits to reflect increases in the applicable limitations pursuant to section 415(d) for a limitation year after the limitation year during which payment of the benefit commenced using the safe harbor methodology described in paragraph (a)(5) of this section, the distribution will be treated as continuing to satisfy the requirements of section 415(b). If a plan adjusts benefits to reflect increases in the applicable limitations pursuant to section 415(d) for a limitation year after the limitation year during which payment of the benefit commenced in a manner other than the manner described in paragraph (a)(5) of this section, the plan must satisfy the requirements of §1.415(b)–2, treating the commencement of the additional benefit as the commencement of a new distribution that gives rise to a new annuity starting date.

(5) *Safe harbor for adjustments to benefit payments resulting from cost-of-living adjustments*. An adjustment to a distribution that is made on account of an increase to the applicable limits pursuant to section 415(d) is made using the safe harbor methodology of this paragraph (a)(5) if—

(i) The participant has received one or more distributions that satisfy the requirements of section 415(b) before the date the increase to the applicable limits is effective;

(ii) The adjusted distribution is solely as a result of the application of the increase to the applicable limits pursuant to section 415(d); and

(iii) The amount payable to the employee for the limitation year and subsequent limitation years is not greater than the amounts that would otherwise be payable without regard to the adjustment, multiplied by a fraction, the numerator of which is the limitation under section 415(b) (*i.e.*, the lesser of the applicable dollar limitation under section 415(b)(1)(A), as adjusted for age at commencement, and the applicable compensation-based limitation under section 415(b)(1)(B)) in effect for the distribution following the section 415(d) increase, and the denominator of which is such limitation under section 415(b) in effect for the distribution immediately before the increase.

(6) *Examples*. The following examples illustrate the application of this paragraph (a):

*Example 1*. (i) X is a participant in a qualified defined benefit plan maintained by X's employer. The plan has a calendar year limitation year. Under the terms of the plan, X is entitled to a benefit consisting of a straight life annuity equal to 100% of X's average compensation for the period of X's high 3 years of service, adjusted as of January 1 of each calendar year for increases in the consumer price index. The plan provides that the annual increases in both the dollar limit of section 415(b)(1)(A) and the compensation limit under section 415(b)(1)(B) pursuant to section 415(d) apply to participants who have commenced receiving benefits under the plan at the earliest time at which that increase is permitted to become effective. X's average compensation for X's high 3 years is $50,000. X separates from the service of his employer on October 3, 2006, at age 65 with a nonforfeitable right to the accrued benefit after more than 10 years of service with the employer and more than 10 years of participation in the plan. X begins to receive annual benefit payments (payable monthly) of $50,000, commencing on November 1, 2006. It is assumed for purposes of this *Example 1* that the dollar limitation for 2006 (as adjusted pursuant to section 415(d)) is $170,000, that the dollar limitation for 2007 (as adjusted pursuant to section 415(d)) is $175,000, and that the annual adjustment factor for adjusting the limitation of section 415(b)(1)(B) for 2007 is 1.0220.

(ii) For the limitation year beginning January 1, 2007, the dollar limit applicable to X under section 415(b)(1)(A) is $175,000, and the compensation limit applicable to X under section 415(b)(1)(B) is $51,100 ($50,000 multiplied by the annual adjustment factor of 1.0220). Accordingly, the adjustment to X's benefit satisfies the safe harbor for cost-of-living adjustments under paragraph (a)(5) of this section if, after the adjustment, X's benefit payable in 2007 is no greater than $50,000 multiplied by $51,100 (X's section 415(b) limitation for 2006)/$50,000 (X's section 415(b) limitation for 2007).

*Example 2*. (i) The facts are the same as in *Example 1* except that X's average compensation for the period of X's high 3 consecutive years of service is $200,000. Consequently, X's annual benefit payments commencing on November 1, 2006, are limited to $170,000.

(ii) For the limitation year beginning January 1, 2007, the dollar limit applicable to X under section 415(b)(1)(A) is $175,000, and the compensation limit applicable to X under section 415(b)(1)(B) is $204,400 ($200,000 multiplied by the annual adjustment factor of 1.0220). Accordingly, the adjustment to X's benefit satisfies the safe harbor for cost-of-living adjustments under paragraph (a)(5) of this section if, after the adjustment, X's benefit payable in 2007 is no greater than $170,000 multiplied by $175,000 (X's section 415(b) limitation for 2006)/$170,000 (X's section 415(b) limitation for 2007).

(b) *Defined contribution plans*—(1) *In general*. Under section 415(d)(1)(C), the dollar limitation described in section 415(c)(1)(A) is adjusted annually to take into account increases in the cost of living. The adjusted dollar limitation is prescribed by the Commissioner and published in the Internal Revenue Bulletin. See §601.601(d) of this chapter.

(2) *Determination of adjusted limit*—(i) *Base period*. The base period taken into account for purposes of adjusting the dollar limitation pursuant to paragraph (b)(2)(ii) of this section is the calendar quarter beginning July 1, 2001.

(ii) *Method of adjustment*—(A) *In general*. The dollar limitation is adjusted with respect to a calendar year based on the increase in the applicable index for the calendar quarter ending September 30 of the preceding calendar year over such index for the base period. Adjustment procedures similar to the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act will be used.

(B) *Rounding*. Any increase in the $40,000 amount specified in section 415(c)(1)(A) which is not a multiple of $1,000 shall be rounded to the next lowest multiple of $1,000.

(iii) *Effective date of adjustment*. The adjusted dollar limitation applicable to defined contribution plans is effective as of January 1 of each calendar year and applies with respect to limitation years ending with or within that calendar year. Annual additions for a limitation year cannot exceed the currently applicable dollar limitation (as in effect before the January 1 adjustment) prior to January 1. However, after a January 1 adjustment is made, annual additions for the entire limitation year are permitted to reflect the dollar limitation as adjusted on January 1.

(c) *Application of rounding rules to other cost-of-living adjustments*. Pursuant to section 415(d)(4)(A), the $5,000 rounding methodology of paragraph (a)(1)(iii) of this section is used for purposes of any provision of chapter 1 of subtitle A of the Internal Revenue Code that provides for adjustments in accordance with section 415(d), except to the extent provided by that provision. Thus, the $5,000 rounding methodology of paragraph (a)(1)(iii) of this section is used for purposes of—

(1) Determining the level of compensation specified in section 414(q)(1)(B) that is used to determine whether an employee is a highly compensated employee;

(2) Calculating the amounts used pursuant to section 409(o)(1)(C) to determine the maximum period over which distributions from an employee stock ownership plan may be made without participant consent; and

(3) Determining the levels of compensation specified in §1.61–21(f)(5)(i) and (iii) used in determining whether an employee is a control employee of a nongovernmental employer for purposes of the commuting valuation rule of §1.61–21(f).

(d) *Implementation of cost-of-living adjustments*. A plan is permitted to be amended to reflect any of the adjustments described in this section at any time after those limitations become applicable. Alternatively, a plan is permitted to incorporate any of the adjustments described in this section by reference in accordance with the rules of §1.415(a)–1(d)(3)(v). Because the accrued benefit of a participant can reflect increases in the applicable limitations only after those increases become effective, a pattern of repeated plan amendments increasing annual benefits to reflect the increases in the section 415(b) limitations pursuant to section 415(d) does not result in any protection under section 411(d)(6) for future increases to reflect increases in the section 415(b) limitations pursuant to §1.411(d)–4, Q&A–1(c)(1). Thus, a plan does not violate the requirements of section 411(d)(6) merely because the plan has been amended annually for a number of years to increase annual benefits to reflect the increases in the section

415(b) limitations pursuant to section 415(d) and subsequently is not amended to reflect later increases in the section 415(b) limitations.

Par. 12. Section 1.415(f)–1 is added to read as follows:

*§1.415(f)–1 Combining and aggregating plans.*

(a) *In general*. Under section 415(f) and this section, except as provided in paragraph (g) of this section (regarding multiemployer plans), for purposes of applying the limitations of section 415(b) and (c) applicable to a participant for a particular limitation year—

(1) All defined benefit plans (without regard to whether a plan has been terminated) ever maintained by the employer (or a predecessor employer within the meaning of paragraph (c) of this section) under which the participant has ever accrued a benefit are treated as one defined benefit plan,

(2) All defined contribution plans (without regard to whether a plan has been terminated) ever maintained by the employer (or a predecessor employer within the meaning of paragraph (c) of this section) under which the participant receives annual additions are treated as one defined contribution plan; and

(3) All section 403(b) annuity contracts purchased by an employer (including plans purchased through salary reduction contributions) for the participant are treated as one section 403(b) annuity contract.

(b) *Affiliated employers, affiliated service groups, and leased employees*. See §1.415(a)–1(f)(1) and (2) for rules regarding aggregation of employers in the case of affiliated employers and affiliated service groups. See §1.415(a)–1(f)(3) for rules regarding the treatment of leased employees.

(c) *Predecessor employer*. For purposes of section 415 and the regulations thereunder, a former employer is a predecessor employer with respect to a participant in a plan maintained by an employer if the employer maintains a plan under which the participant had accrued a benefit while performing services for the former employer, but only if that benefit is provided under the plan maintained by the employer. In addition, with respect to an employer of a participant, a former entity that antedates the employer is a predecessor employer with respect to the participant if, under the facts and circumstances, the employer constitutes a continuation of all or a portion of the trade or business of the former entity. This will occur, for example, where formation of the employer constitutes a mere formal or technical change in the employment relationship and continuity otherwise exists in the substance and administration of the business operations of the former entity and the employer.

(d) *Annual compensation taken into account where employer maintains more than one defined benefit plan*—(1) *Determination of high 3 years of compensation*. If two or more defined benefit plans are aggregated under section 415(f) and this section for a particular limitation year, in applying the defined benefit compensation limitation (as described in section 415(b)(1)(B)) to the annual benefit of a participant under the aggregated plans, the participant's average compensation for the participant's high 3 years of service is determined in accordance with §1.415(c)–2(g)(2), and includes compensation for all years in which the participant was an active participant in any of the aggregated plans.

(2) *Requirement of independent satisfaction of compensation limit*. If two or more defined benefit plans are aggregated under section 415(f) and this section for a particular limitation year, then, pursuant to section 415(f)(1)(B), each such plan must also satisfy the compensation limit of section 415(b)(1)(B) on a separate basis, determining each participant's average compensation for the participant's high 3 years of service using only compensation with respect to periods of active participation in that separate plan.

(e) *Years of participation and service taken into account where employer maintains more than one defined benefit plan at different times*—(1) *Determination of years of participation*. If two or more defined benefit plans are aggregated under section 415(f) and this section for a particular limitation year, in applying the reduction for participation of less than ten years (as described in section 415(b)(5)(A)) to the dollar limitation under section 415(b)(1)(A), time periods that are counted as years of participation under any of the plans are counted in computing the limitation of the combined plans under this section.

(2) *Determination of years of service*. If two or more defined benefit plans are aggregated under section 415(f) and this section for a particular limitation year, in applying the reduction for service of less than ten years (as described in section 415(b)(5)(B)) to the compensation limitation under section 415(b)(1)(B), time periods that are counted as years of service under any of the plans are counted in computing the limitation of the combined plans under this section.

(f) *Previously unaggregated plans*—(1) *In general*. This paragraph (f) provides rules for those situations in which two or more existing plans, which previously were not required to be aggregated pursuant to section 415(f) and this section, are aggregated during a particular limitation year and, as a result, the limitations of section 415(b) or (c) are exceeded for that limitation year. Paragraph (f)(2) of this section provides rules for defined contribution plans that are first required to be aggregated pursuant to section 415(f) and this section in a plan year. Paragraph (f)(3) of this section provides rules for defined benefit plans that are first required to be aggregated pursuant to section 415(f) and this section, and for defined benefit plans under which a participant's benefit is frozen following aggregation.

(2) *Defined contribution plans*. Two or more defined contribution plans that are not required to be aggregated pursuant to section 415(f) and this section as of the first day of a limitation year do not fail to satisfy the requirements of section 415 with respect to a participant for the limitation year merely because they are aggregated later in that limitation year, provided that no annual additions are credited to the participant's account after the date on which the plans are required to be aggregated.

(3) *Defined benefit plans*—(i) *First year of aggregation*. Two or more defined benefit plans that are not required to be aggregated pursuant to section 415(f) and this section as of the first day of a limitation year do not fail to satisfy the requirements of section 415 for the limitation year merely because they are aggregated later in that limitation year, provided that no plan amendments increasing benefits with respect to the participant under either plan

are made after the occurrence of the event causing the plan to be aggregated.

(ii) *All years of aggregation in which accrued benefits are frozen*. Two or more defined benefit plans that are required to be aggregated pursuant to section 415(f) and this section during a limitation year subsequent to the limitation year during which the plans were first aggregated do not fail to satisfy the requirements of section 415 with respect to a participant for the limitation year merely because they are aggregated if there have been no increases in the participant's accrued benefit derived from employer contributions (including increases as a result of increased compensation or service) under any of the plans within the period during which the plans have been aggregated.

(g) *Section 403(b) annuity contracts*—(1) *In general*. In the case of a section 403(b) annuity contract, except as provided in paragraph (g)(2) of this section, the participant on whose behalf the annuity contract is purchased is considered for purposes of section 415 to have exclusive control of the annuity contract. Accordingly, except as provided in paragraph (g)(2) of this section, the participant, and not the participant's employer who purchased the section 403(b) annuity contract, is deemed to maintain the annuity contract, and such a section 403(b) annuity contract is not aggregated with a qualified plan that is maintained by the participant's employer.

(2) *Special rules under which the employer is deemed to maintain the annuity contract*—(i) *In general*. Where a participant on whose behalf a section 403(b) annuity contract is purchased is in control of any employer for a limitation year as defined in paragraph (g)(2)(ii) of this section (regardless of whether the employer controlled by the participant is the employer maintaining the section 403(b) annuity contract), the annuity contract for the benefit of the participant is treated as a defined contribution plan maintained by both the controlled employer and the participant for that limitation year. Accordingly, where a participant on whose behalf a section 403(b) annuity contract is purchased is in control of any employer for a limitation year, the section 403(b) annuity contract is aggregated with all other defined contribution plans maintained by that employer. In addition, in such a case, the section 403(b) annuity contract is aggregated with all other defined contribution plans maintained by the employee or any other employer that is controlled by the employee. Thus, for example, if a doctor is employed by a non-profit hospital to which section 501(c)(3) applies and which provides him with a section 403(b) annuity contract, and the doctor also maintains a private practice as a shareholder owning more than 50% of a professional corporation, then any qualified defined contribution plan of the professional corporation must be combined with the section 403(b) annuity contract for purposes of applying the limitations of section 415(c) and §1.415(c)–1. For purposes of this paragraph (g)(2), it is immaterial whether the section 403(b) annuity contract is purchased as a result of a salary reduction agreement between the employer and the participant.

(ii) *Definition of control*. For purposes of paragraph (g)(2)(i) of this section, a participant is in control of an employer for a limitation year if, pursuant to paragraph (b) of this section, a plan maintained by that employer would have to be aggregated with a plan maintained by an employer that is 100% owned by the participant. Thus, for example, if a participant owns 60% of the common stock of a corporation, the participant is considered to be in control of that employer for purposes of applying paragraph (g)(2)(i) of this section.

(3) *Aggregation of section 403(b) annuity with qualified plan of controlled employer*. If a section 403(b) annuity contract is combined or aggregated with a qualified plan of a controlled employer in accordance with paragraph (g)(2) of this section, the plans must satisfy the limitations of section 415(c) both separately and in combination. In applying separately the limitations of section 415 to the qualified plan and to the section 403(b) annuity, compensation from the controlled employer may not be aggregated with compensation from the employer purchasing the section 403(b) annuity (*i.e.*, without regard to §1.415(c)–2(g)(3)).

(h) *Multiemployer plans*—(1) *Multiemployer plan combined with another multiemployer plan*. Pursuant to section 415(f)(3)(B), multiemployer plans, as defined in section 414(f), are not aggregated with other multiemployer plans for purposes of applying the limits of section 415.

(2) *Multiemployer plan combined with other plan*—(i) *Aggregation only for benefits provided by the employer*. Notwithstanding the rule of §1.415(a)–1(e), a multiemployer plan is permitted to provide that only the benefits under that multiemployer plan that are provided by an employer are aggregated with benefits under plans maintained by that employer that are not multiemployer plans. If the multiemployer plan so provides then, where an employer maintains both a plan which is not a multiemployer plan and a multiemployer plan, only the benefits under the multiemployer plan that are provided by the employer are aggregated with benefits under the employer's plans other than multiemployer plans (in lieu of including benefits provided by all employers under the multiemployer plan pursuant to the generally applicable rule of §1.415(a)–1(e)).

(ii) *Nonapplication of aggregation for purposes of applying section 415(b)(1)(B) compensation limit*. Pursuant to section 415(f)(3)(A), a multiemployer plan is not combined or aggregated with any other plan that is not a multiemployer plan for purposes of applying the compensation limit of section 415(b)(1)(B) and §1.415(b)–1(a)(1)(ii).

(i) [Reserved.]

(j) *Special rules for combining certain plans, etc*. If a plan, annuity contract or arrangement is subject to a special limitation in addition to, or instead of, the regular limitations described in section 415(b) or (c), and is combined under this section with a plan which is subject only to the regular section 415(b) or (c) limitations, the following rules apply—

(1) Each plan, annuity contract or arrangement which is subject to a special limitation must meet its own applicable limitation and each plan subject to the regular limitations of section 415 must meet its applicable limitation.

(2) The combined limitation is the larger of the applicable limitations.

(k) *Examples*. The following examples illustrate the rules of this section:

*Example 1*. (i) M is an employee of ABC Corporation and XYZ Corporation. ABC maintains a qualified defined benefit plan and a qualified defined contribution plan in which M participates and XYZ maintains a qualified defined benefit plan and a qualified defined contribution plan in which M participates. ABC Corporation owns 60% of XYZ Corporation.

(ii) ABC Corporation and XYZ Corporation are members of a controlled group of corporations within the meaning of section 414(b) as modified by section 415(h). Because ABC Corporation and XYZ Corporation are members of a controlled group of corporations within the meaning of section 414(b) as modified by section 415(h), M is treated as being employed by a single employer.

(iii) The sum of M's annual benefit under the defined benefit plan maintained by ABC and M's annual benefit under the defined benefit plan maintained by XYZ is not permitted to exceed the limitations of section 415(b) and §1.415(b)–1; and the sum of the annual additions to M's account under the defined contribution plans maintained by ABC and XYZ may not exceed the limitations of section 415(c) and §1.415–(c)–1. For purposes of satisfying the requirements of section 415 on this aggregated basis, M's compensation from both ABC and XYZ is taken into account and years of service and participation under either defined benefit plan are used.

(iv) M's annual benefit under the defined benefit plan maintained by ABC and M's annual benefit under the defined benefit plan maintained by XYZ also must be within the limitations of section 415(b) and §1.415(b)–1, determined without regard to the aggregation of employers (*i.e.*, by taking into account only compensation and years of service and participation for the respective employers).

*Example 2*. (i) N is employed by a hospital which purchases an annuity contract described in section 403(b) on N's behalf for the current limitation year. N is in control of the hospital within the meaning of section 414(b) or (c), as modified by section 415(h). The hospital also maintains a qualified defined contribution plan during the current limitation year in which N participates.

(ii) Under section 415(k)(4), the hospital, as well as N, is considered to maintain the annuity contract. Accordingly, the sum of the annual additions under the qualified defined contribution plan and the annuity contract must satisfy the limitations of section 415(c) and §1.415(c)–1.

*Example 3*. (i) The facts are the same as in *Example 2*, except that instead of being in control of the hospital, N is the 100% owner of a professional corporation P, which maintains a qualified defined contribution plan in which N participates.

(ii) Under section 415(k)(4), the hospital, as well as N, is considered to maintain the annuity contract. Accordingly, the sum of the annual additions under the qualified defined contribution plan maintained by professional corporation P and the annuity contract must satisfy the limitations of section 415(c) and §1.415(c)–1. See §1.415(g)–1(c)(2) for an example of the treatment of a contribution to an annuity contract that exceeds the limits of section 415(c) by reason of the aggregation required by this section.

*Example 4*. (i) J is an employee of two corporations, N and M, each of which has employed J for more than 10 years. N and M are not required to be aggregated pursuant to section 415(f) and this section. Each corporation has a qualified defined benefit plan in which J has participated for more than 10 years. Each plan provides a benefit which is equal to 75% of a participant's average compensation for his high 3 years of service and is payable in the form of a straight life annuity beginning at age 65. J's average compensation (within the meaning of §1.415(c)–2) for his high three years of service from each corporation is $160,000. Each plan uses the calendar year for the limitation and plan year. In July 2007, N Corporation becomes a wholly owned subsidiary of M Corporation.

(ii) As a result of the acquisition of N Corporation by M Corporation, J is treated as being employed by a single employer under section 414(b). Therefore, because section 415(f)(1)(A) requires that all defined benefit plans of an employer be treated as one defined benefit plan, the two plans must be aggregated for purposes of applying the limitations of section 415. However, under paragraph (f)(3)(i) of this section, since the plans were not aggregated as of the first day of the 2007 limitation year (January 1, 2007), they will not be considered aggregated until the limitation year beginning January 1, 2008.)

(iii) As a result of such aggregation, J becomes entitled to a combined benefit which is equal to $240,000, which is in excess of the section 415(b) dollar limitation for 2005 of $170,000. However, under paragraph (f)(3)(ii) of this section, the limitations of section 415(b) and §1.415(b)–1 applicable to J may be exceeded in this situation without plan disqualification so long as J's accrued benefit derived from employer contributions is not increased (*i.e.*, does not increase on account of increased compensation, service, or other accruals) during the period within which the limitations are being exceeded.

*Example 5*. (i) A, age 30, owns all of the stock of X Corporation and also owns 10% of the stock of Z Corporation. F, A's father, directly owns 75% of the stock of Z Corporation. Both corporations have qualified defined contribution plans in which A participates and both plans use the calendar year for the limitation and plan year. A's compensation (within the meaning of §1.415(c)–2) for 2007 is $20,000 from Z Corporation and $150,000 from X Corporation. During the period January 1, 2007 through June 30, 2007, annual additions of $20,000 are credited to A's account under the plan of Z Corporation, while annual additions of $40,000 are credited to A's account under the plan of X Corporation. In both instances, the amount of annual additions represent the maximum allowable under section 415(c) and §1.415(c)–1. On July 15, 2007, F dies, and A inherits all of F's stock in Z in 2007.

(ii) As of July 15th 2007, A is considered to be in control of X and Z Corporations, and the two plans must be aggregated for purposes of applying the limitations of section 415. However, even though A's total annual additions for 2007 are $60,000, the limitations of section 415(c) and §1.415(c)–1 are not violated for 2007, provided no annual additions are credited to A's accounts after July 15, 2007 (the date that A is first in control of Z).

*Example 6*. (i) P is a key employee of employer XYZ who participates in a qualified defined contribution plan with (Plan X) a calendar year limitation year. P is also provided post-retirement medical benefits, and XYZ has taken into account a reserve for those benefits under section 419A(c)(2). In 2007, P's compensation is $30,000 and P's annual additions under Plan X are $5,000. Pursuant to section 419A(d), a separate account is maintained for P and that account is credited with an allocation of $32,000 for 2007.

(ii) Under paragraph (j)(1) of this section, Plan X and the individual medical account must separately satisfy the requirements of section 415(c), taking into account any special limit applicable to that arrangement. In this case, the contributions to Plan X separately satisfy the limitations of section 415(c). The individual medical account is not subject to the 100% of compensation limit of section 415(c), so the contributions to that account satisfy the limitations of section 415(c).

(iii) The sum of the annual additions under Plan X and the amounts contributed to the separate account on P's behalf must satisfy the requirements of section 415(c). Under paragraph (j)(2) of this section, the limit applicable to the combined plan is equal to the greater of the limits applicable to the separate plan. In this case, the limit applicable to the medical account is $40,000 (which is greater than the limit of $30,000 applicable to the qualified plan), so the limit that applies to the aggregated plan is $40,000 and the aggregated plans satisfy the requirements of section 415.

Par. 13. Section 1.415(g)–1 is added to read as follows:

*§1.415(g)–1 Disqualification of plans and trusts*.

(a) *Disqualification of plans*—(1) *In general*. Under section 415(g) and this section, with respect to a particular limitation year, a plan (and the trust forming part of the plan) is disqualified in accordance with the rules provided in paragraph (b) of this section, if the conditions described in paragraph (a)(2) or (a)(3) of this section apply. For purposes of this paragraph (a), the determination of whether a plan or a combination of plans exceeds the limitations imposed by section 415 for a particular limitation year is, except as otherwise provided, made by taking into account the aggregation of plan rules provided in sections 415(f) and §1.414(f)–1.

(2) *Defined contribution plans*. A plan is disqualified in accordance with the rules provided in paragraph (b) of this section if annual additions (as defined in §1.415(c)–1(b)) with respect to the account of any participant in a defined contribution plan maintained by the employer exceed the limitations of section 415(c) and §1.415(c)–1.

(3) *Defined benefit plans*. A plan is disqualified in accordance with the rules provided in paragraph (b) of this section if the annual benefit (as defined in §1.415(b)–1(b)(1), taking into account the rules of §1.415(b)–2) of a participant in a defined benefit plan maintained by the employer exceeds the limitations of section 415(b) and §1.415(b)–1.

(b) *Rules for disqualification of plans and trusts*—(1) *In general*. If any plan (in-

cluding a trust which forms part of such plan) is disqualified for a particular limitation year under the rules set forth in this paragraph (b), then the disqualification is effective as of the first day of the first plan year containing any portion of the particular limitation year.

(2) *Single plan*. In the case of a single qualified defined benefit plan (determined without regard to section 415(f) and §1.415(f)–1) maintained by the employer that provides an annual benefit (as defined in §1.415(b)–1(b)(1), taking into account the rules of §1.415(b)–2) in excess of the limitations of section 415(b) and §1.415(b)–1 for any particular limitation year, such plan is disqualified in that limitation year. Similarly, if the employer only maintains a single defined contribution plan (determined without regard to section 415(f) and §1.415(f)–1) under which annual additions (as defined in §1.415(c)–1(b)) allocated to the account of any participant exceed the limitations of section 415(c) and §1.415(c)–1 for any particular limitation year, such plan is also disqualified in that limitation year.

(3) *Multiple plans*—(i) *In general*. If the limitations of section 415(b) and §1.415(b)–1 (taking into account the rules of §1.415(b)–2), or section 415(c) and §1.415(c)–1 are exceeded for a particular limitation year with respect to any participant solely because of the application of the aggregation rules of section 415(f)(1) and §1.415(f)–1 or section 414(b) or (c), as modified by section 415(h), then one or more of the plans is disqualified in accordance with the ordering rules set forth in paragraphs (b)(3)(ii) of this section, applied in accordance with the rules of application set forth in paragraph (b)(3)(iii) of this section, subject to the special rules set forth in paragraph (b)(3)(iv) of this section, until, without regard to annual benefits or annual additions under the disqualified plan or plans, the remaining plans satisfy the applicable limitations of section 415.

(ii) *Ordering rules*—(A) *Disqualification of ongoing plans other than multiemployer plans*. If there are two or more plans that have not been terminated at any time including the last day of the particular limitation year, and if one or more of those plans is a multiemployer plan described in section 414(f), then one or more of the plans (as needed to satisfy the limitations of section 415) that has not been terminated and is not a multiemployer plan is disqualified in that limitation year. For purposes of the preceding sentence, the determination of whether a plan is a multiemployer plan described in section 414(f) is made as of the last day of the particular limitation year.

(B) *Disqualification of ongoing multiemployer plans*. If, after the application of paragraph (b)(3)(ii)(A) of this section, there are two or more plans and one or more of the plans has been terminated at any time including the last day of the particular limitation year, then one or more of the plans (as needed to satisfy the applicable limitations of section 415) that has not been so terminated (regardless of whether the plan is a multiemployer plan described in section 414(f)) is disqualified in that limitation year.

(iii) *Rules of application*—(A) *Employer elects which plan is disqualified*. If there are two or more plans of an employer within a group of plans one or more of which is to be disqualified pursuant to paragraph (b)(3)(ii)(A) or (B) of this section, then the employer may elect, in a manner determined by the Commissioner, which plan or plans are disqualified. If those two or more plans are involved because of the application of section 414(b) or (c), as modified by section 415(h), the employers of the controlled group may elect, in a manner determined by the Commissioner, which plan or plans are disqualified. However, the election described in the preceding sentence is not effective unless made by all of the employers within the controlled group.

(B) *Commissioner determines which plan is disqualified*. If the election described in paragraph (b)(3)(iii)(A) of this section is not made with respect to the two plans described in paragraph (b)(3)(iii)(A) of this section, then the Commissioner, taking into account all of the facts and circumstances, has the discretion to determine the plan that is disqualified in the particular limitation year. In making this determination, some of the factors that will be taken into account include, but are not limited to, the number of participants in each plan, the amount of benefits provided on an overall basis by each plan, and the extent to which benefits are distributed or retained in each plan.

(iv) *Special rules*—(A) *Simplified employee pensions (SEPs)*. If there are two or more plans one or more of which is to be disqualified pursuant to paragraph (b)(3)(ii)(A) or (B) of this section, and if one of the plans is a simplified employee pension (as defined in section 408(k)), then the simplified employee pension is not disqualified until all of the other plans have been disqualified. However, if one of the plans has been terminated, then the simplified employee pension is disqualified before the terminated plan. For purposes of this paragraph (b)(3)(iv)(A), the disqualification of a simplified employee pension means that the simplified employee pension is no longer described under section 408(k).

(B) *Combining medical accounts with defined contribution plans*. In the event that combining a medical account described in §1.415(c)–1(a)(2)(ii)(C) or (D) and a defined contribution plan other than such a medical account causes the limitations of section 415(c) and §1.415(c)–1 applicable to a participant to be exceeded for a particular limitation year, the defined contribution plan other than the medical account is disqualified for the limitation year.

(C) *Combining section 403(b) annuity contract and qualified defined contribution plan—(1) In general*. In the event that combining a section 403(b) annuity contract and a qualified defined contribution plan under the provisions of section 415(f)(1)(B) causes the limitations of section 415(c) and §1.415(c)–1 applicable to a participant under the combined defined contribution plans to be exceeded for a particular limitation year, the excess of the contributions to the annuity contract plus the annual additions to the plan over such limitations is treated as a disqualified contribution to the annuity contract and therefore includable in the gross income of the participant for the taxable year with or within which that limitation year ends. See §1.415(a)–1(b)(2) and §1.403(b)–3(b)(2) for rules regarding the treatment of a contribution to a section 403(b) annuity contract that exceeds the limitations of section 415.

(*2*) *Example*. The following example illustrates the application of this paragraph (b)(3)(iv)(C). It is assumed for purposes of this example that the dollar limitation under section 415(c)(1)(A) that applies for all

relevant limitation years is $42,000. The example is as follows:

*Example*. (i) N is employed by a hospital which purchases an annuity contract described in section 403(b) on N's behalf for the current limitation year. N is also the 100% owner of a professional corporation P that maintains a qualified defined contribution plan during the current limitation year in which N participates. (The facts of this example are the same as in *Example 3* of §1.415(f)–1(k)). N's compensation (within the meaning of §1.415(c)–2) from the hospital for the current limitation year is $150,000. For the current limitation year, the hospital contributes $30,000 for the section 403(b) annuity contract on N's behalf, which is within the limitations applicable to N under the annuity contract (*i.e.*, $42,000)). Professional corporation P also contributes $30,000 to the qualified defined contribution plan on N's behalf for the current limitation year (which represents the only annual additions allocated to N's account under the plan for such year), which is within the $42,000 limitation of section 415(c)(1) applicable to N under the plan.

(ii) Under section 415(k)(4), the hospital, as well as N, is considered to maintain the annuity contract. Accordingly, the sum of the annual additions under the qualified defined contribution plan maintained by professional corporation P and the annuity contract must satisfy the limitations of section 415(c) and §1.415(c)–1.

(iii) Because the total combined contributions ($60,000) exceed the section 415(c) limitation applicable to N under the plan ($42,000), under the special rules contained in this paragraph (b)(3)(iv)(C), $20,000 of the $30,000 contributed to the section 403(b) annuity contract is considered a disqualified contribution and therefore currently includable in N's gross income. The contract continues to be a section 403(b) annuity contract only if, for the current limitation year and all years thereafter, the issuer of the contract maintains separate accounts for each portion attributable to such disqualified contributions. See §§1.415(a)–1(b)(2) and 1.403(b)–3(c)(3).

(c) *Plan year for certain annuity contracts and individual retirement plans*. For purposes of this section, unless the plan under which the annuity contract or individual retirement plan is provided specifies that a different twelve-month period is considered to be the plan year—

(1) An annuity contract described in section 403(b) is considered to have a plan year coinciding with the taxable year of the individual on whose behalf the contract has been purchased; and

(2) A simplified employee pension described in section 408(k) is considered to have a plan year coinciding with the year under the plan that is used pursuant to section 408(k)(7)(C).

Par. 14. Section 1.415(j)–1 is added to read as follows:

*§1.415(j)–1 Limitation year.*

(a) *In general*. Unless the terms of a plan provide otherwise, the limitation year, with respect to any qualified plan maintained by the employer, is the calendar year.

(b) *Alternative limitation year election*. The terms of a plan may provide for the use of any other consecutive twelve month period as the limitation year. This includes a fiscal year with an annual period varying from 52 to 53 weeks, so long as the fiscal year satisfies the requirements of section 441(f). A plan may only provide for one limitation year regardless of the number or identity of the employers maintaining the plan.

(c) *Multiple limitation years*—(1) *In general*. Where an employer maintains more than one qualified plan, those plans may provide for different limitation years. The rule described in this paragraph (c) also applies to a controlled group of employers (within the meaning of section 414(b) or (c), as modified by section 415(h)). If the plans of an employer (or a controlled group of employers whose plans are aggregated) have different limitation years, section 415 is applied in accordance with the rule of paragraphs (c)(2) and (3) of this section.

(2) *Testing rule for defined contribution plans*. If a participant is credited with annual additions in only one defined contribution plan, in determining whether the requirements of section 415(c) are satisfied, only the limitation year applicable to that plan is considered. However, if a participant is credited with annual additions in more than one defined contribution plan, each such plan satisfies the requirements of section 415(c) only if the limitations of section 415(c) are satisfied with respect to amounts that are annual additions for the limitation year with respect to the participant under the plan, plus amounts credited to the participant's account under all other plans required to be aggregated with the plan pursuant to section 415(f) and §1.415(f)–1 that would have been considered annual additions for the limitation year under the plan if they had been credited under the plan rather than an aggregated plan.

(3) *Testing rule for defined benefit plans*. If a participant accrues a benefit or receives a distribution under only one defined benefit plan, in determining whether the requirements of section 415(b) are satisfied, only the limitation year applicable to that plan is considered. However, if a participant accrues a benefit or receives a distribution under more than one defined benefit plan, a plan satisfies the requirements of section 415(b) only if the annual benefit under all plans required to be aggregated pursuant to section 415(f) and §1.415(f)–1 for the limitation year of that plan with respect to the participant satisfy the applicable limitations of section 415(b). Thus, for example, the dollar limitation of section 415(b)(1)(A) applicable to the limitation year for each plan must be applied to annual benefits under all aggregated plans to determine whether the plan satisfies the requirements of section 415(b).

(d) *Change of limitation year*—(1) *In general*. Once established, the limitation year may be changed only by amending the plan. Any change in the limitation year must be a change to a twelve-month period commencing with any day within the current limitation year. For purposes of this section, the limitations of section 415 are to be applied in the normal manner to the new limitation year.

(2) *Application to short limitation period*. Where there is a change of limitation year, the limitations of section 415 are to be separately applied to a "limitation period" which begins with the first day of the current limitation year and which ends on the day before the first day of the first limitation year for which the change is effective. In the case of a defined contribution plan, the dollar limitation with respect to this limitation period is determined by multiplying the applicable dollar limitation for the calendar year in which the limitation period ends by a fraction, the numerator of which is the number of months (including any fractional parts of a month) in the limitation period, and the denominator of which is 12.

(e) *Limitation year for individuals on whose behalf section 403(b) annuity contracts have been purchased.* The limitation year of an individual on whose behalf a section 403(b) annuity contract has been purchased by an employer is determined in the following manner.

(1) If the individual is not in control (within the meaning of §1.415(f)–1(g)(2)(ii)) of any employer,

the limitation year is the calendar year. However, the individual may elect to change the limitation year to another twelve-month period. To do this, the individual must attach a statement to his or her income tax return filed for the taxable year in which the change is made. Any change in the limitation year must comply with the rules set forth in paragraph (d) of this section.

(2) If the individual is in control (within the meaning of §1.415(f)–1(g)(2)(ii)) of an employer, the limitation year is to be the limitation year of that employer.

(f) *Limitation year for individuals on whose behalf individual retirement plans are maintained*. The limitation year of an individual on whose behalf an individual retirement plan (within the meaning of section 7701(a)(37)) is maintained shall be determined in the manner described in paragraph (e) of this section.

(g) *Examples*. The following examples illustrate the application of this section:

*Example 1*. (i) Participant M is employed by both Employer A and Employer B, each of which maintains a qualified defined contribution plan. M participates in both of these plans. The limitation year for Employer A's plan is January 1 through December 31, and the limitation year for Employer B's plan is April 1 through March 31. Employer A and Employer B are both corporations, and Corporation X owns 100% of the stock of Employer A and Employer B.

(ii) The two plans in which M participates are required under section 415(f) to be aggregated for purposes of applying the limitations of section 415(c) to annual additions made with respect to M. Thus, for example, for the limitation year of Employer A's plan that begins January 1, 2008, annual additions with respect to M that are subject to the limitations of section 415(c) include both amounts that are annual additions with respect to M under Employer A's plan for the period beginning January 1, 2008, and ending December 31, 2008, and amounts contributed to Employer B's plan with respect to M that would have been considered annual additions for the period beginning January 1, 2008, and ending December 31, 2008, under Employer A's plan if those amounts had instead been contributed to Employer A's plan.

*Example 2*. In 2007, an employer with a qualified defined contribution plan using the calendar year as the limitation year elects to change the limitation year to a period beginning July 1 and ending June 30. Because of this change, the plan must satisfy the limitations of section 415(c) for the limitation period beginning January 1, 2007, and ending June 30, 2007. In applying the limitations of section 415(c) to this limitation period, the amount of compensation taken into account may only include compensation for this period. Furthermore, the dollar limitation for this period is the otherwise applicable dollar limitation for calendar year 2007, multiplied by 6/12.

Par. 15. Section 1.457–4 is amended by revising paragraph (d) to read as follows:

*§1.457–4 Annual deferrals, deferral limitations, and deferral agreement under eligible plans.*

* * * * *

(d) *Deferrals after severance from employment, including sick, vacation, and back pay under an eligible plan*—(1) *In general*. An eligible plan may provide that a participant who has not had a severance from employment may elect to defer accumulated sick pay, accumulated vacation pay, and back pay under an eligible plan if the requirements of section 457(b) are satisfied. For example, the plan must provide, in accordance with paragraph (b) of this section, that these amounts may be deferred for any calendar month only if an agreement providing for the deferral is entered into before the beginning of the month in which the amounts would otherwise be paid or made available and the participant is an employee on the date the amounts would otherwise be paid or made available. For purposes of section 457, compensation that would otherwise be paid for a payroll period that begins before severance from employment is treated as an amount that would otherwise be paid or made available before an employee has a severance from employment. In addition, deferrals may be made for former employees with respect to compensation described in §1.415(c)–2(e)(3)(ii) (relating to certain compensation paid within 2½ months following severance from employment), compensation described in §1.415(c)–2(g)(4) (relating to compensation paid to participants who are permanently and totally disabled), and compensation relating to qualified military service under section 414(u).

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

*Example 1*. (i) *Facts*. Participant G, who is age 62 in 2006, is an employee who participates in an eligible plan providing a normal retirement age of 65 and a *bona fide* sick leave and vacation pay program of the eligible employer. Under the terms of G's employer's eligible plan and the sick leave and vacation pay program, G is permitted make a one-time election to contribute amounts representing accumulated sick pay to the eligible plan. G has a severance from employment on January 12, 2007, at which time G's accumulated sick and vacation pay that is payable on March 15, 2007, total $12,000. G elects, on February 4, 2007, to have the $12,000 of accumulated sick and vacation pay contributed to the eligible plan.

(ii) *Conclusion*. Under the terms of the eligible plan and the sick and vacation pay program, G may elect before March 1, 2007, to defer the accumulated sick and vacation pay because the agreement providing for the deferral is entered into before the beginning of the month in which the amount is currently available and the amount is *bona fide* accumulated sick and vacation pay that would otherwise be payable within 2½ months after G has a severance from employment, as described in §1.415(c)–2(e)(3)(ii). Thus, under this section and §1.415(c)–2(e)(3)(ii), the $12,000 is included in G's includible compensation for purposes of determining G's includible compensation in 2007.

*Example 2*. (i) *Facts*. Same facts as in *Example 1*, except that G's severance from employment is on December 1, 2006, G's $12,000 of accumulated sick and vacation pay is payable on February 15, 2007 (which is within 2½ months after G's severance from employment), and G's election to defer the accumulated sick and vacation pay is made before February 1, 2007.

(ii) Conclusion. Under this section and §1.415(c)–2(e)(3)(ii), the $12,000 is included in G's includible compensation for purposes of determining G's includible compensation in 2007.

*Example 3*. (i) *Facts*. Employer X maintains an eligible plan and a vacation leave plan. Under the terms of the vacation leave plan, employees generally accrue three weeks of vacation per year. Up to one week's unused vacation may be carried over from one year to the next, so that in any single year an employee may have a maximum of four weeks vacation time. At the beginning of each calendar year, under the terms of the eligible plan (which constitutes an agreement providing for the deferral), the value of any unused vacation time from the prior year in excess of one week is automatically contributed to the eligible plan, to the extent of the employee's maximum deferral limitations. Amounts in excess of the maximum deferral limitations are forfeited.

(ii) *Conclusion*. The value of the unused vacation pay contributed to X's eligible plan pursuant to the terms of the plan and the terms of the vacation leave plan is treated as an annual deferral to the eligible plan for January of the calendar year. No amounts contributed to the eligible plan will be considered made available to a participant in X's eligible plan.

* * * * *

Par. 16. Section 1.457–5 is amended by revising *Example 2* of paragraph (d) to read as follows:

*§1.457–5 Individual limitation for combined annual deferrals under multiple eligible plans.*

* * * * *

(d) *Examples*. * * *

*Example (2)*. (i) *Facts*. Participant E, who will turn 63 on April 1, 2006, participates in four eligible plans during 2006, Plan W which is an eligible governmental plan; and Plans X, Y, and Z which are each eligible plans of three different tax-exempt entities. For 2006, the limitation that applies to Participant E under all four plans under §1.457–4(c)(1)(i)(A) is $15,000. For 2006, the additional age 50 catch-up limitation that applies to Participant E under Plan W under §1.457–4(c)(2) is $5,000. Further, for

2006, different limitations under §1.457–4(c)(3) and (c)(3)(ii)(B) apply to Participant E under each of these plans, as follows: under Plan W, the underutilized limitation under §1.457–4(c)(3)(ii)(B) is $7,000; under Plan X, the underutilized limitation under §1.457–4(c)(3)(ii)(B) is $2,000; under Plan Y, the underutilized limitation under §1.457–4(c)(3)(ii)(B) is $8,000; and under Plan Z, §1.457–4(c)(3) is not applicable since normal retirement age is age 62 under Plan Z. Participant E's includible compensation is in each case in excess of any applicable deferral.

(ii) *Conclusion*. For purposes of applying this section to Participant E for 2006, Participant E could elect to defer $23,000 under Plan Y, which is the maximum deferral limitation under §1.457–4(c)(1) through (3), and to defer no amount under Plans W, X, and Z. The $23,000 maximum amount is equal to the sum of $15,000 plus $8,000, which is the catch-up amount applicable to Participant E under Plan Y and which is the largest catch-up amount applicable to Participant E under any of the four plans for 2006. Alternatively, Participant E could instead elect to defer the following combination of amounts: an aggregate total of $15,000 to Plans X, Y, and Z, if no contribution is made to Plan W; an aggregate total of $20,000 to any of the four plans, assuming at least $5,000 is contributed to Plan W; or $22,000 to Plan W and none to any of the other three plans.

(iii) If the underutilized amount under Plans W, X, and Y for 2006 were in each case zero (because E had always contributed the maximum amount or E was a new participant) or an amount not in excess of $5,000, the maximum exclusion under this section would be $20,000 for Participant E for 2006 ($15,000 plus the $5,000 age 50 catch-up amount), which Participant E could contribute to any of the plans assuming at least $5,000 is contributed to Plan W.

Par. 17. Section 1.457–6 is amended by revising paragraphs (a) and (c) to read as follows:

*§1.457–6 Timing of distributions under eligible plans.*

(a) *In general*. Except as provided in paragraph (c) of this section (relating to distributions on account of an unforeseeable emergency), paragraph (e) of this section (relating to distributions of small accounts), §1.457–10(a) (relating to plan terminations), or §1.457–10(c) (relating to domestic relations orders), amounts deferred under an eligible plan may not be paid to a participant or beneficiary before the participant has a severance from employment with the eligible employer or when the participant attains age 70½, if earlier. For rules relating to loans, see paragraph (f) of this section. This section does not apply to distributions of excess amounts under §1.457–4(e). However, except to the extent set forth by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin, this section applies to amounts held in a separate account for eligible rollover distributions maintained by an eligible governmental plan as described in §1.457–10(e)(2).

* * * * *

(c) *Rules applicable to distributions for unforeseeable emergencies*—(1) *In general*. An eligible plan may permit a distribution to a participant or beneficiary faced with an unforeseeable emergency. The distribution must satisfy the requirements of paragraph (c)(2) of this section.

(2) *Requirements*—(i) *Unforeseeable emergency defined*. An unforeseeable emergency must be defined in the plan as a severe financial hardship of the participant or beneficiary resulting from an illness or accident of the participant or beneficiary, the participant's or beneficiary's spouse, or the participant's or beneficiary's dependent (as defined in section 152, and, for taxable years beginning on or after January 1, 2005, without regard to section 152(b)(1), (b)(2), and (d)(1)(B)); loss of the participant's or beneficiary's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, *e.g.*, as a result of a natural disaster); or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary. For example, the imminent foreclosure of or eviction from the participant's or beneficiary's primary residence may constitute an unforeseeable emergency. In addition, the need to pay for medical expenses, including non-refundable deductibles, as well as for the cost of prescription drug medication, may constitute an unforeseeable emergency. Finally, the need to pay for the funeral expenses of a spouse or a dependent (as defined in section 152, and, for taxable years beginning on or after January 1, 2005, without regard to section 152(b)(1), (b)(2), and (d)(1)(B)) may also constitute an unforeseeable emergency. Except as otherwise specifically provided in this paragraph (c)(2)(i), the purchase of a home and the payment of college tuition are not unforeseeable emergencies under this paragraph (c)(2)(i).

(ii) *Unforeseeable emergency distribution standard*. Whether a participant or beneficiary is faced with an unforeseeable emergency permitting a distribution under this paragraph (c) is to be determined based on the relevant facts and circumstances of each case, but, in any case, a distribution on account of unforeseeable emergency may not be made to the extent that such emergency is or may be relieved through reimbursement or compensation from insurance or otherwise, by liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or by cessation of deferrals under the plan.

(iii) *Distribution necessary to satisfy emergency need*. Distributions because of an unforeseeable emergency must be limited to the amount reasonably necessary to satisfy the emergency need (which may include any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution).

* * * * *

Par. 18. Section 1.457–10 is amended by revising paragraph (b)(8) to read as follows:

*§1.457–10 Miscellaneous provisions.*

* * * * *

(b) *Plan-to-plan transfers*. * * *

(8) *Purchase of permissive service credit by plan-to-plan transfers from an eligible governmental plan to a qualified plan*—(i) *General rule*. An eligible governmental plan of a State may provide for the transfer of amounts deferred by a participant or beneficiary to a defined benefit governmental plan (as defined in section 414(d)), and no amount shall be includible in gross income by reason of the transfer, if the conditions in paragraph (b)(8)(ii) of this section are met. A transfer under this paragraph (b)(8) is not treated as a distribution for purposes of §1.457–6. Therefore, such a transfer may be made before severance from employment.

(ii) *Conditions for plan-to-plan transfers from an eligible governmental plan to a qualified plan*. A transfer may be made under this paragraph (b)(8) only if the transfer is either—

(A) For the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under the receiving defined benefit governmental plan; or

(B) A repayment to which section 415 does not apply by reason of section 415(k)(3).

(iii) *Example*. The provisions of this paragraph (b)(8) are illustrated by the following example:

*Example*. (i) *Facts*. Plan X is an eligible governmental plan maintained by County Y for its employees. Plan X provides for distributions only in the event of death, an unforeseeable emergency, or severance from employment with County Y (including retirement from County Y). Plan S is a qualified defined benefit plan maintained by State T for its employees. County Y is within State T. Employee A is an employee of County Y and is a participant in Plan X. Employee A previously was an employee of State T and is still entitled to benefits under Plan S. Plan S includes provisions allowing participants in certain plans, including Plan X, to transfer assets to Plan S for the purchase of service credit under Plan S and does not permit the amount transferred to exceed the amount necessary to fund the benefit resulting from the service credit. Although not required to do so, Plan X allows Employee A to transfer assets to Plan S to provide a service benefit under Plan S.

(ii) *Conclusion*. The transfer is permitted under this paragraph (b)(8).

PART 11—EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

Par. 19. The authority citation for part 11 is amended to read, in part, as follows:

Authority: 26 U.S.C. 7805. * * *

* * * * *

**Part 11.415(c)(4)–1 [Removed]**

Par. 20. Section 11.415(c)(4)–1 is removed.

Mark E. Matthews,
*Deputy Commissioner for Services and Enforcement.*

(Filed by the Office of the Federal Register on May 25, 2005, 8:45 a.m., and published in the issue of the Federal Register for May 31, 2005, 70 F.R. 31214)

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## Foundations Status of Certain Organizations

## Announcement 2005–46

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

*Former Public Charities.* The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Abundant Life in Christ Ministries, Inc., Lake City, FL
Additude Foundation, Houston, TX
Aiken Association of Christian Education, Aiken, SC
Alan Abele Research Laboratory Foundation, Marblehead, OH
Alliance for Global Celebration, Inc., Windsor, CT
Alliance for Good Government Education Foundation, Raleigh, NC
Alternatives in Day Care and Skill Acquisition, Tucson, AZ
Altha Church of God, Altha, FL
Amateur Hockey of Pensacola, Inc., Gulf Breeze, FL
American Children Foundation, Inc., Roswell, GA
American Corporation of the Care & Treatment of Intersexed Persons, Santa Rose, CA
American Indian Women Keepers of the Circle, Inc., Kanapolis, NC
Angels for Orphans, Inc., Richardson, TX
Arizona Episcopal Schools Foundation, Tucson, AZ
Arlington Community Action Program Community Development Corp., Inc., Arlington, VA
Arlington Elementary School Parent Teacher Organization, Gastonia, NC
Atlanta African American Museum, Inc., Atlanta, GA
Attitude Recovery Center, Detroit, MI
Bainbridge High School Choral Boosters, Inc., Bainbridge, GA
Bay High School Basketball Booster Club, Inc., Panama City, FL
Beacon Hill Housing Corporation, Atlanta, GA
Bethany Christian Radio Fund, Inc., New Hartford, NY
Boy Scouts of America National Council — Cub Scout Pack 700, Titusville, FL
Brain Injury Association of Alabama, Inc., Hoover, AL
Brians Place, Inc., Douglasville, GA
Bridges to Leadership, Inc., Milwaukee, WI
Bridging the Rift, Inc., New York, NY
Burlington-Alamance Sister Cities, Inc., Burlington, NC
Business 2000 Foundation, Owatonna, MN
Camp Ashbell Run, Inc., New York, NY
Career Development & Technology, Inc., Winton, CA
Caring Foundation, Kansas City, MO
Caro Research Institute, Inc., Concord, MA
Casa Kirk, Inc., Chicago, IL
Center for Women's Reproductive Health, Inc., Philadelphia, PA
Central Florida Holiday Gold Classic Toys for Tots, Inc., Orlando, FL
Chapel Hill High School, Douglasville, GA
Chapel Hill High School Boosters, Inc., Douglasville, GA
Charles Town Health Right, Inc., Charlestown, WV
Charles Whittingham Foundation, Arcadia, CA
Charlotte Mecklenburg Public Access Corporation, Charlotte, NC
Chase Mackellar Troxell Foundation, Inc., Leesburg, VA
Chemo-Care, Inc., Hockessin, DE
Chets Charities, Inc., Boulder City, NV
Citizen Review Panels for Hillsborough Children, Inc., Tampa, FL
Clays Day Care Center, Incorporated, Baton Rouge, LA
Clover Housing & Redevelopment Services, Clover, SC
Columbus Housing Initiative, Inc., Columbus, GA
Communitas, Inc., Marietta, GA
Community Development Advisors, Inc., Atlanta, GA
Community Help Now, Inc., Arnold, MD
Computer Literacy Resources, Inc., Prescott, AZ
Conservatory for the Arts at Tampa Bay, Inc., Tampa, FL
Coop-D-Ville, St. Louis, MO
Cotton Charitable Trust, Loudonville, NY
Council on Egyptian-American Relations, Washington, DC
Counseling Center of Central Oregon, Bend, OR

County Line Riders of Catalina, Inc., Tucson, AZ
Crayton Educational Foundation, Inc., Columbia, SC
Crio Ministries Evangelistic Association, Inc., Poteau, OK
Dare to Care Development Corporation, Atoka, TN
Deems May Foundation, Lexington, NC
Del Rio Baseball Club, Del Rio, TX
Delaware River Steamboat Floating Classroom, Inc., Princeton, NJ
Denison Sister Cities, Denison, TX
Denver Press Club, Denver, CO
District 7710 Charitable Foundation, Holly Springs, NC
Downtown Burgaw Association, Inc., Burgaw, NC
Dr. Jorge Bocobo Philippine American Cultural Center Archives & Museum, San Francisco, CA
Drugs Don't Work Camden-Glynn, Inc., Kingsland, GA
East Mesa Friends, Inc., Organ, NM
East Wake Warrior Club, Zebulon, NC
Eastlake Neighbors Development Corp., Atlanta, GA
Ed-Ventures, Inc., Lakeland, FL
Edison PTO, Centralia, WA
Educational Resource Center, Inc., Lithonia, GA
Educational Welding Corporation, New Orleans, LA
Effingham County Council for the Arts, Inc., Guyton, GA
Elshaddai Charitable Organizations, Inc., Alpharetta, GA
Enduring Faith Ministries, Inc., Houston, TX
Engelhard Volunteer Fire Department, Inc., Engelhard, NC
Fair Haven Homeless Foundation, Shreveport, LA
Faith of Our Fathers Radio Broadcast, Miranda, CA
Final Harvest Ministries International, Inc., Riverview, FL
Firehouse Foundation, Inc., Chicago, IL
Florida Business Partners for Juvenile Justice, Inc., Tallahassee, FL
Florida EMT and Paramedic Foundation, Inc., Coral Springs, FL
Florida Institute of Hyperbaric and Dive Medicine, Inc., Melbourne, FL
Foolery, Inc., Charlottesville, VA
Foundation for Environmental Technology, Inc., Baton Rouge, LA
Franklin County Volunteer Center, Inc., Louisburg, NC
Frederick Baxter Foundation, Inc., Atlanta, GA
Free Spirit Equine Rescue Shelter, Chesterfield, VA
Friends of Honduras, Portland, OR
Friends of Hospice, Girard, OH
Friends Stopping Aids, Inc., Jonesboro, GA
Full Time for Jesus Ministries, Inglewood, CA
Gateway Center, Inc., Cordele, GA
Gibbs Procurement Group, Pamplico, SC
Good and Faithful Servants, Inc., Tallahassee, FL
Greater La Crosse Area Chamber of Commerce Foundation, Inc., La Crosse, WI
Greenpoint Nursing Home, Inc., Brooklyn, NY
Greenwich Agora, Inc., Greenwich, CT
Halifax County Crimestoppers, Inc., Roanoke Rapids, NC
Harbor House, Inc., Tequesta, FL
Harold C. Enloe Lodge No. 1 of the Fraternal Order of Police Foundation, Ashevill, NC
Harriet Tubman Cultural Center, Louisville, KY
Health for Youth Foundation, Washington, DC
Health Resource Corporation, Williamston, NC
Heavens Heroes Foundation, Rockport, TX
Heights Interneighborhood Council Housing Development Fund Corp., Bronx, NY
Help is Here, Inc., Miami, FL
Higher Level Ministries Social and Community Development Agency, E. Saint Louis, IL
Hillsborough County United SC, Inc., Tampa, FL
Historic Downtown North Wilkesboro, Inc., N. Wilkesboro, NC
Historic St. Augustine Research Institute, Inc., St. Augustine, FL
Historical and Cultural Association at Nahunta, Inc., Pikeville, NC
Hogar Infantil, San Ysidro, CA
Homage, Inc., Austin, TX
Home Planet, Inc., Red Feather Lakes, CO
Howard Jones Wilson OIC Scholarship Foundation, Wilson, NC
Inner Spaces Network, Inc., Pittsburgh, PA
Instruments of Love, Inc., Los Gatos, CA
International Association of Lions Clubs, Avon Park, FL
International Centre for Eyecare Education Foundation, Washington, DC
International Youth Development Foundation, Inc., Miami Beach, FL
Jazz Array Performing Arts Society, Purcellville, VA
Johnson Equestrian Foundation, Omaha, NE
Junior Service League of Thomasville Georgia, Thomasville, GA
Kidsville Preschool & Daycare Center, Jackson, MS
Kwan-S-Temple, Inc., Milford, MA
Laredo Independent School District Educational Foundation, Laredo, TX
Latin American Festival, Incorporated, Charlotte, NC
Lincoln Park Youth in Touch, Incorporated, Hampton, VA
Long-Term Enrichment and Growth of Assets in Children and Youths, Greenwood, SC
Lusitania Institute, Inc., Ludlow, MA
Macon County-Tuskegee Public Library, Tuskegee, AL
Main Street 21st Century, Inc., Douglas, GA
Marie Able Youth Center, Inc., Paw Creek, NC
Mattamuskeet Indian Tribe, Incorporated, Jamesville, NC
Mayo High School Athletic Hall of Fame, Darlington, SC
Maywood Baseball League, Inc., Hammond, IN
McDonough Ministries, Newport News, VA
McDowell Street Center for Family Law, Inc., Charlotte, NC
Messiah Nutrition Assistance & Human Development Foundation, Los Angeles, CA
Mid-America Economic Development Foundation, St. Paul, MN
Milford Rotary Club Educational Foundation, Milford, DE
Military Housing of America, Inc., Atlanta, GA
Miracle Caregivers for Needy Children, Atlanta, GA
Miramonte Visual and Performing Arts Club, Orinda, CA
Mission New Life, Inc., Anniston, AL
Mooresville Lions Charities, Inc., Mooresville, NC

Mountaineer Health Foundation, Paw Paw, WV
Mozaic Institute, Inc., Savannah, GA
MPIB Parents Advisory Council, Inc., Charlotte, NC
Myers Foundation, Big Fork, MT
National Sportsmans Council for Outdoor Awareness, Freeport, PA
NE Registry, Inc., Wayne, NJ
Net Family News, Salt Lake City, UT
New Millenium Club, Inc., Houston, TX
Next Charity Organization, Inc., Alpharetta, GA
Nonprofit Resource Center of Tampa Bay, Inc., Tampa, FL
North Davidson Enrichment Center, Inc., Welcome, NC
Northeast Florida Leadership Council, Lake City, FL
Northern Arizona Soccer League, Flagstaff, AZ
Oakboro Elementary Parent/Teacher Organization, Oakboro, NC
Officeplease Foundation, Glen Ellen, CA
Old Town Community Development Corporation, Alexandria, VA
On Our Own of Carroll County, Inc., Westminster, MD
Operation Lifeforce, Inc., Atlanta, GA
Options Properties, Inc., Marlborough, MA
Parenting International Institute, Springfield, VA
Parker Sayles Foundation, N. Charleston, SC
Partnerships in Housing, Inc., Short Hills, NJ
Phern, Inc., Beckley, WV
Phlex Diversified Services, Inc., Memphis, TN
Phoebe Community Development Corporation, Clarkston, GA
PIH Associates, Inc., Athens, GA
Pool of Shiloam Outreach Ministries, Champaign, IL
Powerup Bridging the Digital Divide, Inc., Washington, DC
Priority Insight, Inc., Savannah, GA
Professionals & Entrepreneurs of America, Inc., PROESA, West Palm Beach, FL
Providence Community Center, Inglewood, CA
Quest Music Ministry, Inc., Fairfax, VA
Renaissance Community Development Corporation, Washington, DC
Repairer of the Breach Ministries, Incorporated, Griffith, IN
Reverend Vincent Robert Capodanno Foundation, Inc., Burke, VA
Rites of Passage Youth Empowerment Foundation, Durham, NC
R.J.S. Community Outreach, Inc., Westland, MI
Robinson Elementary School PTO, Dawsonville, GA
Ron Krause Ministries, Broken Arrow, OK
R.U.T.H. Resources United to Help Fellowship Corporation, Flint, MI
Rutherford High School Soccer Booster Club, Panama City, FL
Saluda River Elementary PTO, West Columbia, SC
Senior Citizens Club of Willow Springs, Willow Springs, MO
Seniors & Technology, Inc., Matawan, NJ
Shasta Works, Inc., Redding, CA
Sheila Rosenzweig Memorial Scholarship Fund, Inc., Lakewood, NJ
Shiloh Development for Community Home Care, Inc., Fayetteville, NC
Simmons Transportation Service, Inc., Jefferson, GA
Sinai Center for Advancement, Inc., Murfreesboro, NC
Sister for Sister Foundation, Inc., Nashville, TN
SMP Retreat Center, St. Paul, MN
Society for the Advancement of African-Americans, Detroit, MI
South Carolina Awareness and Rescue for Equines, Inc., Lexington, SC
South Carolina Human and Community Relations Association, Greenville, SC
South Carolina Pain Initiative, West Columbia, SC
South Coastal Area Health Education Center, Corpus Christi, TX
South East Convention Fandom, Inc., Roswell, GA
Southside Recreation and Education Center, Homewood, IL
Southwest Georgia Child Development Council, Inc., Albany, GA
Southwestern Ohio Double Dutch League, Cincinnati, OH
Special Technical Aquatic Rescue Team, Inc., Greenwich, CT
St. Augustine Group Home, Inc., St. Augustine, FL
St. Augustine Lions Foundation, Inc., St. Augustine, FL
St. Peters Community Development Corporation, Miami, FL
Street Heat, Inc., Virginia Beach, VA
Strength Through Empowering People, Inc., Fairborn, OH
Student Business Incubator, Inc., Moscow, ID
Sumter-Shaw AFB Highway Beautification Committee, Dalzell, SC
SunRise Ecopolis Foundation, Inc., St. George, UT
Sunrise to Sunset Educational Development Center, Charlotte, NC
Tao Guan Harmony, Inc., Chamblee, GA
Tap Tap Tap Vehicle for Communication, Pasadena, CA
TCB Florida Affordable Housing, Inc., Boston, MA
Technology Institute of Teamwork, Inc., Annadale, NJ
Texoma Critical Incident Stress Management Team, Wichita Falls, TX
Therapeutic Spiral International, Charlottesville, VA
Third Planet, Inc., Fort Lauderdale, FL
Three Angels Educational Broadcasting, Inc., Flagstaff, AZ
Threshold House of Genesis, Inc., Charlotte, NC
Thunderbolt Ministries, Inc., Jacksonville, FL
Total Family Care, Greensboro, NC
Touch of Love Adult Day Health Center, Hickory, NC
Transglobal Communications Foundation, New York, NY
Ukrainian Relief Fund Rochester NY, Inc., Rochester, NY
Umoja Kwest Action Agency, Inc., Baltimore, MD
Upward Bound Recovery Center, Indianapolis, IN
Urban M-Pact, Inc., Wilmington, NC
Vision Mortgage Training Center, Inc., Charlotte, NC
Vision Team, Dallas, TX
Vista Youth Sports Fields Foundation, Inc., Vista, CA
Walton Oconee Morgan Environmental Group, Inc., High Shoals, GA
Wednesdays Woman Foundation, Inc., New York, NY
West St. Paul Hockey Hall of Fame, West St. Paul, MN
Western Wisconsin Workforce Development Board, Inc., La Crosse, WI
Westminster Services, Inc., Orlando, FL
Weston Lakes Women's Association Community Foundation, Inc., Fulshear, TX

Wildplaces Foundation, Beverly Hills, CA
Willow Towers, Inc., New Rochelle, NY
Winter Haven Concert Band, Inc., Lake Alfred, FL
With Open Arms, Incorporated, Raeford, NC
Womens Resource Center of Clay County, Orange Park, FL
World Evangelical Mission Team of New England, Inc., Mattapan, MA
Youth & Family Transitional Center, Inc., High Point, NC

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

# Definition of Terms

*Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:*

*Amplified* describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

*Clarified* is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

*Distinguished* describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

*Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

*Revoked* describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

*Supplemented* is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

*Suspended* is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

# Abbreviations

*The following abbreviations in current use and formerly used will appear in material published in the Bulletin.*

*A*—Individual.
*Acq.*—Acquiescence.
*B*—Individual.
*BE*—Beneficiary.
*BK*—Bank.
*B.T.A.*—Board of Tax Appeals.
*C*—Individual.
*C.B.*—Cumulative Bulletin.
*CFR*—Code of Federal Regulations.
*CI*—City.
*COOP*—Cooperative.
*Ct.D.*—Court Decision.
*CY*—County.
*D*—Decedent.
*DC*—Dummy Corporation.
*DE*—Donee.
*Del. Order*—Delegation Order.
*DISC*—Domestic International Sales Corporation.
*DR*—Donor.
*E*—Estate.
*EE*—Employee.
*E.O.*—Executive Order.
*ER*—Employer.
*ERISA*—Employee Retirement Income Security Act.
*EX*—Executor.
*F*—Fiduciary.
*FC*—Foreign Country.
*FICA*—Federal Insurance Contributions Act.
*FISC*—Foreign International Sales Company.
*FPH*—Foreign Personal Holding Company.
*F.R.*—Federal Register.
*FUTA*—Federal Unemployment Tax Act.
*FX*—Foreign corporation.
*G.C.M.*—Chief Counsel's Memorandum.
*GE*—Grantee.
*GP*—General Partner.
*GR*—Grantor.
*IC*—Insurance Company.
*I.R.B.*—Internal Revenue Bulletin.
*LE*—Lessee.
*LP*—Limited Partner.
*LR*—Lessor.
*M*—Minor.
*Nonacq.*—Nonacquiescence.
*O*—Organization.
*P*—Parent Corporation.
*PHC*—Personal Holding Company.
*PO*—Possession of the U.S.
*PR*—Partner.
*PRS*—Partnership.
*PTE*—Prohibited Transaction Exemption.
*Pub. L.*—Public Law.
*REIT*—Real Estate Investment Trust.
*Rev. Proc.*—Revenue Procedure.
*Rev. Rul.*—Revenue Ruling.
*S*—Subsidiary.
*S.P.R.*—Statement of Procedural Rules.
*Stat.*—Statutes at Large.
*T*—Target Corporation.
*T.C.*—Tax Court.
*T.D.* —Treasury Decision.
*TFE*—Transferee.
*TFR*—Transferor.
*T.I.R.*—Technical Information Release.
*TP*—Taxpayer.
*TR*—Trust.
*TT*—Trustee.
*U.S.C.*—United States Code.
*X*—Corporation.
*Y*—Corporation.
*Z* —Corporation.

## Numerical Finding List[1]

Bulletin 2005–27

**Announcements:**



**Notices:**



**Proposed Regulations:**



**Revenue Rulings:**



[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2005–1 through 2005–26 is in Internal Revenue Bulletin 2005–26, dated June 27, 2005.

## Finding List of Current Actions on Previously Published Items[1]

Bulletin 2005–27

[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2005–1 through 2005–26 is in Internal Revenue Bulletin 2005–26, dated June 27, 2005.